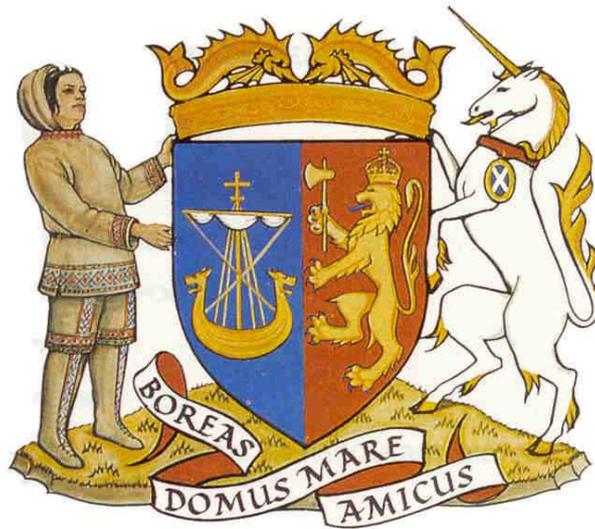


# ORKNEY ISLANDS COUNCIL



## ANNUAL REPORT AND ACCOUNTS OF THE PENSION FUND 2011/2012

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# FOREWORD BY HEAD OF FINANCE

## Introduction

Welcome to the Annual Report and Accounts for the Orkney Islands Council Pension Fund for the year ended 31 March 2012.

The Local Government Pension Scheme Amendment (Scotland) Regulations 2010 (SSI 2010/234) require the Council, as administering authority for the Fund, to produce a separate statement of accounts for the Pension Fund and incorporate it into an annual report.

This Annual Report has been produced to provide elected members, employers, scheme members and other interested parties with information concerning the administration and performance of the Fund in financial year 2011/12 and I hope you find its content useful.

The statement of accounts contained in this report present the Fund's financial position for the year ended 31 March 2012. These have been prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2011/12 ("the Code"), supported by International Financial Reporting Standards (IFRS).

The Annual Report also contains a governance compliance statement which demonstrates how well the Fund complies with the best practice principles set out by the Scottish Government.

## Key Facts And Figures

**Value of the Fund** at 31 March 2012 was £170.7 million (£160.3m at 31 March 2011).

**An Operational and Investment Income Surplus** of £10.5 million was generated on the activities of the Fund (compared to £21.9m for year ended 31 March 2011).

**The Increase in the Value of the Fund** was achieved mainly through a surplus of contributions over expenditure (£4.3m), investment net income (£3.5m) and increases in the market value of investments (£2.7m).

**Performance of the Fund** on a three year rolling average basis has been 19.10% p.a., giving a relative return above benchmark of 4.1%.

**Fund membership** increased by 79 to 2,930

**Employers contributed** £7.5 million to the Fund (£6.7m to 31 March 2011).

**Employees contributed** £2.6 million (£2.5m to 31 March 2011).

**Pension and other benefits paid out** were £5.5 million (£4.3m to 31 March 2011).

**Net Transfer values paid into the Fund because staff changed employers** were £0.1 million (£0.2m to 31 March 2011).

## Highlights for the Year

### Investment Returns

Despite the prevailing economic climate, the sovereign debt crisis affecting the “Eurozone”, and continued volatility in investment markets during the year, the value of the Fund has grown to £171m at 31 March 2012. The overall performance of the Fund has been 19.1% on a 3 year rolling average basis, outperforming the benchmark by 4.1%.

### Actuarial Valuation

The detailed triennial actuarial valuation undertaken by the Fund actuary Hymans Robertson LLP was completed during 2011/12. This valuation estimated that the Fund's assets, which at 31 March 2011 were valued at £160m, were sufficient to meet 106.3% of its future obligations to pay pension benefits. The funding level had risen from 86% at the previous valuation at 31 March 2008. However the funding update produced at 31 March 2012 showed that the funding level has worsened since the 2011 valuation due to falling real bond yields and lower asset returns than expected.

The three year valuation reflected the assumption that the Fund's equity type investments will outperform gilts/bonds over the long-term and allows for the change in benefit indexation from RPI to CPI. No allowance was made for any possible effect on the Fund of government reforms of public sector pensions. Based on this valuation individual employers' contributions for the period 1 April 2012 to 31 March 2015 were set in accordance with the funding policy set out in the Funding Strategy Statement.

## Future Developments

### Hutton

The Independent Public Sector Pension Commission (the Hutton Review) reported in March 2011 with its key recommendations being the introduction of a career average earnings pension scheme (CARE) to replace the current final salary scheme, and an increase in employee contribution rates. The aim of Lord Hutton was to strike an appropriate balance between those working for the public sector and the tax payer ensuring access to good pensions for staff while also improving control over future costs. The Hutton Review has been subject to much public debate and consultation, especially in England and Wales. Discussions on how this will be taken forward for the Scottish LGPS funds have started but no firm proposals have been agreed at this stage and therefore it is likely that this debate will become the focus of much attention for the Fund over the next few years as these become clearer.

### Auto Enrolment

Auto-enrolment of employees will be implemented by the Fund during 2013/14 and planning for these changes will be ongoing for both the fund administrators and the employer bodies who participate in it.

### Development of the Investments Sub-Committee

Following the May 2012 Election, the Investment Sub-Committee will contain a substantially new membership and the focus for 2012/13 will be to provide support and training to enable Councillors charged with the governance of the Fund to execute their role as quasi-trustees effectively.

## Acknowledgement

I would like to take this opportunity to thank my colleagues in the Finance Department and the members of the Investments Sub-Committee for their help and co-operation in managing the financial affairs of the Pension Fund.



**Gareth Waterson, BAcc, CA**  
**Head of Finance**

**27 September 2012**

# REVIEW OF THE YEAR

## Fund Performance

During much of the past year, the overriding sentiment among investors was uncertainty, as a solution to problems in the Eurozone remained elusive and concerns persisted over the possibility of further weakness in the global economy. Meanwhile, confidence among consumers remained muted. This was reflected in poor retail sales and further weakness in house prices, especially in the UK, where several retailers closed for business. However, during the early part of 2012, the European Central Bank made its latest attempt to stabilise the situation in the single currency area, and improving economic data began to emerge from the United States. Both of these factors had a generally positive impact on investment markets. Elsewhere, the outlook for China remained positive overall and spending by wealthy consumers in parts of Asia and the Middle East was buoyant.

Given the mixed backdrop, it is unsurprising that stock markets around the world enjoyed mixed fortunes while UK Government bond markets benefited from their perceived status as a safe haven in times of extreme turbulence. Market movements during the period offered the fund managers the opportunity to increase exposure to some stocks which appeared to have been unfairly hit by the negative mood. The fund managers also hold positions in several companies which they believe have an excellent long-term outlook that is not fully reflected in their share price. On a longer-term view, the fund managers prefer equities over bonds.

Against this background, the Pension Fund has performed very well over the last year and returned a gain on investments of 4.1%, performing ahead of the benchmark which rose by 2.6%.

Of the £10.5m increase in the value of the Fund, £0.6m was realised through sales of investments. The surplus of contributions receivable over pensions payable was £4.3m (2011: £4.7m surplus), the main cause of the drop being a significant level of lump sum payments made in respect of staff retirements during the year and transfers out to other schemes. Net investment income (dividends and interest) and gain in market value of investments accounted for the remaining change in value of the Fund.

The Council employed external fund managers Baillie Gifford to manage the investments of the Pension Fund.

Detail of the performance of the Fund against benchmarks is shown on page 7.

(\* m = million)

### ***“Realised and Unrealised” Gains and Losses.***

*Only when an investment is sold does the Fund actually make a profit or loss. Realised profits and losses are those that have actually arisen via sales throughout the year. Our accounts are however based on the market value of investments at 31 March 2012. This means that we have to show what profit or loss we would have made if we had sold all our investments on that day. The result is a notional “unrealised” profit or loss.*

# REVIEW OF THE YEAR

## Investment Strategy

The detail of the Fund's investment structure was reviewed in December 2010. The revised asset allocation and range guidelines that were applied with effect from 1<sup>st</sup> April 2011 are shown in the table below. Baillie Gifford's performance target is to outperform the WM Performance Services (WM) Local Authority benchmark ex property (re-balanced quarterly) by 1% p.a. when assessed over rolling 5 year periods, with effect from 1 July 2006. Baillie Gifford's asset allocation is periodically compared to the benchmark WM Local Authority average allocation for each asset class.

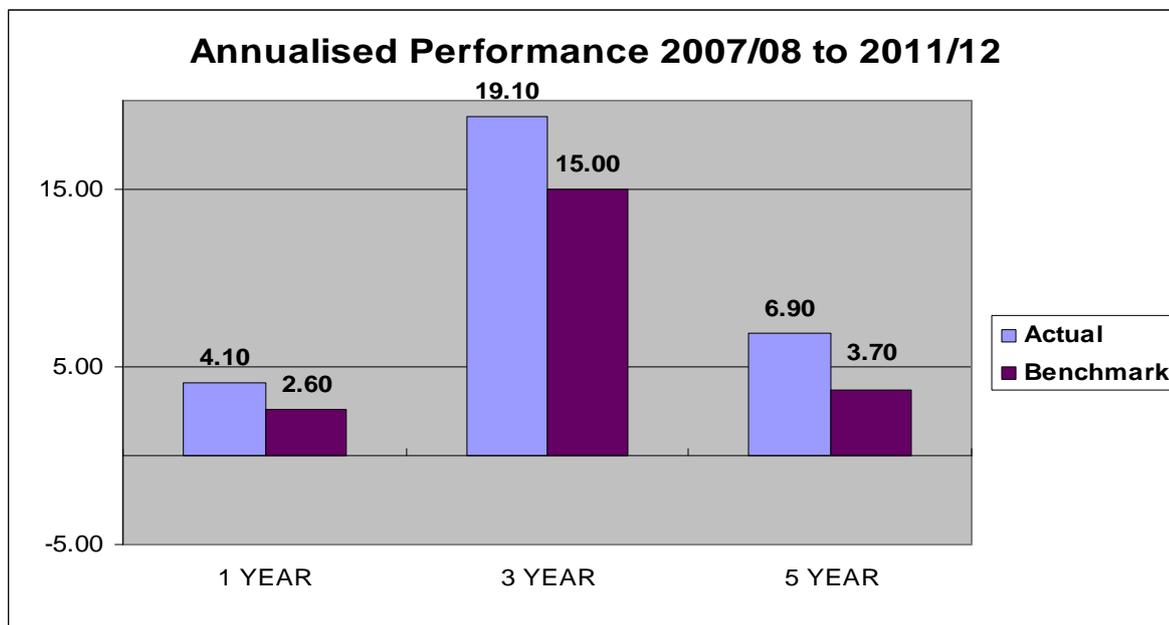
The following table indicates the 31 March 2012 position in relation to asset allocation versus the range guidelines and benchmark:

<b>Asset Class</b>	<b>Asset Allocation at 31/3/12 %</b>	<b>Range %</b>
Total Equities	75%	50-90
Gilts & Bonds	0%	10-30
Alternative Assets	0%	0-20
Cash	3%	0-10
Composite (Pooled)	22%	WL LA Median ex property
<b>Total</b>	<b>100</b>	

# REVIEW OF THE YEAR

## Investment Performance

On an annualised basis the investment performance can be summarised as follows over the 1 year, 3 year and 5 year period:-



The overall Fund return over 5 years was 6.90% versus the benchmark of 3.70%.

The Fund's Investments are measured against the WM Performance Services UK Local Authority Weighted Average excluding property.

*The **benchmark** return is calculated against the Fund's chosen "benchmarking" group, which comprises a composite of different market indices. The indices in use cover all the markets in which the Fund is invested. The Fund's target was to exceed the sum of these indices by 1% over rolling 5-year periods.*

### The top 10 direct equity holdings at 31 March 2012 were

Company	Market Value of Holding £ m
Prudential PLC	3.3
Nestle	2.5
iShares MSCI Brazil Index Fund	2.4
Wolseley PLC	2.4
Svenska Handelsbanken	2.2
Richemont SA	1.9
Naspers Ltd	1.9
Amazon.Com	1.9
Pepsico	1.9
Atlas Copco AB	1.9

## Fund Update

### Membership Details

<b>Member Status</b>	<b>As at 31/03/2011</b>	<b>As at 31/03/2012</b>
Contributing members	1,588	1,566
Pensioners	569	624
Deferred members	694	740
<b>Total</b>	<b>2,851</b>	<b>2,930</b>

***Contributing member***

*Someone who is currently employed by a scheduled or admitted body and is making contributions from pay to the pension scheme. Such a person is sometimes referred to as an "active" member.*

***Deferred member***

*Someone who was once a contributing member and who has chosen to leave his or her accumulated contributions in the Fund to benefit from a pension in due course.*

***Pensioner/dependent member***

*Someone who is receiving benefits from the Fund either as a former contributor or as a dependent of a former contributor who has deceased.*

## Employer Bodies

The Fund invests and administers pensions on behalf of 15 employers. These include scheduled bodies, brought into the Fund by legislation, and admitted bodies, which choose to join the Fund. The detailed listing of employers and their membership numbers is contained in Note 20 of the financial statements (page 22).

## Pension Increases

Pensions which are in payment and deferment are increased each April in accordance with the Pension (Increase) Act 1971. Since April 2011, this increase has been linked to the Consumer Price Index (CPI) rather than the Retail Price Index (RPI).

## Pensions Administration

Orkney Islands Council as administering authority to the Orkney Islands Council Pension Fund applies the following key service standards in its day to day activities:

	<b>Performance Standard</b>
Pension Estimate Turnaround Time	Within 10 working days
Query Response Time	Within 10 working days
Annual Benefit Statements	Issued by 31 March of the following year

## Actuarial Valuation

Annex 1 contains the formal Actuarial Statement for 2011/12 which is prepared in line with the International Accounting Standard (IAS) 26 and supports the preparation of the financial statements for the Pension Fund.

In addition, under Local Government Pension Scheme (LGPS) requirements the Fund undertook its triennial valuation as at the 31 March 2011 which is about identifying the long term funding position for the Fund and the appropriate employer contribution rates.

The valuation shows that the funding level of the Fund as at 31 March 2011 was 106.3% which compares with 86.3% at the previous March 2008 valuation.

The improvement in the funding position reflects the positive cash flow and good investment performance of the Fund since the previous valuation. Investment returns for the three years to 31 March 2011 were significantly better than anticipated. In addition, the change of linking pension increases from an RPI inflation measure to a CPI inflation measure has reduced the value of the liabilities significantly, helping improve the funding position. However, market conditions over the last year have not favoured the Fund, and the actuary calculated that had the valuation used assumptions based on 31 March 2012, a deficit of 90.9% would have resulted.

As a result of the valuation process, the Fund's actuary (Hymans Robertson) calculated the total contribution rate at 16.5%. However, taking into account recent market conditions, the actuary recommended that the current contribution rate of 21.4% be maintained until 2014/15.

# STATEMENT OF RESPONSIBILITIES FOR THE STATEMENT OF ACCOUNTS

## The Council's responsibilities

The Council is required to:

- Make arrangements for the proper administration of the financial affairs of the Orkney Islands Council Pension Fund (the Fund) and to secure that one of its officers has the responsibility for the administration of those affairs. In this Council, that officer is the Head of Finance.
- Manage the affairs of the Fund to secure economic, efficient and effective use of resources and safeguard its assets.
- Approve the statement of accounts of the Fund (in Scotland, the audited accounts must be laid before a meeting of the Authority within two months of receipt of the audit certificate).

## The Head of Finance's responsibilities

The Head of Finance is responsible for the preparation of the statement of accounts in accordance with the Local Government Pension Scheme (Administration) (Scotland) Regulations 2008, as updated by the Local Government Pension Scheme Amendment (Scotland) Regulations 2010 (SSI 2010/234) and supporting guidance issued by the Scottish Government.

In preparing this statement of accounts, the Head of Finance has:

- Selected suitable accounting policies and then applied them consistently
- Made judgements and estimates that were reasonable and prudent
- Complied with the Code of Practice on Local Authority Accounting

The Head of Finance has also:

- Kept proper accounting records which were up to date
- Taken reasonable steps for the prevention and detection of fraud and other irregularities

## Statement of Accounts

The statement of accounts presents a true and fair view of the financial position of the Orkney Islands Council Pension Fund as at 31 March 2012, and of its income and expenditure for the year ended 31 March 2012.



**Gareth Waterson, BAcc, CA**  
**Head of Finance**  
**27 September 2012**

## STATEMENT ON THE SYSTEM OF INTERNAL FINANCIAL CONTROL

1. This statement is given in respect of the Accounts for Orkney Islands Council Pension Fund. As Statutory Officer for Finance (Section 95 officer) for the Council, I acknowledge my responsibility for ensuring the proper administration of the financial affairs of the Pension Fund. This includes ensuring appropriate advice is given to the Pension Fund on all financial matters, keeping proper financial records and accounts, and maintaining an effective system of internal financial control.
2. The system of internal financial control operates within a financial strategy and is based on a framework of delegation and accountability for officers and elected members embodied in procedural standing orders, financial regulations, scheme of delegation, scheme of administration, committees and sub-committees, supported by a framework of administrative procedures including the segregation of duties, and regular financial management information. In particular, this includes:
  - (a) Comprehensive accounting systems that record income and expenditure for both member and investment activities,
  - (b) Regular reviews of investment reports that measure investment returns against agreed benchmarks,
  - (c) Regular reviews of investment manager reports that measure performance against agreed targets, and
  - (d) Independent performance reviews of the Fund by the Fund's investment consultant and performance monitoring services provider.
3. The system can provide only reasonable and not absolute assurance that assets are safeguarded, transactions authorised and properly recorded, and that material errors or irregularities are either prevented or would be detected within a timely period.
4. The Pension Fund responds to findings and recommendations of external audit, scrutiny and inspection bodies and its own independent internal audit section. The Monitoring and Audit Committee is integral to overseeing independent and objective assurance and monitoring improvements in internal control and governance.
5. The Chief Internal Auditor (CIA) reports to the Chief Executive and the Monitoring and Audit Committee and is in regular contact with the Head of Finance and Monitoring Officer. The CIA provides an independent and objective annual assurance statement on the effectiveness of internal control, risk management and governance based on the delivery of an approved plan of systematic and continuous internal audit review of the Council's arrangements.
6. My review of the effectiveness of the system of internal financial control is informed by:
  - (a) The work of the Internal Auditors as described above;
  - (b) The work of professional accountancy staff within the Council;
  - (c) The External Auditors' reports.
7. I have undertaken the role of the Statutory Officer for Finance (Section 95 Officer), whose duties include putting in place the arrangements for the proper administration of financial affairs of the Pension Fund. Having reviewed the above, it is my opinion that reasonable assurance can be placed upon the adequacy and effectiveness of the Council's internal financial control systems during the year ended 31 March 2012.

8. However, I have noted that work in the following areas would further enhance the internal financial control environment to manage financial risks:
- (a) The ongoing implementation of:
- Recommendations made by Internal Audit and External Audit, with particular emphasis on prompt implementation of high priority recommendations.
  - The regular review and compliance testing of Procedural Standing Orders, Financial Regulations and the Scheme of Delegation and the formal adoption of these by the Pension Fund.

Signed

A handwritten signature in cursive script that reads "Gareth Waterson".

**Gareth Waterson, BAcc, CA**  
**Head of Finance**  
**27 September 2012**

## STATEMENT OF ACCOUNTS 2011/12

### FUND ACCOUNT

2010/11 £'000		2011/12 £'000	Notes
	<b>Dealings with members, employers and others directly involved in the scheme</b>		
8,843	Contributions receivable	9,571	<b>6,14</b>
393	Transfers in	516	<b>7</b>
9,236		10,087	
(4,046)	Benefits payable	(5,036)	<b>8,14</b>
(231)	Payments to and on account of leavers	(441)	<b>9</b>
(251)	Administration expenses	(276)	
(4,528)		(5,753)	
<b>4,708</b>	<b>Net additions/(withdrawals) from dealings with members</b>	<b>4,334</b>	
	<b>Return on investments</b>		
4,119	Investment income	3,995	<b>10</b>
13,668	Profits and losses on disposal of investments and changes in the market value of investments	2,715	<b>11</b>
(223)	Taxes on income	(203)	
(366)	Investment management expenses	(389)	
<b>17,198</b>	<b>Net return on investments</b>	<b>6,118</b>	
<b>21,906</b>	<b>Net increase/(decrease) in the Fund during the year</b>	<b>10,452</b>	
138,373	Opening net assets of the scheme	160,279	
<b>160,279</b>	<b>Closing net assets of the scheme</b>	<b>170,731</b>	

## NET ASSETS STATEMENT as at 31 March 2012

2011 £'000		2012 £'000	Notes
	<b>Investment assets</b>		
3,528	Fixed interest - Public Sector	0	
88	Fixed interest – other	0	
119,200	Equities	125,944	
5,547	Index linked – Public Sector	0	
	<b>Managed funds</b>		
24,809	Pooled investment vehicles	37,888	
6,531	Cash deposits	5,327	
159,703		169,159	12
	<b>Current assets &amp; liabilities</b>		
0	Cash balances	1,944	
794	Sundry debtors	2	
(218)	Other current liabilities	(374)	
576		1,572	
<b>160,279</b>	<b>Net assets</b>	<b>170,731</b>	<b>13</b>

The Fund account and net assets statement do not show any liability to pay pensions or other benefits in the future. The liability to pay pensions is detailed in the actuarial statement in annex 1.

The unaudited accounts were issued on 29 June 2012 and the audited accounts were authorised for issue on 27 September 2012.



**Gareth Waterson, BAcc, CA**  
**Head of Finance**  
**27 September 2012**

# NOTES TO THE ANNUAL ACCOUNTS

## 1 THE LOCAL GOVERNMENT PENSION SCHEME

The Local Government Pension Scheme is a funded defined benefit, final salary scheme, established under the Superannuation Act 1972, with pensioners receiving index-linked pensions. It is administered by Orkney Islands Council in accordance with The Local Government Pension Scheme (Scotland) Regulations 2008 (as amended) and is contracted out of the State Second Pension. The Pension Fund is subject to a triennial valuation by an independent, qualified Actuary, whose report indicates the required future employers' contributions.

## 2 BASIS OF PREPARATION OF THE FINANCIAL STATEMENTS

Local authorities responsible for administering a pension fund that forms part of the local government pension scheme (LGPS) are required by an amendment to The Local Government Pension Scheme (Administration) (Scotland) Regulations 2008 to publish a Pension Fund annual report, which is required to include financial statements. Local authorities have a duty under section 12 of the Local Government in Scotland Act 2003 to observe proper accounting practices.

## 3 STATEMENT OF ACCOUNTING POLICIES

A summary of the more important accounting policies has been set out below:

### 1 Basis of Preparation

The statement of accounts summarises the Fund's transactions for the 2011/12 financial year and its position as at 31 March 2012. The accounts for the Fund have been prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2011/12 which is based upon International Financial Reporting Standards (IFRS), as amended for the UK public sector.

The accounts have been prepared on an accruals basis and do not take account of liabilities to pay pensions and other benefits after the year end. However, the actuarial position does account for such obligations. This is disclosed in note 5 of the accounts and should be read in conjunction with the actuary's report.

### 2 Transfers to and from other schemes

Transfer values represent the amounts received and paid during the year for members who have either joined or left the Fund during the financial year and are calculated in accordance with the LGPS Regulations.

Individual transfers in/out are accounted for when received/paid, which is normally when the member liability is accepted or discharged.

Transfers in from members wishing to use the proceeds of their additional voluntary contributions to purchase scheme benefits are accounted for on a receipts basis and are included in Transfers in.

Bulk (group) transfers are accounted for on an accruals basis in accordance with the terms of the transfer agreement.

### **3 Financial Instruments**

#### **Investments**

Investments are included at market values, which are assessed as follows:-

- a UK quoted securities are valued at bid market prices at close of business on the last working day of the financial year.
- b Overseas securities are valued at bid market prices from the relevant overseas stock exchanges converted at closing rates of exchange on the last day of the financial year.
- c Unlisted investments, which comprise the fund manager's unit trusts and open ended investment companies, are valued at bid market prices on the last working day of the financial year as supplied by the fund manager.

Since Investments are all held at market value disclosure in the accounts is at fair value. Fair values are derived from unadjusted quoted prices in active markets.

#### **Debtors and Creditors**

The accounts have been prepared on an accruals basis; that is income and expenditure is included as it is earned or incurred, not as it is received or paid, except for transfer values which are included when they are paid or received.

#### **Investment Income**

Income from fixed interest, index linked securities and other interest receivable is taken into account on an accruals basis. Income from all other marketable securities is taken into account on the date when stocks are quoted ex-dividend.

#### **Foreign Currency**

Income and expenditure arising from transactions denominated in a foreign currency are translated into £ sterling at the exchange rate in operation on the date on which the transaction occurred. Where the transaction is to be settled at a contracted rate that rate is used.

### **4 Investment Management Expenses**

Investment management expenses consist of direct charges in line with management agreements, management charges levied on pooled funds, overseas charges and non-recoverable withholding tax.

### **5 Acquisition Cost**

Any acquisition costs of investments are included in the book cost of the investment.

### **6 Critical Judgements in Applying Accounting Policies**

#### **Pension Fund liability**

The Pension Fund liability is calculated every three years by the appointed actuary, with annual updates in the intervening years. The methodology used is in line with accepted guidelines and in accordance with International Accounting Standard 19. Assumptions underpinning the valuations are agreed with the actuary and are summarised in the Actuary's Statement. This estimate is subject to significant variances based on changes to the underlying assumptions.

### **7 Assumptions made about the future and other major sources of estimation and uncertainty**

The Statement of Accounts contains estimated figures that are based on assumptions made by the council about the future or that are otherwise uncertain. Estimates are made taking into account historical experience, current trends and other relevant factors. However, because balances cannot be determined with certainty, actual results could be materially different from the assumptions and estimates.

The items in the Net Assets Statement at 31 March 2012 for which there is a significant risk of material adjustment in the forthcoming financial year are as follows:-

<b>Item</b>	<b>Uncertainties</b>
Actuarial present value of promised retirement benefits	Estimation of the net liability to pay pensions depends on a number of complex judgements relating to the discount rate used, the rate at which salaries are projected to increase, changes in retirement ages, mortality rates and expected returns on pension fund assets. A firm of consulting actuaries is engaged to provide the Fund with expert advice about the assumptions to be applied.

The sensitivities regarding the principal assumptions used to measure the scheme liabilities are set out below:

<b>Change in assumptions at year ended 31 March 2012:</b>	<b>Approximate % increase to Employer Liability</b>	<b>Approximate monetary amount (£000)</b>
0.5% decrease in Real Discount Rate	10%	17,666
1 year increase in member life expectancy	3%	5,279
0.5% increase in the Salary Increase Rate	3%	5,473
0.5% increase in the Pension Increase Rate	7%	12,033

## 4 ACTUARIAL VALUATION

The actuarial valuation assesses the health of the Fund and provides a check that the Funding Strategy and assumptions used are appropriate. It also sets the future rates of contributions payable by employers.

The most recent full actuarial valuation based on the projected unit methodology was undertaken for the Fund as at 31 March 2011 and was completed during the financial year 2011/12 by the Fund's actuaries Hymans Robertson. The funding level of the Fund as at the 31 March 2011 was 106%. The following table summarises the funding position.

### Past Service Funding Position – Orkney Islands Council Pension Fund

Valuation Date	2008 £m	2011 £m
Past Service Liabilities	128	151
Market Value of Assets	<u>110</u>	<u>160</u>
<b>Surplus/ (Deficit)</b>	<b>(18)</b>	<b>9</b>
<b>Funding Level</b>	<b>86.3%</b>	<b>106.3%</b>

The value of the scheme liabilities is an estimate of the assets required to pay pensions over the coming years. The market value of assets is the contributions received from employers and members as well as investment returns. The surplus or deficit on the Fund is the difference between the two. The actuary certified a common rate of contribution of 16.5% of payroll which represented a 4.9% decrease compared to the position as at 31st March 2008.

The next detailed actuarial valuation will be carried out for the Fund as at 31<sup>st</sup> March 2014.

## 5 ACTUARIAL PRESENT VALUE OF PROMISED RETIREMENT BENEFITS

The actuarial present value of promised retirement benefits at the accounting date, calculated in line with International Accounting Standard 19 Employee Benefits (IAS 19) assumptions, is estimated to be £184m (2011: £173m). This figure is used for statutory accounting purposes by Orkney Islands Council Pension Fund and complies with the requirements of IAS 26 Accounting and Reporting by Retirement Benefit Plans. The assumptions underlying the figure are detailed in the Actuarial Statement - see Annex 1. The figure is only prepared for the purposes of IAS 26 and has no validity in other circumstances. In particular, it is not relevant for calculations undertaken for funding purposes and setting contributions payable to the fund.

## 6 CONTRIBUTIONS RECEIVABLE

Employers £'000	2010/11			Employers £'000	2011/12	
	Members £'000	Total £'000			Members £'000	Total £'000
6,647	2,146	8,793	Normal contributions	6,849	2,086	8,935
50	-	50	Additional contributions	636	0	636
<b>6,697</b>	<b>2,146</b>	<b>8,843</b>	<b>Total</b>	<b>7,485</b>	<b>2,086</b>	<b>9,571</b>

## 7 TRANSFERS IN

There were no group transfers into the scheme during 2011/12 or 2010/11 and the total of £0.5m (2010/11: £0.4m) represents the total of transfer values in respect of individual members joining the scheme.

## 8 BENEFITS PAYABLE

2010/11 £'000		2011/12 £'000
(3,908)	Pension Payments	(4,811)
(138)	Lump Sums/Death Benefits	(225)
<b>(4,046)</b>		<b>(5,036)</b>

## 9 PAYMENTS TO AND ON ACCOUNT OF LEAVERS

2010/11 £'000		2011/12 £'000
(18)	Contributions Returned	(19)
(205)	Individual Transfers to other Schemes	(415)
(8)	State Scheme Premiums	(7)
<b>(231)</b>		<b>(441)</b>

## 10 INVESTMENT INCOME

2010/11 £'000		2011/12 £'000
255	Income from Fixed Interest Securities	0
2,884	Dividends from Equities	2,867
824	Income from Pooled Investment Vehicles	1,090
119	Income from Index Linked Securities	3
19	Interest on Cash Deposits	32
18	Recoverable Tax	3
<b>4,119</b>		<b>3,995</b>

## 11 CHANGE IN THE MARKET VALUE OF INVESTMENTS

2010/11 £'000		2011/12 £'000
31,792	Realised gains	624
(18,124)	Unrealised (losses)/gains	2,091
<b>13,668</b>	<b>Total</b>	<b>2,715</b>

## 12 ANALYSIS OF INVESTMENTS

As at 31 March 2012 the market value of the assets under management is as follows:

	31/03/2011	31/03/2012
	£000	£000
<b>Baillie Gifford</b>		
Fixed Interest – Public Sector	9,163	0
Equities - UK	36,253	40,044
Equities - Global	82,947	85,900
Pooled Investment Vehicles – UK Fixed Income	9,402	21,770
Pooled Investment Vehicles – Diversified Growth	15,407	16,118
Cash Balance Held By Managers	6,531	5,327
<b>Totals</b>	<b>159,703</b>	<b>169,159</b>

## 13 RECONCILIATION OF MOVEMENTS IN INVESTMENTS

As at 31 March 2012 assets valued at £169m were quoted on the Stock Exchange (31 March 2011: £160m). During 2011/12, sales of investments totalled £64m and purchases totalled £71m. Transaction costs are included in the cost of purchases and sales proceeds and amounted to £0.17M.

The following value of investments exceeds 5% of the total value of the net assets of the Pension Fund at 31 March 2012.

	<b>Total £'000</b>
Baillie Gifford & Company – Open Ended Investment Company (Diversified Growth Fund)	16,118

### Investment Transactions

	Opening Market Value	Purchases	Sales Proceeds	Change in Market Value	Closing Market Value
	£'000	£'000	£'000	£'000	£'000
<b>Investment Assets</b>					
Fixed Interest – Public Sector	3,528	0	(3,557)	29	0
Fixed Interest – Other	88	0	(89)	1	0
Equities	119,200	26,222	(19,690)	212	125,944
Index Linked – Public Sector	5,547	0	(5,594)	47	0
<b>Managed Funds</b>					
Pooled Investment	24,809	10,597	0	2,482	37,888
Cash Deposits	6,531	34,073	(35,223)	(54)	5,327
	<b>159,703</b>	<b>70,892</b>	<b>(64,153)</b>	<b>2,717</b>	<b>169,159</b>
<b>Internal Net Current Assets</b>					
Net Current Assets	<b>576</b>				<b>1,572</b>
Total	<b>160,279</b>				<b>170,731</b>

## 14 ANALYSIS OF CONTRIBUTIONS AND BENEFITS

	2011/12	
	Benefits Payable	Contributions Receivable
	£'000	£'000
Orkney Islands Council	4,712	8,659
Admitted Bodies	324	912
<b>Total</b>	<b>5,036</b>	<b>9,571</b>

## 15 AUDIT REMUNERATION

In 2011/12 the agreed audit fee for the year was £22,300, 2010/11: £26,300.

## 16 STATEMENT OF INVESTMENT PRINCIPLES AND FUNDING STRATEGY STATEMENT

The Council approved the current Statement of Investment Principles in 2010. The statement defines the Fund's operational framework insofar as investments are concerned. It is reviewed periodically to ensure that it continues to reflect the needs of the Fund and the views of its stakeholders.

The Council's Funding Strategy Statement defines how the Fund intends to meet its financial obligations and is effective from 31 March 2009.

Both these documents are published on the Council's web site and are available on request from the Council's Head of Finance.

Following the completion of the triennial actuarial valuation the Fund will review these documents during 2012/13.

## 17 INVESTMENT MANAGEMENT ARRANGEMENTS

The Orkney Islands Council Pension Fund investments are managed on an active basis by external fund manager Baillie Gifford.

From the 1<sup>st</sup> July 2006 the benchmark was revised to the WM Local Authority Average. The target is to outperform the WM Local Authority (ex Property) Universe by 1% p.a. over rolling five year periods.

The total Fund return for the year was 4.1% which was 1.5% ahead of the benchmark.

Over three years the Fund has generated an annualised return of 19.1% per annum which outperformed the benchmark by 4.1% per annum. Over five years the Fund has generated an annualised return of 6.9% per annum which outperformed the benchmark by 3.2% per annum.

## 18 STOCK LENDING

In accordance with the Funding Strategy Statement, stock lending is not permitted within any of its segregated investment mandates. As at 31 March 2012 no stock had been released to a third party under a stock lending arrangement.

## 19 RELATED PARTY TRANSACTIONS

Orkney Islands Council Pension Fund is administered by Orkney Islands Council. The Council incurred costs of £187k (2010/11: £189k) in relation to the administration of the Fund and was subsequently reimbursed by the Fund for these expenses. The Council is also the single largest employer of members of the Pension Fund and contributed £8.7m to the fund in 2011/12 (2010/11: £7.9m). All monies owing to and due from the Fund were paid in year. There are no additional related party transactions that require to be disclosed.

## 20 MEMBERSHIP DETAILS

Under the Local Government Pension Scheme (LGPS), member contributions are paid on a tiered basis, the contribution rate being determined by the amount of salary falling into each earnings tier.

### Eligibility to join the scheme

Employees must have a contract of at least 3 months duration to become a member. All casual employees are therefore now excluded from joining the scheme.

The following table gives details of the various bodies' membership and their contribution rates.

<b>Membership Details at 31/03/2012</b>	<b>Active</b>	<b>Deferred</b>	<b>Pensioner</b>	<b>Dependant</b>
Orkney Islands Council	1,447	651	496	86
Orkney Islands Property Development	2	6	1	0
Orkney Meat Limited	0	1	0	0
Orkney Heritage Society	0	0	0	0
Weyland Farms Limited	0	1	1	0
Orkney Towage Company Limited	14	17	14	1
Pickaquoy Centre Trust	26	16	2	1
Orkney Enterprise	5	4	2	0
Orkney Tourist Board	1	7	1	0
Orkney Ferries Limited	70	33	15	1
D & H Glue	0	3	0	0
Drinkwise Orkney	0	0	1	0
Orkney Opportunities Centre	0	1	0	0
Assessors	0	0	1	1
Golder Landscapes	1	0	0	0
<b>Summary of Members</b>				
OIC	1,447	651	496	86
Admitted Bodies	119	89	38	4
Totals	1,566	740	534	90

## 22 SCHEME ARRANGEMENTS

The new look LGPS came into force from 1 April 2009. It remains a final salary scheme but there are a number of changes to the benefits package including:

- A change in the accrual rate from 1/80<sup>th</sup> pension plus 3/80<sup>th</sup> lump sum to an improved accrual rate of 1/60<sup>th</sup> for membership from 1 April 2009
- Choice of improved lump sum at retirement
- Introduction of dependent partner's pension
- Increased death in service cover
- Increased flexible retirement options

- Tiered contributions

## 23 FINANCIAL INSTRUMENTS

### Categories of Financial Instruments

The following categories of financial instrument are carried in the Net Assets Statement:

Financial Instruments Balances	31st March	31st March
	2011	2012
	£000	£000
<b>Investments</b>		
Available for sale financial assets	153,172	163,832
Loans and receivables	6,531	5,327
<b>Total investments</b>	<b>159,703</b>	<b>169,159</b>
<b>Current assets and liabilities</b>		
Loans and receivables	794	1,946
Financial liabilities at contract amount	(218)	(374)
<b>Total current assets and liabilities</b>	<b>576</b>	<b>1,572</b>

### Income, Expenses, Gains and Losses

Financial Instruments Gains/Losses	2010/11	2011/12
	Financial Assets	
	Available for sale financial assets £000	
Net gains/(losses) on available for sale financial assets	13,668	2,715
Investment income	4,119	3,995
Investment management expenses including taxation	(589)	(592)
<b>Total investment gains and losses</b>	<b>17,198</b>	<b>6,118</b>

### Fair Values of Assets and Liabilities

Financial assets represented by investments are carried in the Net Assets Statement at their current market value, as determined by the investment managers and the global custodian, based upon publicly quoted prices. This provides a close approximation to fair value.

### RISK AND RISK MANAGEMENT

The Fund's primary long-term risk is that the Fund's assets will fall short of its liabilities (i.e. promised benefits payable to members). Therefore the aim of investment risk management is to minimise the risk of an overall reduction in the value of the Fund and to maximise the opportunity for gains across the whole Fund portfolio. The Fund achieves this through asset diversification to reduce exposure to market risk (price risk, currency risk and interest rate risk) and credit risk to an acceptable level. In addition, the Fund manages its liquidity risk to ensure there is sufficient liquidity to meet the Fund's forecast cash flows.

Responsibility for managing the fund's risk rests with the Investments Sub Committee.

## A) Market risk

Market risk is the risk of loss from fluctuations in equity and commodity prices, interest and foreign exchange rates and credit spreads. The Fund is exposed to market risk from its investment activities, particularly through its equity holdings. The level of risk exposure depends on market conditions, expectations of future price and yield movements and the asset mix. The objective of the Funding Strategy is to identify, manage and control market risk exposure within acceptable parameters, whilst optimising the return on risk.

In general, excessive volatility in market risk is managed through the diversification of the portfolio in terms of geographical and industry sectors and individual securities. To mitigate market risk, the Council and its Investment Advisors undertake appropriate monitoring of market conditions and benchmark analysis.

### (i) Other Price Risk

Other price risk represents the risk that the value of a financial instrument will fluctuate as a result of changes in market prices (other than those arising from interest rate risk or foreign exchange risk), whether those changes are caused by factors specific to the individual instrument or its issuer or factors affecting all such instruments in the market.

The Fund is exposed to share price risk, arising from investments held by the Fund for which the future price is uncertain. All securities investments present a risk of loss of capital. The maximum risk resulting from financial instruments is determined by the fair value of the financial instruments.

The Fund's investment managers mitigate this price risk through diversification and the selection of securities and other financial instruments is monitored by the Council to ensure it is within limits specified in the Fund Investment Strategy.

### Other price risk – sensitivity analysis

In consultation with the Fund's independent provider of performance and analytical data (WM), the Council has determined that the following movements in market price risk were reasonably possible for the reporting period.

Asset Type	Potential Market Movement +/- (%p.a.)
UK Equities	14.5
Overseas Equities	16.7
Cash	0.0

Potential price changes are determined based on the observed historical volatility of asset class returns. The potential volatilities are consistent with a one standard deviation movement in the change in value of the assets over the latest three years. Had the market price of the Fund investments increased/decreased in line with the above, the change in the net assets available to pay benefits in the market price would have been as follows:

			Potential change in year in the net assets available to pay benefits	
Asset Type	Value	% Change	Favourable Market Movement	Unfavourable Market Movement
	£'000		£'000	£'000
UK Equities	40,043	14.5%	45,849	34,237
Overseas Equities	85,900	16.7%	100,246	71,555
Cash	5,327	0.0%	5,327	5,327
<b>Total Assets</b>	<b>131,270</b>		<b>151,422</b>	<b>111,119</b>

## (ii) Interest rate risk

The Fund invests in financial assets for the primary purpose of obtaining a return on investments. These investments are subject to interest rate risks, which represent the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

The Fund's interest rate risk is routinely monitored by the Council and its Investment Consultants, including monitoring the exposure to interest rates and assessment of actual interest rates against the relevant benchmarks.

The Fund's direct exposure to interest rate movements as at 31 March 2012 and 31 March 2011 is set out below. These disclosures present interest rate risk based on the underlying financial assets at fair value:

<b>Asset Type</b>	<b>At 31 March 2011</b>	<b>At 31 March 2012</b>
	<b>£'000</b>	<b>£'000</b>
Cash and cash equivalents	7,107	5,327
Fixed Interest securities	9,163	0
<b>Total</b>	<b>16,270</b>	<b>5,327</b>

## Interest rate risk sensitivity analysis

The Council recognises that interest rates can vary and can affect both income to the Fund and the value of the net assets available to pay benefits.

The analysis that follows assumes that all other variables, in particular exchange rates, remain constant, and shows the effect in the year on the net assets available to pay benefits of a +/- 100 Basis Points (BPS) change in interest rates:

<b>Asset Type</b>	<b>Carrying amount as at 31 March 2012</b>	<b>Potential change in year in the net assets available to pay benefits</b>	
		<b>+100 BPS</b>	<b>-100 BPS</b>
	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
Cash and cash equivalents	5,327	53	(53)
Fixed Interest securities	0	0	0
<b>Total change in assets available</b>	<b>5,327</b>	<b>53</b>	<b>(53)</b>

## (iii) Currency risk

Currency risk represents the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. The Fund is exposed to currency risk on financial instruments that are denominated in any currency other than the functional currency of the fund (£UK). The Fund is invested in equities overseas that are denominated in currencies other than £UK. The Fund also holds a low level of bonds denominated in overseas currencies.

The following table summarises the Fund's currency exposure at 31 March 2012:

<b>Currency exposure - asset type</b>	<b>Asset value at 31 March 2012</b>
	<b>£'000</b>
Overseas quoted equities	85,900
Pooled funds - Global Basket	37,888
<b>Total</b>	<b>123,788</b>

## Currency risk – sensitivity analysis

Following analysis of historical data in consultation with WM, the likely volatility associated with foreign exchange movements on an individual currency basis is shown on the table on the following page. The weight of each currency in relation to the total currency basket is multiplied by the change in its exchange rate (relative to GBP) to create the aggregate potential currency change of the 'basket' as follows:

Currency	Value (£'000)	% Change	Value on Increase (£'000)	Value on Decrease (£'000)
Australian Dollar	1,983	10.5%	2,191	1,775
Danish Krone	1,543	8.3%	1,671	1,415
Egyptian Pound	416	9.3%	455	377
EURO	5,272	8.4%	5,715	4,829
Hong Kong Dollar	2,053	9.6%	2,250	1,856
Indonesian Rupiah	406	9.0%	443	369
Japanese Yen	5,851	13.3%	6,629	5,073
Norwegian Krone	1,183	10.5%	1,307	1,059
Singapore Dollar	903	7.5%	971	835
South African Rand	2,856	13.6%	3,244	2,468
Swedish Krona	4,917	10.2%	5,419	4,415
Swiss Franc	9,248	10.2%	10,191	8,305
US Dollar	49,269	9.8%	54,097	44,441
Pooled Investments – Global Basket	37,888	6.5%	40,351	35,425
<b>Total</b>	<b>123,788</b>		<b>134,934</b>	<b>112,642</b>

## B) Credit risk

Credit risk represents the risk that the counterparty to a transaction or a financial instrument will fail to discharge an obligation and cause the fund to incur a financial loss. The market values of investments generally reflect an assessment of credit in their pricing and consequently the risk of loss is implicitly provided for in the carrying value of the Fund's financial assets and liabilities. The selection of high quality counterparties, brokers and financial institutions minimises credit risk that may occur through the failure to settle a transaction in a timely manner.

The Council's Annual Treasury Management Strategy Statement sets out the Fund's approach to credit risk for internally managed funds. Deposits are not made with banks and financial institutions unless they are rated independently and meet the Council's credit criteria. The strategy has also set limits as to the maximum percentage of the deposits placed with any one class of financial institution.

The Fund believes it has managed its exposure to credit risk, and the Fund has had no experience of default or uncollectable deposits over the past five financial years. The Fund's cash holding under its treasury management arrangements at 31 March 2012, including current account cash, was £1.9m. (31 March 2011: £0.8m). This was held with the following institutions:

	Rating	Balance at 31 March 2012 (£'000)
<b>Bank current accounts</b>		
Royal Bank of Scotland	A	1,944

## C) Liquidity Risk

Liquidity risk represents the risk that the Fund will not be able to meet its financial obligations as they fall due. The Council therefore takes steps to ensure that the Pension Fund has adequate cash resources to meet its commitments.

The Council has immediate access to its Pension Fund cash holdings

The Fund defines liquid assets as assets that can be converted to cash within three months. Illiquid assets are those assets which will take longer than three months to convert in to cash. As at 31 March 2012, the Fund had no illiquid assets.

## 24 FUNDING AND VALUATION NOTE

In line with the Local Government Pension Scheme (Administration) (Scotland) Regulations 2008, the Fund's actuary undertakes a funding valuation every three years for the purpose of setting employer contribution rates for the forthcoming triennial period. The last such valuation took place as at 31 March 2011. The next valuation will take place as at 31 March 2014.

The key elements of the funding policy are:

- To ensure the long-term solvency of the Fund, i.e. that sufficient funds are available to meet all pension liabilities as they fall due for payment
- To ensure that employer contribution rates are as stable as possible
- To minimise the long-term cost of the scheme by recognising the link between assets and liabilities and adopting an investment strategy that balances risk and return
- To reflect the different characteristics of employing bodies in determining contribution rates where the administering authority considers it reasonable to do so
- To use reasonable measures to reduce the risk to other employers and ultimately to the council tax payer from an employer defaulting on its pension obligations

The aim is to achieve 100% solvency over a period of 20 years and to provide stability in employer contribution rates by spreading any increases in rates over a period of time. Solvency is achieved when the funds held, plus future expected investment returns and contributions are sufficient to meet expected future pension benefits payable.

At the 2011 actuarial valuation, the Fund was assessed as 106.3% funded (86.3% at the March 2008 valuation). This corresponded to a surplus of £9m (2008 valuation: deficit of £18m) at that time.

However, the actuary also considers events after the valuation date and noted that:

- equity markets have remained broadly the same but have been very volatile
- bond yields have fallen significantly
- anticipated price inflation has fallen.

Therefore, on the recommendation of the actuary and in accordance with the Funding Strategy Statement, the administering authority has adopted employer contributions over 3 years to achieve the identified contribution rate of 21.4% as follows:

2012/13	21.4%
2013/14	21.4%
2014/15	21.4%

The valuation of the Fund has been undertaken using the projected unit method under which the salary increase for each member is assumed to increase until they leave active service by death, retirement or withdrawal from service. The principal assumptions were:

### Financial Assumptions

Financial Assumptions	31st March 2008 Funding basis (% p.a.)	31st March Funding basis (% p.a.)	2011 Gilts basis (% p.a.)
Discount rate	6.1%	5.9%	4.3%
Price Inflation	5.1%	5.1%	5.1%
Pay Increases	3.6%	2.8%	2.8%
Pension Increases:			
In excess of GMP*	3.6%	2.8%	2.8%
post-88 GMP	2.8%	2.8%	2.8%
pre-88 GMP	0.0%	0.0%	0.0%
Revaluation of deferred pension	3.6%	2.8%	2.8%
Expenses	0.6%	0.8%	0.8%

\* GMP = guaranteed minimum pension

### Mortality assumptions

The mortality assumptions used and applied to all members are based on the Self Administered Pension Schemes year of birth tables with improvements from 2008 in line with the Medium Cohort and a 1% p.a. underpin.

## 25 POST BALANCE SHEET EVENTS

The Head of Finance, being the officer responsible for the council's financial affairs, signed the Annual Report and Accounts of the Pension Fund on 27 September 2012. Events taking place after this date are not reflected in the financial statements or notes. Where events taking place before this date provided information about conditions existing at 31 March 2012, the figures in the financial statements and notes have been adjusted in all material respects to reflect the impact of this information.

## 26 ADDITIONAL VOLUNTARY CONTRIBUTIONS

Under Inland Revenue rules, scheme members are permitted to make contributions towards retirement and death in service benefits in addition to those which they are required to make as members of the Local Government Pension Scheme. These contributions are known as Additional Voluntary Contributions and are treated separately from the scheme's assets under arrangement with Prudential Assurance Company Limited.

During the year, member contributions amounted to £386K.

Members contributions are invested in "with profits" Fund or a "deposit" Fund. During the year, the value of AVC investments increased by £232K from £1,587K to £1,819K as at 31 March 2012.

# GOVERNANCE ARRANGEMENTS

## Orkney Islands Council Pension Fund

### Introduction

This Statement outlines the governance arrangements in place for administering the pension scheme administered by Orkney Islands Council.

### 1. Administering Authority

- 1.1 Orkney Islands Council (the Council) is the Administering Authority for the Local Government Pension Scheme (LGPS) set up for the Orkney Islands Council geographic area.
- 1.2 The Council has delegated its pensions functions to the Investments Sub-Committee.

### 2. Regulatory Framework

- 2.1 The Scottish Public Pensions Agency (SPPA) is responsible for regulating the LGPS in Scotland and the Council administers the pension scheme in accordance with these regulations.
- 2.2 The Orkney Islands Council LGPS scheme is open to all employees of scheduled bodies except for those whose employment entitles them to belong to another statutory pension scheme (e.g. Teachers). Employees of admitted bodies can join the scheme subject to those bodies meeting the statutory requirements and on such terms and conditions as the Council (as Administering Authority) may require. A list of scheduled and admitted bodies is attached in Annex 2.
- 2.3 The Investments Sub-Committee (the Sub-Committee) is a formal sub-committee of Orkney Islands Council's Policy and Resources Committee. The Scheme of Administration for the Council refers to the Investments Sub-Committee all matters relating to the management of the Council's Pension Fund.
- 2.4 Financial affairs are conducted in compliance with the Council's Financial Regulations which have been formally adopted by the Pension Fund in 2011.
- 2.5 Funds are invested in compliance with the Council's Statement of Investment Principles.

### 3. Investments Sub-Committee

- 3.1 The members of the Sub-Committee act as quasi-trustees and oversee the management of the Orkney Islands Council Pension Fund (the Fund).
- 3.2 Their overriding duty is to ensure the best possible outcomes for the Fund, its participating employers and scheme members.
- 3.3 The members' knowledge is supplemented by professional advice from officers of the Council, professional advisers and external experts.
- 3.4 The Sub-Committee is comprised of five members of the Council:
  - Convenor (Chair of Policy & Resources Committee)
  - Vice Convenor (Vice chair of Policy & Resources Committee)
  - Three other elected members of the Council
- 3.5 The Independent Investment Consultant, the Executive Director of Corporate Services, Head of Finance, and the Corporate Finance Senior Manager also attend the Sub-Committee meetings as advisers.
- 3.6 The Sub-Committee meets at least quarterly. Additional meetings are called as appropriate.
- 3.7 The Sub-Committee papers and minutes are publicly available on the Council's website, unless they have been considered as private business in terms of Schedule 7A to the Local Government (Scotland) Act 1973. Minutes of the Sub-Committee are presented to the Policy and Resources Committee of the Council.

### 4. Administration and Management of the Fund

#### 4.1 Head of Finance

- i The Council's Head of Finance is the officer with responsibility to ensure proper administration of the Council's financial affairs in terms of Section 95 of the Local Government (Scotland) Act 1973.
- ii He is responsible for:
  - 4.1.ii.1. the financial accounting of the Fund,
  - 4.1.ii.2. the preparation of the Pension Fund Annual Report, and
  - 4.1.ii.3. being the principal advisor on investment management to the Council in its capacity as Trustee to the Fund and as the Fund's Administering Authority.
- 4.2 The day-to-day management of the investment activities of the Fund is managed by the Corporate Finance Section within Corporate Services.
- 4.3 The pension benefits policy oversight and day-to-day administration for the Fund is managed by the Pensions Section within Corporate Services.

## 5. Professional Advisers and External Service Providers

- 5.1 Hymans Robertson has been appointed to act as Actuary to the Fund. The services provided include advice on funding and actuarial valuations.
- 5.2 Hymans Robertson is the Independent Investment Consultant employed by the Council to advise the Sub-Committee on investment strategy.
- 5.3 The Fund has appointed investment managers who have responsibility for the selection, retention and realisation of individual investments. Where appropriate, they also implement the Sub-Committee's policy in relation to corporate socially responsible investment and corporate governance.
- 5.4 Bank of New York Mellon is the global custodian for the Fund and is responsible for the safekeeping of the assets including transaction processing and making tax claims.
- 5.5 WM Performance Services provides independent performance services for the Fund. They have responsibility for measuring and reporting on the performance of individual portfolios and the overall Fund.

## 6. Internal and External Review

- 6.1 The annual financial statement of the Fund is subject to external audit. The auditors are appointed by Audit Scotland, as part of the process to ensure that public funds are properly safeguarded and accounted for.
- 6.2 The Council provides internal audit arrangements to the Fund both as a tool of management and with direct reporting to the Council's Monitoring and Audit Committee.

## 7. Risk Management

- 7.1 The Council has a corporate risk management policy which includes the maintenance and regular review of a risk register.
- 7.2 Risk awareness is embedded into the investment performance management process.

## 8. Access to Information

- 8.1 Sub-Committee papers and minutes are available via the Council website <http://www.orkney.gov.uk>.
- 8.2 The Fund's Annual Report and Accounts is available via the Council's website <http://www.orkney.gov.uk>.

## 9. Compliance with Best Practice

- 9.1 The Local Government Pension Scheme (Administration) (Scotland) Regulations 2008 require Administering Authorities to measure their governance arrangements set out against standards set by Scottish Ministers. These standards are established against a number of best practice principles. The Governance Compliance Statement details the Fund's status against these standards.

# GOVERNANCE COMPLIANCE STATEMENT

The Regulations that govern the management of LGPS Funds in Scotland require that a Governance Compliance Statement is published. The following compliance statement sets out the extent to which governance arrangements comply with best practice.

Principle		Full Compliance	Comments
<b>Structure</b>	The management of the administration of benefits and strategic management of Fund assets clearly rests with the main committee established by the appointing Council.	Yes	The Orkney Islands Council as administering authority has delegated all pension scheme matters to the Policy and Resources Committee and the Investment Sub-Committee (ISC) which comprises of 5 elected members.
	That representatives of participating LGPS employers, admitted bodies and scheme members (including pensioner and deferred members are members of either the main or secondary committee established to underpin the work of the main committee.	No	The existing membership of the ISC includes both active and pensioner members of the Orkney Island Council Pension Fund. There are currently no admitted bodies or deferred members represented on the ISC or Policy and Resources Committee.
	That where a secondary committee of panel has been established, the structure ensures effective communication across both levels.	N/A	
	That where a secondary committee or panel has been established; at least one seat of the main committee is allocated for a member from the secondary committee or panel.	N/A	
<b>Representation</b>	a) That all key stakeholders are afforded the opportunity to be represented within the main or secondary committee structure. These include: <ul style="list-style-type: none"> <li>• Employing authorities (including non-scheme employers, e.g. admitted bodies;</li> <li>• Scheme members (including deferred and pensioner scheme members <ul style="list-style-type: none"> <li>• Where appropriate, independent professional observers, and</li> <li>• Expert advisors (on an ad-</li> </ul> </li> </ul>	No	Members of the Policy and Resources Committee and ISC are selected from the membership of the Council.  Committee structure and responsibility for Pension Fund matters is currently under review.  Input from Hymans Robertson as expert advisors to the Pension Fund is routinely sought on policy matters.

Principle		Full Compliance	Comments
	hoc basis).		
	b) That where lay members sit on a main or secondary committee, they are treated equally in terms of access to papers and meetings, training and are given full opportunity to contribute to the decision making process, with or without voting rights	N/A	
<b>Selection and Role of Lay Members</b>	a) That committee or panel members are made fully aware of the status, role and function that they are required to perform on either a main or secondary committee.	Yes	The current arrangements whereby training is provided to members of the ISC on an ad-hoc basis, or where a specific need has been identified, is under review. The CIPFA framework will be used to identify gaps in knowledge. Training for ISC members includes presentations from investment managers, actuary and investment advisors. Attendance at meetings and training is monitored and reported as appropriate.
	b) That at the start of any meeting, committee members are invited to declare any financial or pecuniary interest related to specific matters on the agenda.	Yes	The declaration of Member's interests is a standard item on the agenda of the Investment Sub-Committee.
<b>Voting</b>	The policy of individual administering authorities on voting rights is clear and transparent, including the justification for not extending voting rights to each body or group represented on main LGPS committees.	Yes	Full voting rights are given to all members of the Policy and Resources Committee.
<b>Training/ Facility Time/ Expenses</b>	a) That in relation to the way in which statutory and related decisions are taken by the administering authority, there is a clear policy on training, facility time and reimbursement of expenses in respect of members involved in the decision making process.	Yes	Members' training is funded from the Council's Pension Fund.
	b) That where such a policy exists it applies equally to all members of committees,	Yes	All members are treated equally under the training policy.

Principle		Full Compliance	Comments
	sub-committees, advisory panels or any other form of secondary forum.		
	c) That the administering authority considers the adoption of annual training plans for committee members and maintains a log of all such training.	No	Annual training plans will be developed in the future. Members currently receive training each year and this is monitored and reported as appropriate.
<b>Meeting Frequency</b>	a) That an administering authority's main committee or committees meet at least quarterly.	Yes	The Policy and Resources Committee and ISC are scheduled to meet at four times a year.
	b) That an administering authority's secondary committee or panel meet at least twice a year and is synchronised with the dates when the main committees sits.	N/A	
	c) That an administering authority that does not include lay members in their formal governance arrangements must provide a forum outside of those arrangements by which the interests of key stakeholders can be represented.	No	These arrangements are currently under review.
<b>Access</b>	That subject to any rules in the council's constitution, all members of main and secondary committees or panels have equal access to committee papers, documents and advice that falls to be considered at meetings of the main committee.	Yes	All members are treated equally.
<b>Scope</b>	That administering authorities have taken steps to bring wider scheme issues within the scope of their governance arrangements.	Yes	The Policy and Resources Committee and ISC deal with all matters relating to both the administration and investment of the Pension Fund.
<b>Publicity</b>	That administering authorities have published details of their governance arrangements in such a way that stakeholders, can express an interest in wanting to be part of those arrangements.	Yes	The Orkney Islands Council Pension Fund governance documents are available upon request. The Council as administering authority communicates regularly with employers and scheme members.

## **Independent auditor's report to the members of Orkney Islands Council as administering body for the Orkney Islands Council Pension Fund and the Accounts Commission for Scotland**

I certify that I have audited the financial statements of the Orkney Islands Council Pension Fund for the year ended 31 March 2012 under Part VII of the Local Government (Scotland) Act 1973. The financial statements comprise the fund account, the net assets statement and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union, and as interpreted and adapted by the Code of Practice on Local Authority Accounting in the United Kingdom 2011/12 (the 2011/12 Code).

This report is made solely to the parties to whom it is addressed in accordance with Part VII of the Local Government (Scotland) Act 1973 and for no other purpose. In accordance with paragraph 125 of the Code of Audit Practice approved by the Accounts Commission for Scotland, I do not undertake to have responsibilities to members or officers, in their individual capacities, or to third parties.

### **Respective responsibilities of the Head of Finance and auditor**

As explained more fully in the Statement of Responsibilities, the Head of Finance is responsible for the preparation of financial statements and for being satisfied that they give a true and fair view. My responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) as required by the Code of Audit Practice approved by the Accounts Commission for Scotland. Those standards require me to comply with the Auditing Practices Board's Ethical Standards for Auditors.

### **Scope of the audit of the financial statements**

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the fund's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Head of Finance; and the overall presentation of the financial statements. In addition, I read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my report.

### **Opinion on financial statements**

In my opinion the financial statements:

- give a true and fair view in accordance with applicable law and the 2011/12 Code of the financial transactions of Orkney Islands Council Pension Fund during the year ended 31 March 2012, and of the amount and disposition at that date of its assets and liabilities;
- have been properly prepared in accordance with IFRSs as adopted by the European Union, as interpreted and adapted by the 2011/12 Code; and
- have been prepared in accordance with the requirements of the Local Government (Scotland) Act 1973 and the Local Government in Scotland Act 2003.

### **Opinion on other prescribed matters**

In my opinion the information given in the Foreword by Head of Finance for the financial year for which the financial statements are prepared is consistent with the financial statements.

### **Matters on which I am required to report by exception**

I am required to report to you if, in my opinion:

- adequate accounting records have not been kept; or
- the financial statements are not in agreement with the accounting records; or
- I have not received all the information and explanations I require for my audit; or
- the Governance Compliance Statement does not comply with guidance from the Scottish Ministers.

I have nothing to report in respect of these matters.

Stephen O'Hagan  
Assistant Director of Audit  
Audit Scotland  
7th Floor Plaza Tower  
East Kilbride  
Glasgow G74 1LW

27 September 2012

## ANNEX 1

### ORKNEY ISLANDS COUNCIL PENSION FUND

### ACTUARIAL STATEMENT FOR 2011/12

This statement has been prepared in accordance with Regulation 31A (1) (d) of the Local Government Pension Scheme (Scotland) (Administration) Regulations 2008, and Chapter 6 of the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the UK 2011/12.

#### **Description of Funding Policy**

The funding policy is set out in the Orkney Islands Council's Funding Strategy Statement (FSS). In summary, the key funding principles are as follows:

- to ensure the long-term solvency of the Fund as a whole and of the share of the Fund attributable to each individual employer;
- to ensure that sufficient funds are available to meet all benefits as they fall due for payment;
- not to restrain unnecessarily the investment strategy of the Fund, so that the Administering Authority can seek to maximise investment returns (and hence minimise the cost of the benefits) for an appropriate level of risk;
- to help employers recognise and manage pension liabilities as they accrue;
- to minimise the degree of short-term change in the level of each employer's contributions where the Administering Authority considers it reasonable to do so;
- to use reasonable measures to reduce the risk to other employers and ultimately to the Council Tax payer from an employer defaulting on its pension obligations; and
- to maintain the affordability of the Fund to employers as far as is reasonable over the longer term.

The FSS sets out how the Administering Authority seeks to balance the conflicting aims of securing the solvency of the Fund and keeping employer contributions stable.

#### **Funding Position as at the last formal funding valuation**

The most recent actuarial valuation carried out under Regulation 32 of the Local Government Pension Scheme (Scotland) (Administration) Regulations 2008 was as at 31 March 2011. This valuation revealed that the Fund's assets, which at 31 March 2011 were valued at £160 million, were sufficient to meet 106% of the liabilities (i.e. the present value of promised retirement benefits) accrued up to that date. The resulting surplus at the 2011 valuation was £9 million.

Individual employers' contributions for the period 1 April 2012 to 31 March 2015 were set in accordance with the Fund's funding policy as set out in its FSS.

#### **Principal Actuarial Assumptions and Method used to value the liabilities**

Full details of the methods and assumptions used are described in my valuation report dated 31 March 2012.

#### **METHOD**

The liabilities were assessed using an accrued benefits method which takes into account pensionable membership up to the valuation date, and makes an allowance for expected future salary growth to retirement or expected earlier date of leaving pensionable membership.

## ASSUMPTIONS

A market-related approach was taken to valuing the liabilities, for consistency with the valuation of the Fund assets at their market value.

The key financial assumptions adopted for the 2011 valuation were as follows:

Financial assumptions	31 March 2011	
	% p.a. Nominal	% p.a. Real
Discount rate	5.9%	3.1%
Pay increases *	5.1%	2.3%
Price inflation/Pension increases	2.8%	-

\* Plus an allowance for promotional pay increases. Short term pay growth was assumed to be 1% p.a. for 2011/12 and 2012/13, reverting to 5.1% p.a. thereafter.

The key demographic assumption was the allowance made for longevity. As discussed in the accompanying report, life expectancy is based on the SAPS year of birth tables with improvements from 2008 in line with the Medium Cohort and a 1% p.a. underpin. Based on these assumptions, the average future life expectancies at age 65 are as follows:

	Males	Females
Current Pensioners	23.0 years	25.8 years
Future Pensioners	24.9 years	27.7 years

Copies of the 2011 valuation report and Funding Strategy Statement are available on request from Orkney Islands Council, administering authority to the Fund.

### Experience over the period since April 2011

The Administering Authority monitors the funding position on a regular basis as part of its risk management programme. The most recent funding update was produced as at 31 March 2012. It showed that the funding level (excluding the effect of any membership movements) has worsened since the 2011 valuation due to falling real bond yields and lower asset returns than expected.

The next actuarial valuation will be carried out as at 31 March 2014. The Funding Strategy Statement will also be reviewed at that time.

Barry McKay  
Fellow of the Institute and Faculty of Actuaries  
For and on behalf of Hymans Robertson LLP  
10 May 2012

Hymans Robertson LLP  
20 Waterloo Street  
Glasgow  
G2 6DB

# Orkney Islands Council Pension Fund

## Scheduled and Admitted Bodies

### Scheduled Bodies

- Orkney Islands Council

### Admitted Bodies

#### Active Admitted Bodies

- Orkney Tourist Board (Visit Scotland)
- Orkney Towage Company Limited
- Orkney Ferries Limited
- Orkney Enterprise
- Pickaquoy Centre Trust
- Orkney Islands Property Development Limited
- Golder Landscapes

#### Admitted bodies with Deferred or Retired Members only

- Assessors
- D & H Glue
- Drinkwise Orkney
- Orkney Heritage Society
- Orkney Meat Limited
- Orkney Opportunities Centre
- Weyland Farms Limited

### GLOSSARY OF TERMS

#### ACTIVE MANAGEMENT

An investment management style that seeks to outperform by way of self-selected decisions on stock choice, timing of market incursions, or asset allocation. Compare this with Passive Management.

#### ASSET ALLOCATION

The division of the Fund's assets between different classes of assets, for example, UK Equities, Japanese Equities, UK Bonds. In the long run the asset allocation choices should support the Fund's strategic financial objectives. In the short term tactical changes might be made to achieve short-term advantage.

#### BALANCED MANAGEMENT

An arrangement under which investments are spread over a range of asset classes at the manager's discretion. The manager controls investments over as many classes as are available under the Fund's overall strategy. Compare this with specialist management.

#### GROWTH MANAGER

An investment manager who fundamentally believes in picking stocks that he believes will achieve an above-average growth in profits. This is sometimes caricatured as buying stock irrespective of price because the price will rise. Compare this with value manager.

#### MANDATE

An agreement between an investment manager and his client as to how investments are to be managed, specifying whatever targets and investment limitations are to apply.

#### PASSIVE MANAGEMENT

A style of investment management that seeks performance equal to market returns or to some appropriate index. Such investment entails a more mechanical approach to asset allocation and stock selection because such decisions are largely dictated by general market shifts rather than individual manager discretion. Compare this with active management.

#### POOLED FUND

A fund in which a number of investors hold units rather than owning the underlying assets. This is a useful way for smaller funds to diversify investments without exposing them to undue risks. Unit Trusts are pooled funds as are Open-ended Investment Companies. Compare this with segregated Fund.

#### RETURN

The value of capital enhancement and income received by a Fund in a year, expressed as a percentage of the opening value of the Fund. If values fall "Return" would be negative.

#### RISK

The danger or chance that returns will vary against benchmarks or targets. If risks are high the expected return should be higher still (the risk premium).

#### SEGREGATED FUND

The management of a particular fund's assets independently of those of other funds managed by the same investment house. Compare this with a pooled Fund.

#### SPECIALIST MANAGEMENT

The use of a number of managers, each specialising in a particular asset class. Such managers have no say in asset allocation, being only concerned with stock selection.

**VALUE MANAGER**

A manager who selects stocks that he believes to have potential that is not reflected in the price. This is sometimes caricatured as buying stock because it is cheap. Compare this with growth manager.

**VESTED/NON VESTED OBLIGATIONS**

Vested obligations refer to employee benefits that are not conditional on future employment. Non vested obligations refer to employee benefits that are conditional on future employment.

**PENSION FUND STRAIN**

The cost to employers of the early release of pension benefits.

**OPERATING SURPLUS/DEFICIT**

The surplus/deficit arising from dealing with members, employers and others directly involved in the scheme.

## ADDITIONAL INFORMATION

### Key Documents Online

You can find further information on our website, <http://www.orkney.gov.uk/Council/P/pension-Fund-annual-reports.htm>, including the following documents:

- Annual Report and Accounts

### Fund Advisers

<b>Actuaries:</b>	Hymans Robertson
<b>Auditors:</b>	Audit Scotland
<b>Bankers:</b>	Royal Bank of Scotland
<b>Investment Advisors:</b>	Hymans Robertson
<b>Investment Custodians:</b>	Bank of New York Mellon
<b>Investment Managers:</b>	Baillie Gifford & Co
<b>Performance Measurement:</b>	WM Performance Services
<b>Additional Voluntary Contributions (AVC) Managers:</b>	Prudential

### Contact Details

For further information and advice on administration, benefits and scheme membership please contact

Bryan Hay	Telephone 01856 873535	Ext 2108
Pensions Manager	E-mail <a href="mailto:bryan.hay@orkney.gov.uk">bryan.hay@orkney.gov.uk</a>	

*Scheme members should have a copy of the “Employees’ Guide to the Local Government Pension Scheme Administered by the Orkney Islands Council”, and can obtain their own copy of an Annual Report on request.*

Or visit Orkney Islands Council pension Fund website at: <http://www.orkney.gov.uk>

For further information on the Fund’s investments, please contact

Gareth Waterson	Telephone 01856 873535	Ext 2521
Head of Finance	E-mail <a href="mailto:gareth.waterson@orkney.gov.uk">gareth.waterson@orkney.gov.uk</a>	
Colin Kemp	Telephone 01856 873535	Ext 2106
Corporate Finance Senior Manager	E-mail <a href="mailto:colin.kemp@orkney.gov.uk">colin.kemp@orkney.gov.uk</a>	