Shetland Islands Council

Pension Fund
Annual Report and Accounts
2013-14

Securing the Best for Shetland

Contents

Inside cover photograph of Crofthouse Museum, Dunrossness by Andrew J Shearer

Foreword

Introduction

Welcome to the Annual Report and Accounts for the Shetland Islands Council Pension Fund for the year ended 31 March 2014.

The Local Government Pension Scheme (Scotland Regulation 31A of the Local Government Pension Scheme Amendment (Scotland) Regulations 2010) requires the Council, as administering authority of the Pension Fund, to prepare a separate Pension Fund Annual Report for the financial year running from 1 April to 31 March.

The principal financial statements within the statement of accounts are the Fund Account and the Net Assets Statement as explained below:

The Fund Account (Page 17)
The Fund Account is the revenue account of the Pension Fund, and discloses the size and type of financial additions to, withdrawals from and changes to the value of the Fund during the accounting period. This covers dealings with members, employers and others directly involved with the scheme. Also incorporated here are returns on investments, which include both investment income and gains and losses on investments.

The Net Assets Statement (Page 18)
The Net Assets Statement discloses the size and type of net assets of the scheme at the end of the financial year.

These statements do not take account of the obligations to pay pensions and benefits, which fall due after the end of the year. These obligations, as required by IAS26, are disclosed by the actuarial position of the Fund, which is revealed in the Actuarial Statement sections of this report (notes 17 and 18). The financial statements should therefore be read in conjunction with that information.

Valuation and Membership
At 31 March 2014, the value of the Fund stood at £333m, an increase of £27m on the previous year. The increase in value of the fund is predominately investment gains and also through excess employer and employee contributions over benefit payments.

The Pension Fund membership increased during the financial year by 248 to 5,805 members. This increase in members is due to pensioner and deferred members increasing while employee members reduced slightly.

Future Influences

Administration
Reform of the Local Government Pension Scheme in Scotland has been finalised. The new Scheme will commence on 1 April 2015 and will meet the conditions laid down by recent legislation on public sector pensions.

The key changes are:

- A move to benefits being worked out using career average related earnings (CARE) rather than final salary.
- Pension being built up at a rate of 1/49th of annual pensionable pay.

- Member's normal retirement age being linked to their own State Pension Age. Members will still be able to retire any time from age 60 but a reduction for early payment may apply.
- Protection of benefits for members age 55 and over at 1 April 2012 who will be guaranteed that their benefits will not be less than they would have been if the 2015 scheme had never been introduced.
- Benefits built up before April 2015 will continue to be calculated using actual final pensionable pay at date of leaving.

The move towards a CARE Scheme is going to have significant implications for the Fund in relation to the transition to and administration of a new a scheme, as well as implications in relation to the Fund's assets, liabilities and future funding requirements. A cost control mechanism is to be developed to make sure the Scheme remains affordable and sustainable in the future.

Pension auto enrolment commenced for some of the Fund employers from 1 May 2013. The Council (being the largest employer) utilised the "transitional delay period" to defer auto-enrolment for existing eligible jobholders who were not members of the Local Government Pension Scheme, until 30 September 2017.

Investments

The Shetland Islands Council approved a new Pension Fund investment strategy on the 17th March 2014. This new strategy is focusing on improving the funding position, with an aim of achieving a 100% funding position before employer and employee contributions match pension benefits payable.

The new strategy requires the allocation of three new investment mandates to complement the existing two mandates. These mandates will be in active equities, a diversified growth fund and an alternative credit fund. It is anticipated that the new strategy will be in place by the end of the 2014/15 financial year.

Acknowledgement

I would like to take this opportunity to thank all the staff and advisers who contribute to the successful management of the Shetland Islands Council Pension Fund.

James Gray MA (Hons) CPFA
Executive Manager - Finance
23 September 2014

Administrative and Management Arrangements

Scheme Management and Advisors

The Council's Executive Manager - 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 (the "section 95 officer").

The Section 95 officer has responsibility for:

a) the financial accounting of the Fund;

b) the preparation of the Pension Fund Annual Report; and

c) being the principal adviser on investment management to the Council in its capacity as Trustee to the Fund and as the Fund's Administering Authority.

The day-to-day management of the investment activities of the Fund is undertaken by the Treasury Section within Finance Services.

The day-to-day benefits administration for the Fund is managed by the Pensions and Payroll Sections within Finance Services.

The Pensions and Payroll Sections ensure that members of the scheme are kept up-to-date by means of an annual mail-shot which includes relevant information, for example, revised Pension Scheme booklets, Pension Fund Accounts, etc. Pension seminars, in conjunction with the Council's Additional Voluntary Contributions (AVC) provider, take place at least once a year. The Council's Corporate Induction training sessions ensure that new employees are aware of the benefits of the LGPS. The Council's later life training sessions are aimed at communicating the benefits of the scheme to members whose retirement is imminent.

Investment Managers

Manager	Mandate
BlackRock	Passive Equities and Bonds
Schroders	Property (Fund of Funds)

Investment Advisor
Hymans Robertson

Custodian
Northern Trust

AVC Providers
Prudential
Equitable Life (closed to new members)

Fund Actuary
Hymans Robertson

Banker
Bank of Scotland

External Auditor
Audit Scotland

Performance Measurement
WM Company

Risk Management

The Pension Fund Consultative Panel discusses, makes comments and recommendations to the Executive Committee on all Pension matters relating to the operation of the Pension Scheme. This panel has representatives from admitted bodies, employers, employees, union, beneficiaries and councillors.

The overview of the financial performance of the Pension Fund rests with the Executive Committee*. The Executive Committee is made up of the Convener, the Political Leader, the Chairs and Vice Chairs of each of the main committees and an additional Councillor.

The ultimate responsibility for the governance of Shetland Islands Council Pension Fund rests with the full Council. The Council takes specific decisions regarding the investment strategies and major funding policy decisions.

The custodian is responsible for the safekeeping of the Pension Fund's assets while the external fund managers are responsible for the management of those assets. The investment risk is managed, as set out in the Statement of Investment Principles below, through investing in a diversified range of asset classes, over a long-term investment horizon.

The Council is the main employer in the Pension Fund, which reduces the risks of late payments. All contributions from external payroll providers are balanced monthly.

WM Company provide independent fund manager performance analysis on a quarterly basis. The overall Pension Fund investment performance is reported through the Pension Fund Consultative Panel to the Executive Committee at the mid-year point and again after the end of the financial year.

Funding Strategy Statement (FSS)

The Regulations on the management of the Pension Fund require the administering authority to prepare, maintain and publish a written Funding Strategy Statement (the FSS). Details of the FSS are found in note 17.

The purpose of the FSS is to:

- establish a clear and transparent Fund-specific strategy which will identify how employers' pension liabilities are best met going forward;
- support the regulatory requirement to maintain as near constant employer contribution rates as possible; and
- take a prudent longer term view of funding those liabilities.

* The Executive Committee was renamed the Policy and Resources Committee on the 14th May 2014.

The Statement of Investment Principles

The Shetland Islands Council meeting of 21 March 2012 approved the Shetland Islands Council Pension Fund Statement of Investment Principles. This Statement includes an introduction, administration details, objective of the Fund, types of investments, balance between different types of investment, risk, expected return on investments, realisation of investments, responsible investment, securities lending and compliance. The Council also complied with the six Myners Principles, which were contained in a schedule to the Statement of Investment Principles.

The Statement of Investment Principles is available for viewing at Finance Services.

Monitoring Arrangements

The fund managers give an annual presentation (apart from years when Local Authority elections are held) to the Council and the members of the Pension Fund Consultative Panel in May each year. This performance review meeting covers the previous financial year and allows the Council and Pension Panel to meet the fund managers, hear their presentations and ask them questions.

Visits are made every November to each fund manager to review the six monthly investment positions. The Council also receives audited quarterly performance books from the fund managers, which are used to produce a quarterly performance review report. The fund managers also provide unaudited weekly Fund values, which are used to inform Council Officers and Councillors of the general investment position.

Access to Information

The Committee papers and minutes are available via the Council committee management system website http://www.shetland.gov.uk/coins/.

This Annual Report and Accounts is available via the Council's website http://www.shetland.gov.uk/about_finances. A full version of this report is provided to the scheduled and active admitted bodies of the scheme and a summary of the review is provided to all Fund members.

Investment Policy and Performance Report

Investment Policy

The investment policy, along with the Council's approach to the management of risk for the Fund as a whole and in respect of the investment managers, is outlined in the Statement of Investment Principles.

The Council has a paramount fiduciary duty to obtain the best possible financial return on the Fund investments against a suitable degree of risk. The fund managers, acting in the best financial interests of the Fund, have delegated powers for the acquisition and realisation of investments, but as part of their investment process they are expected to consider all factors, including the social, environmental and ethical policies of companies in which they may invest to the extent that these may materially affect the long term prospects of such companies.

The Pension Fund asset allocation is diversified between equities, bonds, property and cash and is measured against a customised benchmark as follows:

Asset Class	Allocation %	Benchmark
UK Equities	40	FTSE All Share
Overseas Equities	40	MSCI Relevant Indices
UK Gilts	5	FTSE Gilts All Stocks
UK Corporate Bonds	5	Iboxx £ non Gilts
Property	10	IPD Pooled Property
Total	100	

The Pension Fund has two fund managers. The main fund manager is BlackRock which has a passive mandate investing in equities and bonds. The other fund manager is Schroders which has a mandate to invest in property.

At the end of March 2014 BlackRock invested 93% and Schroders 7% of the Pension Fund assets.

Investment Performance

Investment performance is monitored against this benchmark return on a quarterly and annual basis.

For the year to 31 March 2014 the Fund had a return of 6.5% compared to the benchmark return of 6.7%.

The Pension Fund's investment return for the financial year to 31 March 2014 is shown for each investment area in the following table:

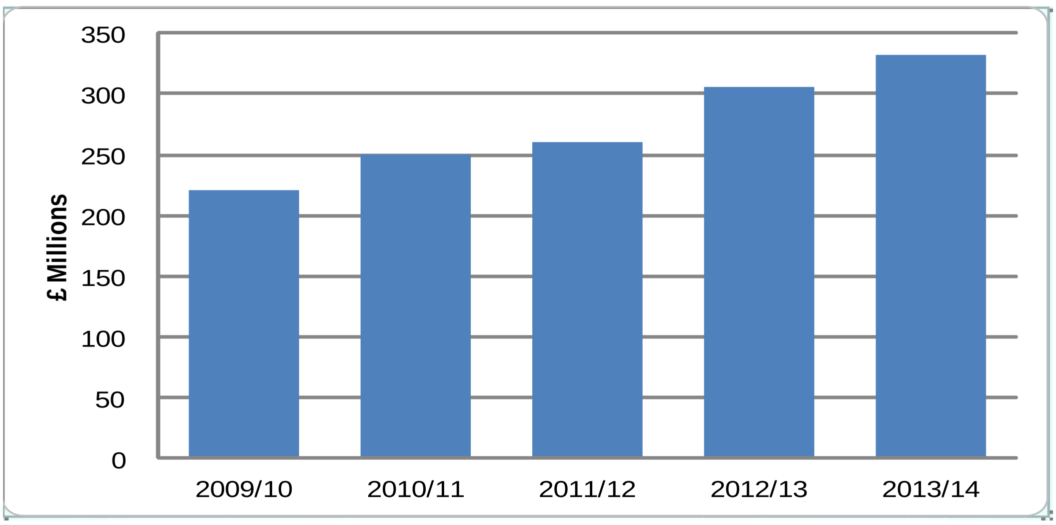
Asset Class	Asset Allocation %	Investment Return 2013/14 %
UK Equities	39	8.8
North America	9	10.3
Continental Europe	13	17.3
Japan	9	-1.6
Total Pacific (ex Japan)	9	-5.8
UK Government Bonds	5	-3.8
Corporate Bonds	5	-2.6
Cash	4	0.4
Property	7	14.0
Total	100	6.5

The total investment return of 6.5% for 2013/14 is calculated from a combination of the quarterly investment returns during 2013/14. The investment return is calculated quarterly from the investment return of each asset class and the asset allocation at that time.

The table below shows the Pension Fund performance over the last five years, and the annualised return over three and five years:

	2009/10 %	2010/11 %	2011/12 %	2012/13 %	2013/14 %	3 Year Annualised %	5 Year Annualised %
Fund Return	39.7	6.5	0.9	15.0	6.5	7.3	12.9
Benchmark	38.8	7.3	1.3	14.6	6.7	7.4	13.0
Performance	0.9	-0.8	-0.4	0.4	-0.2	-0.1	-0.1

The table below shows the market value of the Pension Fund over the last five years:



Governance Compliance Statement

Introduction

This Statement documents the governance arrangements for the pension scheme administered by Shetland Islands Council.

Administering Authority

Shetland Islands Council (the Council) is the Administering Authority for the Local Government Pension Scheme (LGPS) set up for the Shetland Islands geographic area.

Regulatory Framework

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.

The Council manages the Fund in terms of the Local Government Pension Scheme (Scotland) Regulations 2008. The Council discharges this duty partly directly and partly through the Executive Committee*. For consultation purposes, the Council has in place a Pension Fund Consultative Panel comprising three councillors, one representative of the Admitted Bodies' employers, three employee representatives (one representing the Admitted Bodies' employees), a Union Representative, a pensioner and a deferred members' representative. The Panel is advised by relevant officers of the Council as appropriate and meets approximately twice a year.

The financial transactions are conducted in compliance with the Council's Financial Regulations.

The Pension Fund is invested in compliance with the Council's Statement of Investment Principles.

Investment Strategy Review

The Shetland Islands Council approved a new Pension Fund investment strategy on the 17th March 2014. This new strategy is focusing on improving the funding position, with an aim of achieving a 100% funding position before employer and employee contributions match pension benefits payable.

The new strategy requires the allocation of three new investment mandates to complement the existing two mandates. These mandates will be in active equities, a diversified growth fund and an alternative credit fund. It is anticipated that the new strategy will be in place by the end of the 2014/15 financial year.

The investment strategy review was carried out by the Pension Fund's investment consultants Hymans Robertson. They are also conducting the three tender exercises in conjunction with the Council's Finance Service.

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* The Executive Committee was renamed the Policy and Resources Committee on the 14th May 2014.

Scope of Responsibility

The Council is responsible for ensuring that the Pension Fund:

- business is conducted in accordance with the law and appropriate standards;
- is safeguarded and properly accounted for; and
- is invested economically, efficiently and effectively.

In discharging these responsibilities, Council members and staff are responsible for implementing effective arrangements for governing the affairs of the Fund. Considerable work has been undertaken in relation to improving the financial governance framework and ensuring that the Council's arrangements comply with the regulations of CIPFA Statement on the Role of the Chief Financial Officer in Local Government (2010).

The management of the Pension Fund is a service in its own right, governed by a suite of appropriate management arrangements, such as:

- appropriate strategic investment policies (such as the FSS and Statement of Investment Principles);
- service planning arrangements;
- staff time allocations, appropriate to the scale of the Fund;
- performance management arrangements, especially for Fund investments and customer responsiveness;
- systems of internal control to safeguard assets and ensure best value;
- engagement with stakeholders and clear policy on representative roles and responsibilities;
- Governance Statement;
- risk register and business continuity plans;
- support for cash and treasury management;
- training plan; and
- independent and objective scrutiny.

To this end, the Pension Fund is managed within the overall governance arrangements of Shetland Islands Council. The Council has recently refreshed its decision-making arrangements and the governance of the Pension Fund is included within those arrangements. The Shetland Islands Council meeting of 20 September 2012 refreshed the Code of Corporate Governance to ensure compliance with best practice.

Governance Framework

The governance framework consists of the systems, processes, cultures and values by which the Pension Fund is directed and controlled. It describes the way in which staff and representatives inform all the stakeholders and ask for their views on any key issues. It is important to monitor the achievements of the Fund, particularly with regard to the long-term investment strategy. From a service point of view, as with other service areas, there is a need to ensure that the service is delivered efficiently and effectively and in line with all the characteristics of a best value service.

Critical to the success of a well managed Pension Fund is appropriate internal control arrangements. The systems of internal financial control are intended to ensure that:

- assets are safeguarded;
- transactions are authorised and properly recorded; and
- material errors or irregularities are either prevented or detected within a reasonable timescale.

The system is based on a framework of skilled staff who are aware of their responsibilities, good management information, financial regulations and effective systems and procedures.

Within Shetland Islands Council, there is a need to focus on the controls required to ensure clear separation of duties, due to the small number of staff directly employed to work on the Pension Fund. The Pension Fund relies on the same systems of internal control as those which are in place for Shetland Islands Council (which are externally audited and assessed on an annual basis).

The effective arrangements include:

- an appropriate level of knowledge for committee members to ensure that they have adequate under-pinning knowledge to oversee the governance of the Pension Fund business;
- clear objectives, good decision making at committee level, clear delegations to committee and staff, with appropriate, independent scrutiny of decision making and performance;
- a clear set of objectives for the Fund, as described in the FSS and Investment Principles;
- good performance monitoring arrangements, with committee members being able to directly question those responsible for all aspects of the business on a regular basis;
- a clear statement of risk, combined with effective risk management arrangements;
- an annual review of compliance against regulation, guidance and best practice arrangements;
- the Monitoring Officer ensuring compliance with regulation and guidance;
- clear monitoring arrangements;
- compliance with LGPS Investment Regulations;
- compliance with the CIPFA / Myners investment principles;
- appropriate custodian arrangements for investments;
- codes of conduct to support good relationships between committee members and staff who support the work of the Pension Fund;
- a demonstrable best value service, including good use of benchmarking data on the cost and quality of service provided; and
- effective internal control arrangements.

The governance framework cannot eliminate all risks of failure to meet policy objectives. An effective framework can, however, provide a reasonable (but not absolute) assurance of effectiveness.

Review of Effectiveness

The Council has a responsibility for ensuring the continuing effectiveness of its governance framework and systems of internal control. The review of effectiveness is informed by:

- direct feedback from stakeholders;
- effective performance reporting arrangements and management information;
- financial and budget monitoring reports;
- performance indicators and benchmarking data, on cost and quality of service;
- specific internal audit reviews;
- self assessment exercises against performance standards;
- the annual report and accounts; and
- external audit observations, comments and recommendations for improvement.

The Council provides internal audit arrangements to the Fund both as a tool of management and with direct reporting to the Council's Audit Committee. The Internal Audit service operates in accordance with CIPFA's Code of Practice for Internal Audit. The service works to an Annual Plan, based on the approved Audit Strategy and an annual assessment of the known and potential risks.

The Internal Audit service reports directly to the Chief Executive.

The annual financial statement of Shetland Islands Council Pension Fund is subject to external audit. The external auditors are appointed by Audit Scotland, as part of the process to ensure that public funds are properly safeguarded and accounted for.

Each year, the external auditors undertake an assessment of the internal controls in operation in the Council, to determine whether they can place reliance on them in the preparation of the final accounts.

The Local Government Pension Scheme (LGPS) regulations require LGPS administering authorities to measure their governance arrangements against the standards set out in the guidance. Where compliance does not meet the published standard, there is a requirement for administering authorities to set out any reasons for non-compliance in their governance compliance statement.

The Governance Compliance Statement set out below describes the extent to which the governance arrangements comply with best practice and any actions required to implement improvements.

Principle	Compliance and Comments
Structure	
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
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.	Yes
That where a secondary committee or panel has been established, the structure ensures effective communication across both levels.	Yes
That where a secondary committee or panel has been established, at least one seat on the main committee is allocated for a member from the secondary committee or panel.	Yes
Committee Membership and Representation	
All key stakeholders are afforded the opportunity to be represented within the main or secondary committee structure. These include: i) employing authorities (including non-scheme employers, e.g., admitted bodies); ii) scheme members (including deferred and pensioner scheme members); iii) where appropriate, independent professional observers; and expert advisors (on an ad-hoc basis).	i) Yes ii) Yes iii) Yes, e.g. engaging with an actuary or investment manager when professional advice required.

Principle	Compliance and Comments
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.	Yes
Selection and role of lay members	
That committee or panel members are made fully aware of the status, role and function they are required to perform on either a main or secondary committee.	Yes
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
Voting	
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
Training/Facility time/Expenses	
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 A Member Development Programme is in place. The Constitution clearly sets out the scope of approved duties. There is supplementary guidance to ensure Members' expenses are reimbursed in line with regulatory requirements.
That where such a policy exists, it applies equally to all members of committees, sub-committees, advisory panels or any other form of secondary forum.	No The policies for employer representatives and staff representatives are necessarily different and cannot be equally applied.
That the administering authority considers the adoption of annual training plans for committee members and maintains a log of all such training undertaken.	Yes A Member Development Programme is being implemented. All member development is being monitored and logged centrally. Personal development plans are in place for 18 out of 22 Members.
Meetings (frequency/quorum)	
That an administering authority's main committee or committees meet at least quarterly.	Yes, the Policy and Resources Committee (previously named Executive Committee) meets at least six times per annum with pension matters forming only part of their business.

Principle	Compliance and Comments
That an administering authority's secondary committee or panel meet at least twice a year and is synchronised with the dates when the main committee sits.	Yes
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.	Lay members are included in formal governance arrangements.
Access	
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
Scope	
That administering authorities have taken steps to bring wider scheme issues within the scope of their governance arrangements.	Yes
Publicity	
That administering authorities have published details of their governance arrangements in such a way that stakeholders with an interest in the way in which the scheme is governed, can express an interest in wanting to be part of those arrangements.	Yes The Annual Newsletter is available to all Members. The Annual Report and Accounts will be made available on-line.

Certification

It is our opinion that the governance and internal control environment provides reasonable and objective assurance that any significant risks impacting on the achievement of the principal objectives of the Pension Fund will be identified and actions taken to avoid or mitigate their impact.

Mark Boden

Chief Executive

Date: 23 September 2014

James Gray

Executive Manager – Finance

Date: 23 September 2014

Statement of Responsibilities for the Statement of Accounts

The Administering Authority's Responsibility

The Authority is required to:

- make arrangements for the proper administration of its Pension Fund and to ensure that the proper officer has the responsibility for the administration of those affairs; in this Authority the proper officer is the Executive Manager - Finance;

- manage its affairs to secure economic, efficient and effective use of resources and to safeguard its assets; and

- approve the Financial Statements within two months of receipt of the audit certificate.

The Executive Manager – Finance's Responsibilities

The Executive Manager - Finance is responsible for the preparation of the Pension Fund Statement of Accounts in accordance with proper practices as set out in the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom (the Code).

It is the responsibility of the Executive Manager - Finance to sign, date and submit the un-audited statement of accounts to the authority and Controller of Audit by 30 June.

In preparing this Statement of Accounts, the Executive Manager - Finance has:

- selected suitable accounting policies and then applied them consistently;

- made judgements and estimates that were reasonable and prudent; and

- complied with the local authority Code.

The Executive Manager - Finance has also:

- kept proper accounting records which were up to date; and

- taken reasonable steps for the prevention and detection of fraud and other irregularities.

The Statement of Accounts presents a true and fair view of the financial position of the Pension Fund at the reporting date and its income and expenditure for the year ended 31 March 2014.

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James Gray MA (Hons) CPFA
Executive Manager – Finance
(Section 95 Officer)

Pension Fund Account 2013/14

2012/13 £000		Notes	2013/14 £000	2013/14 £000
	Dealings with members, employers and others directly involved in the scheme			
(17,323)	Contributions	7	(17,623)	
(762)	Transfers in from other pension funds	8	(1,477)	
(27)	Other income		(28)	
(18,112)				(19,128)
10,209	Benefits payable	9	11,887	
624	Payments to and on account of leavers	10	189	
207	Administrative expenses	11	242	
3	Other payments		6	
11,043				12,324
(7,069)	**Net (additions)/withdrawals from dealing with members**			(6,804)
	Returns on investments			
(849)	Investment income	12	(935)	
(38,600)	(Profits) and losses on disposal of investments and change in market value of investments	15b	(19,407)	
442	Investment management expenses	13	462	
(39,007)	**Net returns on investments**			(19,880)
(46,076)	**Net (increase)/decrease in the net assets available for benefits during the year**			(26,684)

Net Assets Statement as at 31 March 2014

2012/13 £000		Notes	2013/14 £000	2013/14 £000
294,661	Investment Assets	14	318,840	
10,610	Cash Deposits	14	13,139	
305,271				331,979
1,868	Current Assets	19		2,142
(924)	Current Liabilities	20		(1,222)
306,215	**Net assets of the fund available to fund benefits at the period end**			332,899

These financial statements summarise the transactions and net assets of the Fund and do not take account of liabilities to pay pension and other benefits in the future.

The audited accounts were authorised for issue on 23 September 2014.

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James Gray MA (Hons) CPFA
Executive Manager – Finance
(Section 95 Officer)

Notes to the Accounts

1. Description of Fund

The Shetland Islands Council Pension Fund is part of the Local Government Pension Scheme and is administered by Shetland Islands Council. The Council is the reporting entity for this Pension Fund.

The following description of the Fund is a summary. The underlying statutory powers underpinning the scheme, are the Superannuation Act 1972 and the Local Government Pension Scheme (LGPS) Regulations.

a) General

The Fund is governed by the Superannuation Act 1972. The Fund is administered in accordance with the following secondary legislation:

- the LGPS (Benefits, Membership and Contributions) Regulations 2008 (as amended);
- the LGPS (Administration) Regulations 2008 (as amended); and
- the LGPS (Management and Investment of Funds) Regulations 2010.

It is a contributory defined benefit pension scheme administered by Shetland Islands Council to provide pensions and other benefits for pensionable employees of scheduled bodies, Shetland Islands Council, Orkney and Shetland Valuation Joint Board and admitted bodies within Shetland. Teachers are not included as they have a separate national pension scheme.

The Fund is overseen by the Pension Fund Consultative Panel, which is a Panel of the Shetland Islands Council.

b) Membership

Membership of the LGPS is voluntary and employees are free to choose whether to join the scheme, remain in the scheme or make their own personal arrangements outside the scheme.

Organisations participating in the Shetland Islands Council Pension Fund include:

- Scheduled bodies, which are local authorities and similar bodies whose staff are automatically entitled to be members of the Fund; and

- Admitted bodies, which are other organisations that participate in the Fund under an admission agreement between the Fund and the relevant organisation. Admitted bodies include voluntary, charitable and similar bodies or private contractors undertaking a local authority function following outsourcing to the private sector.

There are 19 employer organisations with active members within Shetland Islands Council Pension Fund including the Council itself, as detailed below:

31 March 2013		Shetland Islands Council Pension Fund	31 March 2014	
	19	Number of employers with active members		19
		Number of employees in scheme		
2,507		Shetland Islands Council	2,455	
351		Other employers	360	
	2,858	**Total**		**2,815**
		Number of pensioners/dependants		
1,187		Shetland Islands Council	1,337	
80		Other employers	93	
	1,267	**Total**		**1,430**
		Deferred pensioners		
1,221		Shetland Islands Council	1,334	
211		Other employers	226	
	1,432	**Total**		**1,560**
	5,557	**Scheme Total**		**5,805**

c) Funding

Benefits are funded by contributions and investment earnings. Contributions are made by active members of the Fund in accordance with the LGPS (Benefits, Membership and Contributions) Regulations 2008 and range from 5.5% to 12% of pensionable pay for the financial year ending 31 March 2014. Employee contributions are matched by employers' contributions which are set based on triennial actuarial funding valuations. The actuarial valuation as at 31 March 2011 set these employers’ contribution rates which range from 16.9% to 29.7% of pensionable pay.

d) Benefits

Pension benefits under the LGPS are based on final pensionable pay and length of pensionable service, summarised below:

	Service pre 1 April 2009	Service post 31 March 2009
Pension	Each year worked is worth 1/80 x final pensionable salary.	Each year worked is worth 1/60 x final pensionable salary.
Lump Sum	Automatic lump sum of 3 x salary. In addition, part of annual pension can be exchanged for a one-off tax-free cash payment. A lump sum of £12 is paid for each £1 of pension given up.	No automatic lump sum. Part of the annual pension can be exchanged for a one-off tax-free cash payment. A lump sum of £12 is paid for each £1 of pension given up.

There are a range of other benefits provided under the scheme including early retirement, disability pensions and death benefits. For more details, please refer to Shetland Islands Council scheme handbook available from Office Headquarters, 8 North Ness Business Park, Lerwick, Shetland.

Benefits are index-linked in order to keep pace with inflation. In June 2010, the Government announced that the method of indexation would change from retail prices to consumer prices index. This change took effect from 1 April 2011.

2. Basis of Preparation

The Statement of Accounts summarises the Fund's transactions for the 2013/14 financial year and its position at year-end as at 31 March 2014. The accounts have been prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2012/13, which is based upon International Financial Reporting Standards (IFRS), as amended for the UK public sector.

The accounts summarise the transactions of the Fund and report on the net assets available to pay pension benefits. The accounts do not take account of obligations to pay pensions and benefits which fall due after the end of the financial year. The actuarial present value of promised retirement benefits, valued on an International Accounting Standard (IAS) 19 basis, is disclosed at Note 18 of these accounts.

a) Accounting Standards Issued, not Adopted

Accounting standards issued but not adopted by the code in 2013/14 are:

- IAS 32 Financial Instruments: Presentation (as amended in December 2011)
- Annual Improvements to IFRS 2009-2011 Cycle

There should be no material impact of not adopting these standards in 2013/14. These will be adopted in the 2014/15 Statement of Accounts.

3. Summary of Significant Accounting Policies

Fund account - revenue recognition

a) Contribution income

Normal contributions, both from the members and from the employers, are accounted for on an accrual basis at the percentage rate recommended by the Fund actuary in the payroll period to which they relate.

Employers' augmentation contributions and pension strain costs are accounted for in the period in which the liability arises. Any amounts due in the year but unpaid will be classed as current financial assets. Amounts not due until future years are classed as long-term financial assets.

b) 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 Local Government Pension Scheme Regulations (see notes 8 and 10).

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

c) Investment income

i) Interest income

Interest income is recognised in the Fund account as it accrues.

ii) Distributions from pooled funds

Distributions from pooled funds are recognised on the date of issue. Any amount not received by the end of the reporting period is disclosed in the net assets statement as a current financial asset.

iii) Movement in the net market value of investments

Changes in the net market value of investments (including investment properties) are recognised as income and comprise all realised and unrealised profits/losses during the year.

Fund account - expense items

d) Benefits payable

Pensions and lump-sum benefits payable include all amounts known to be due as at the end of the financial year. Any amounts due but unpaid are disclosed in the net assets statement as current liabilities.

e) Taxation

The Fund is a registered public service scheme under section 1(1) of Schedule 36 of the Finance Act 2004 and as such is exempt from UK income tax on interest received and from capital gains tax on the proceeds of the investments sold. Income from overseas investments suffers withholding tax in the country of origin, unless exemption is permitted. Irrecoverable tax is accounted for as a Fund expense as it arises.

f) Administrative expenses

All administrative expenses are accounted for on an accruals basis. All costs relating to staff of the pensions administration team are charged direct to the Fund. Management, accommodation and other overheads are apportioned to the Fund in accordance with Council policy.

g) Investment management expenses

All investment management expenses are accounted for on an accruals basis.

Fees of the external investment managers and custodian are agreed in the respective mandates governing their appointments. Broadly, these are based on the market value of the investments under their management and therefore increase or reduce as the value of these investments change.

One of the investment managers invests using a fund of funds approach and within these unit trusts managers levy charges.

Any fees due but unpaid are disclosed in the net assets statement as current liabilities.

The cost of obtaining investment advice from external consultants is included in investment management charges.

A proportion of the Council's costs, representing management time spent by officers on investment management, are charged to the Fund in accordance with Council policy.

Net assets statement

h) Financial assets

Financial assets are included in the net assets statement on a bid market value basis as at the reporting date. A financial asset is recognised in the net assets statement on the date the Fund becomes party to the contractual acquisition of the asset. From this date, any gains or losses arising from changes in the value of the asset are recognised by the Fund.

The values of investments shown in the net assets statement are determined as follows:

Pooled investment vehicles
These are valued at closing bid price if both bid and offer prices are published; or if single priced, at closing single price. In the case of pooled investment vehicles that are accumulation funds, change in market value also includes income which is reinvested in the Fund, net of applicable withholding tax.

i) Foreign currency transactions

Dividends, interest and purchases and sales of investments in foreign currencies have been accounted for at the market rates at the date of transaction. End-of-year market exchange rates are used to value cash balances held in foreign currency bank accounts, market values of overseas investments and purchase and sales outstanding at the end of the reporting period.

j) Cash and cash equivalents

Cash comprises cash in hand and demand deposits.

Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and that are subject to minimal risk of changes in value.

k) Actuarial present value of promised retirement benefits

The actuarial present value of promised retirement benefits is assessed on a triennial basis by the scheme actuary in accordance with the requirements of IAS 19 and relevant actuarial standards.

As permitted under IAS 26, the Fund has opted to disclose the actuarial present value of the promised retirement benefits by way of a note to the net assets statement (Note 18).

l) Additional voluntary contributions

Shetland Islands Council Pension Fund provides an additional voluntary contributions (AVC) scheme for its members, the assets of which are invested separately from those of the Pension Fund. The Fund has appointed Prudential and Equitable Life (closed to new members) as its AVC providers. AVCs are paid to the AVC provider by employers and are specifically for providing additional benefits for individual contributors. Each AVC contributor receives an annual statement showing the amount held in their account and the movements in the year.

AVCs are not included in the accounts in accordance with section 4(2)(b) of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2010 (SSI 2010/233) but are disclosed as a note only (Note 22).

4. 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 IAS 19. Assumptions underpinning the valuations are agreed with the actuary and are summarised in Note 17. This estimate is subject to significant variances based on changes to the underlying assumptions.

5. Assumptions Made about the Future and Other Major Sources of Estimation 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 2014 for which there is a significant risk of material adjustment in the forthcoming financial year are as follows:

Item	Uncertainties	Effect if actual results differ from assumptions
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 effects on the net pension liability of changes in individual assumptions can be measured. For instance, 0.5% increase in the discount rate assumption would result in a decrease in the pension liability of £47.820m. A 0.5% increase in assumed earnings inflation would increase the value of liabilities by approximately £17.706m, and a one-year increase in assumed life expectancy would increase the liability by approximately £13.233m.

6. Events after the Balance Sheet Date

There have been no events since 31 March 2014, and up to the date when these accounts were authorised that require any adjustments to these accounts.

7. Contributions Receivable

By category

31 Mar 2013 £000		31 Mar 2014 £000
(13,168)	Employers - normal	(12,904)
(328)	Employers - augmentation	(1,021)
(3,827)	Members - normal	(3,698)
(17,323)	**Total**	**(17,623)**

By authority

31 Mar 2013 £000		31 Mar 2014 £000
(15,094)	Administering authority	(15,340)
(120)	Scheduled bodies	(119)
(2,109)	Admitted bodies	(2,164)
(17,323)	**Total**	**(17,623)**

8. Transfers in from Other Pension Funds

The total transfers received during the year are as follows:

31 Mar 2013 £000		31 Mar 2014 £000
(762)	Individual transfers in	(1,477)
(762)	**Total**	**(1,477)**

The Pension Fund received 51 transfers in during 2013/14 with an average value of £29,000 compared to 42 transfers in during 2012/13 with an average value of £18,000.

9. Benefits Payable

By category

31 Mar 2013 £000		31 Mar 2014 £000
7,144	Pensions	7,858
2,745	Commutation and lump sum retirement benefits	3,765
320	Lump sum death benefits	264
10,209	**Total**	**11,887**

By authority

31 Mar 2013 £000		31 Mar 2014 £000
9,408	Administering authority	10,918
69	Scheduled bodies	71
732	Admitted bodies	898
10,209	**Total**	**11,887**

10. Payments to and on Account of Leavers

31 Mar 2013 £000		31 Mar 2014 £000
14	Refunds to members leaving service	23
11	Payments for members joining state scheme	48
599	Individual transfers	118
624	**Total**	**189**

11. Administrative Expenses

31 Mar 2013 £000		31 Mar 2014 £000
121	Staff time allocations	140
49	Support services and system costs	61
1	Printing and publications	5
3	Governance costs	0
1	Actuarial fees	4
32	External audit fees	32
207	**Total**	**242**

12. Investment income

31 Mar 2013 £000		31 Mar 2014 £000
(668)	Pooled property unit trusts - UK	(749)
(72)	Pooled property unit trusts - Overseas	(81)
(57)	Interest on cash deposits	(58)
(52)	Other	(47)
(849)	**Total**	**(935)**

13. Investment Expenses

31 Mar 2013 £000		31 Mar 2014 £000
208	Management fees	229
163	Unit trust manager charges	123
35	Custody fees	30
33	Performance monitoring service	48
3	Actuarial fees - investment consultancy	3
0	Consultancy costs	29
442	**Total**	**462**

14. Investments

Market Value 31 Mar 2013 £000		Market Value 31 Mar 2014 £000
	Investment assets	
249,810	Pooled funds	267,813
25,446	Fixed income unit trusts	29,575
19,378	Pooled property unit trusts	21,431
10,610	Cash deposits	13,135
27	Property income due	21
0	Cash income due	4
305,271	**Total investment assets**	**331,979**

14a. Reconciliation of movements in investments

	Market Value 01/04/2013 £000	Purchases during the year £000	Sales during the year £000	Change in market value during the year £000	Market Value 31/3/2014 £000
Investment assets					
Pooled funds	249,810	8,760	(9,047)	18,290	267,813
Fixed income unit trusts	25,446	4,219	0	(90)	29,575
Pooled property unit trusts	19,378	1,965	(1,119)	1,207	21,431
	294,634	14,944	(10,166)	19,407	318,819
Property income due	27				21
	294,661				318,840
Other investment balances:					
Cash deposits	10,610				13,135
Cash income due	0				4
Net investment assets	**305,271**	**14,944**	**(10,166)**	**19,407**	**331,979**

	Market Value 01/04/2012 £000	Purchases during the year £000	Sales during the year £000	Change in market value during the year £000	Market Value 31/3/2013 £000
Investment assets					
Pooled funds	208,266	4,465	(267)	37,346	249,810
Fixed income unit trusts	21,690	1,837	0	1,919	25,446
Pooled property unit trusts	19,156	3,678	(2,791)	(665)	19,378
	249,112	9,980	(3,058)	38,600	294,634
Property income due	17				27
	249,129				294,661
Other investment balances:					
Cash deposits	10,562				10,610
Cash income due	5				0
Net investment assets	**259,696**	**9,980**	**(3,058)**	**38,600**	**305,271**

The Funds are all invested within pooled funds; therefore there are no direct trading costs.

14b. Analysis of investments

31 Mar 2013 £000		31 Mar 2014 £000
	Additional analysis	
122,169	Pooled funds (UK)	131,983
127,641	Pooled funds (Overseas)	135,830
13,332	Fixed income unit trusts (UK bonds)	14,930
12,114	Fixed income unit trusts (UK corp bonds)	14,645
16,265	Pooled property unit trust (UK)	18,689
3,113	Pooled property unit trust (Overseas)	2,742
294,634	**Total investment assets**	**318,819**

Investments analysed by fund manager (including investment assets and external cash):

Market Value 31 Mar 2013 £000	%		Market Value 31 Mar 2014 £000	%
284,971	93	BlackRock	309,724	93
20,300	7	Schroders	22,255	7
305,271			**331,979**	

The following investments represent more than 5% of the net assets of the scheme:

Market Value 31 Mar 2013 £000	%		Market Value 31 Mar 2014 £000	%
40,742	13.3	BlackRock Europe ex UK index	43,926	13.2
28,908	9.5	BlackRock Japan index	29,304	8.8
29,335	9.6	BlackRock North American index	32,139	9.7
28,656	9.4	BlackRock Pacific Rim index	30,460	9.2
121,957	40.0	Aquila Life UK equity index	131,953	39.7

15. Financial Instruments

15a. Classification of financial instruments

Accounting policies describe how different asset classes of financial instruments are measured, and how income and expenses, including gains and losses, are recognised. The following table analyses the carrying amounts of financial assets and liabilities (excluding cash) by category and net assets statement heading. No financial assets were reclassified during the accounting period.

31 Mar 2013				31 Mar 2014		
Fair value through profit and loss	Receivables	Financial liabilities		Fair value through profit and loss	Receivables	Financial liabilities
£000	£000	£000		£000	£000	£000
			Financial assets			
249,810	-		Pooled funds	267,813	-	
25,446	-		Fixed income unit trusts	29,575	-	
19,378	-		Pooled property unit trusts	21,431	-	
-	11,160		Cash	-	13,819	
27	-		Property income due	21	-	
-	1,318		Debtors	-	1,429	
294,661	**12,478**	**0**		**318,840**	**15,248**	**0**
			Financial liabilities			
-	-	(924)	Creditors	-	-	(1,222)
0	**0**	**(924)**		**0**	**0**	**(1,222)**
294,661	**12,478**	**(924)**		**318,840**	**15,248**	**(1,222)**

15b. Net gains and losses on financial instruments

31 Mar 2013 £000		31 Mar 2014 £000
	Financial assets	
(38,600)	Fair value through profit and loss	(19,407)
(38,600)	**Total**	**(19,407)**

15c. Value of financial instruments

31 Mar 2013			31 Mar 2014	
Book value £000	Market value £000		Book value £000	Market value £000
		Financial assets		
187,608	294,661	Fair value through profit and loss	195,890	318,840
187,608	**294,661**	**Total**	**195,890**	**318,840**

16. Nature and Extent of Risks Arising from Financial Instruments

Risk and risk management

The Fund's primary long-term risk is that its 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. The Council manages these investment risks as part of its overall Pension Fund risk management programme.

Responsibility for the Fund's risk management strategy rests with the Council. Risk management policies are established to identify and analyse the risks faced by the Council's pension operations. Policies are reviewed regularly to reflect changes in activity and market conditions.

Market risk

Market risk is the risk of loss from fluctuations in equity, bond and property 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 condition, expectations of future price and yield movements and the asset mix.

The objective of the Fund's risk management 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 industrial sectors and individual securities. To mitigate market risk, the Council and its investment advisors undertake appropriate monitoring of market conditions and benchmark analysis.

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's investment managers mitigate this price risk through diversification and the selection of investments, which is monitored by the Council and the fund managers to ensure it is within limits specified in the Fund investment strategy.

Other Council price risk - sensitivity analysis

In agreement with the Fund's performance analyst and following analysis of historical data and expected investment return during the financial year, the Council has determined that the following movements in market price risk are deemed reasonably possible for the financial year 2014/15 reporting period:

Pooled fund (UK)	12.10%
Pooled funds (Overseas)	11.74%
Fixed income unit trust (UK bonds)	5.41%
Fixed income unit trust (UK corp bonds)	5.28%
Pooled property unit trusts (UK)	2.07%
Pooled property unit trust (Overseas)	8.85%
Cash	0.02%

The potential price changes disclosed above are determined based on the observed historical volatility of asset class returns. ‘Riskier’ assets such as equities will display greater potential volatility than bonds as an example, so the overall outcome will depend largely on Funds’ asset allocations. The potential volatilities are consistent with a one standard deviation movement in the change in value of the assets over the latest three years. This can then be applied to the period end asset mix.

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 (the prior year comparator is shown below):

Asset Type	Value as at 31 March 2014	Percentage Change	Value on Increase	Value on Decrease
	£000	%	£000	£000
Cash and cash equivalents	13,135	0.02%	13,138	13,132
Investment portfolio assets:				
Pooled funds (UK)	131,983	12.10%	147,953	116,013
Pooled funds (Overseas)	135,830	11.74%	151,776	119,884
Fixed income unit trust (UK bonds)	14,930	5.41%	15,738	14,122
Fixed income unit trust (UK corp bonds)	14,645	5.28%	15,418	13,872
Pooled property unit trusts (UK)	18,689	2.07%	19,076	18,302
Pooled property unit trusts (Overseas)	2,742	8.85%	2,985	2,499
Investment income due	25	0.00%	25	25
Total assets	**331,979**		**366,109**	**297,849**

Asset Type	Value as at 31 March 2013	Percentage Change	Value on Increase	Value on Decrease
	£000	%	£000	£000
Cash and cash equivalents	10,610	0.02%	10,612	10,608
Investment portfolio assets:				
Pooled funds (UK)	122,169	12.97%	138,014	106,324
Pooled funds (Overseas)	127,641	12.99%	144,222	111,060
Fixed income unit trust (UK bonds)	13,332	5.50%	14,065	12,599
Fixed income unit trust (UK corp bonds)	12,114	4.63%	12,675	11,553
Pooled property unit trusts (UK)	16,265	1.82%	16,561	15,969
Pooled property unit trusts (Overseas)	3,113	7.56%	3,348	2,878
Investment income due	27	0.00%	27	27
Total assets	**305,271**		**339,524**	**271,018**

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 value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

The Fund's direct exposure to interest rate movements as at 31 March 2013 and 31 March 2014 are set out below:

31 Mar 2013 £000		31 Mar 2014 £000
	Asset type	
10,610	Cash and cash equivalents	13,139
550	Cash balances	680
11,160	**Total**	**13,819**

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. A 110 basis point (BPS) movement in interest rates is viewed as a reasonable level of risk sensitivity for the Fund under current interest rate circumstances. The Fund's performance analyst has also agreed that the long-term average rates are expected to move less than 110 basis points (hence 100 basis points used in the examples below) from one year to the next and experience suggests that such movements are possible.

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 BPS change in interest rates:

Asset Type	Carrying amount as at 31 March 2014	Change in year in the net assets available to pay benefits	
		+100 BPS	-100 BPS
	£000	£000	£000
Cash and cash equivalents	13,139	131	(131)
Cash balances	680	7	(7)
Total change in assets available	**13,819**	**138**	**(138)**

Asset Type	Carrying amount as at 31 March 2013	Change in year in the net assets available to pay benefits	
		+100 BPS	-100 BPS
	£000	£000	£000
Cash and cash equivalents	10,610	106	(106)
Cash balances	550	6	(6)
Total change in assets available	**11,160**	**112**	**(112)**

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 (£ sterling). The Fund holds both monetary and non-monetary assets denominated in currencies other than £ sterling.

The following table summarises the Fund's currency exposure as at 31 March 2014 and as at the previous period end:

31 Mar 2013 £000		31 Mar 2014 £000
	Asset type	
127,641	Pooled Funds - overseas equities	135,830
3,113	Pooled Property Unit Trusts - overseas	2,742
130,754	**Total**	**138,572**

Currency risk - sensitivity analysis

Following analysis of data provided by the Council's performance analysts, the Council considers the likely volatility associated with foreign exchange rate movements to be 5.07%.

This analysis assumes that all other variables, in particular interest rates, remain constant. A 5.07% strengthening/weakening of the pound against the various currencies in which the Fund holds investments would increase/decrease the net assets available to pay benefits as follows:

Asset Type	Carrying amount as at 31 March 2014	Change to net assets available to pay benefits	
		+5.07%	-5.07%
	£000	£000	£000
Pooled Funds - overseas equities	135,830	142,717	128,943
Pooled Property Unit Trusts - overseas	2,742	2,881	2,603
Total change in assets available	**138,572**	**145,598**	**131,546**

Asset Type	Carrying amount as at 31 March 2013	Change to net assets available to pay benefits	
		+5.2%	-5.2%
	£000	£000	£000
Pooled Funds - overseas equities	127,641	134,278	121,004
Pooled Property Unit Trusts - overseas	3,113	3,275	2,951
Total change in assets available	**130,754**	**137,553**	**123,955**

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.

In essence the Fund's entire investment portfolio is exposed to some form of credit risk. However 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.

Deposits are not made with banks and financial institutions unless they meet the Council's credit criteria. The Council has also set limits on the value of these deposits which can be laced with any bank or financial institution, apart from the bank the Council uses for its daily operations.

The Council believes it has managed its exposure to credit risk, and has had no experience of default or uncollectible deposits over the past five financial years. The

Fund's cash holding under its treasury management arrangements at 31 March 2014 was £13.819m (31 March 2013: £11.160m). This was held with the following institutions:

31 Mar 2013 £000		31 Mar 2014 £000
	Fund manager deposits	
9,891	BlackRock - Liquidity Heritage Fund	12,364
683	Schroders cash	772
36	BlackRock cash	3
	Bank current accounts	
550	Bank of Scotland Plc	680
11,160	**Total**	**13,819**

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 all its Pension Fund cash holdings. The Fund also has an overdraft facility to cover any unexpected short-term cash needs. The overdraft facility has not been used over the past five years and therefore the Fund's exposure to credit risk is considered negligible.

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 into cash. As at 31 March 2014 the value of illiquid assets was £21.4m, which represented 6.7% of the Fund assets (31 March 2013: £19.4m, which represented 6.6% of the Fund assets).

Refinancing risk

The key risk is that the Council will be bound to replenish a significant proportion of its Pension Fund financial instruments at a time of unfavourable interest rates. The Council does not have any financial instruments that have a refinancing risk as part of its treasury management and investment strategies.

17. Funding Arrangements

In line with the Local Government Pension Scheme (Administration) 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 valuation for the current accounting period took place as at 31 March 2011.

The funding policy is set out in the Shetland Islands Council Funding Strategy Statement (FSS), dated March 2012.

The key elements of the funding policy are:

- to ensure the long-term solvency of the Fund and the solvency of individual employers’ share of the Fund;

- 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 inform employers of the risks and potential costs associated with pension funding;

- 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 ceasing participation or defaulting on its pension obligations; and

- to address the different characteristics of the disparate employers or groups of employers to the extent that this is practical and cost-effective.

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. For employers whose covenant was considered by the Administering Authority to be sufficiently strong, contributions have been stabilised below the theoretical rate required to return their portion of the Fund to full funding over 20 years if the valuation assumptions are borne out.

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 at 31 March 2011. This valuation revealed that the Fund's assets, which at 31 March 2011 were valued at £251 million, were sufficient to meet 91% (88% at 31 March 2008 valuation) of the liabilities (i.e. the present value of promised retirement benefits) accrued up to that date. The resulting deficit at the 2011 valuation was £25 million (2008 valuation: £26 million).

The common rate of contribution payable by each employing authority under regulation 32(4)(a) of the Administration Regulations for the period 1 April 2012 to 31 March 2015 is 18.8% of pensionable pay, (i.e. the rate which all employers in the Fund pay).

Individual employers' rates are adjusted under regulation 32(4)(b) from the common contribution rate. The contribution rates payable 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.

The payment due by the Shetland Islands Council during this period includes an employer's rate of 18.7% and £2 million per annum to meet a funding shortfall arising from the transfer of pension benefits associated with former Shetland Towage employees. The Council is due to pay a final £1.6 million deficit contribution in the year ending 31 March 2016.

Copies of the 2011 valuation report and Funding Strategy Statement are available on request from the Shetland Islands Council, Administering Authority to the Fund.

Principal actuarial assumptions and method used to value the liabilities

Full details of the method used are described in a valuation report from the actuaries, Hymans Robertson LLP, available on request from the Shetland Islands Council, Administering Authority to the Fund.

Method

The liabilities were assessed using an accrued benefits method which take 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	6.0%	3.2%
Pay increases *	5.1%	2.3%
Price inflation/Pension increases	2.8%	0.0%

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

Mortality assumptions

The key demographic assumption was the allowance made for longevity. The baseline longevity assumptions adopted at this valuation were in line with standard SAPS mortality tables, and included improvements based on medium cohort projections and a 1% p.a. underpin effective from 2008. Based on these assumptions, the average future life expectancies at age 65 are as follows:

Mortality assumption at age 65	Males	Females
Current Pensioners	23.0 years	25.8 years
Future Pensioners	24.9 years	27.7 years

Historic mortality assumptions

Life expectancies for the prior year-end are based on the PFA92 and PMA92 tables. The allowances for future life expectancies are shown in the table below:

Year Ended	Prospective Pensioners	Pensioners
31 March 2013	year of birth, medium cohort and 1% p.a. minimum improvements from 2008	year of birth, medium cohort and 1% p.a. minimum improvements from 2008

Mortality loadings were applied to the PFA92 and PMA92 tables based on membership class.

Commutation assumption

An allowance is included for future retirements to elect to take 70% of the maximum additional tax-free cash up to HMRC limits for pre-April 2009 service and 85% of the maximum tax-free cash post-March 2009 service.

18. Actuarial Present Value of Promised Retirement Benefits

In addition to the triennial funding valuation, the Fund's actuary also undertakes a valuation of the Pension Fund liabilities, on an IAS 19 basis, every year using the same base data as the funding valuation rolled forward to the current financial year, taking account of changes in membership numbers and updating assumptions to the current year.

In order to assess the value of the benefits on this basis, the actuary has updated the actuarial assumptions (set out below) from those used for funding purposes (see Note 17). The actuary has also used ill health and death benefits in line with IAS 19.

The actuarial present value of promised retirement benefits at 31 March 2014 was £478 million (31 March 2013: £432 million). The Fund accounts do not take account of liabilities to pay pensions and other benefits in the future.

The liabilities have been projected using a roll forward approximation from the latest formal funding valuation as at 31 March 2011.

Assumptions used

The assumptions used are those adopted for the Administering Authority's IAS 19 report as required by the Code of Practice. These are given below:

31 March 2013 % p.a.	Year ended	31 March 2014 % p.a.
2.8%	Inflation/pension increase rate	2.8%
5.1% *	Salary increase rate	5.1%
4.5%	Discount rate	4.3%

*Salary increases are 1% p.a. nominal for the three years to 31 March 2015, reverting to the long term rate thereafter.

19. Current Assets

31 Mar 2013 £000		31 Mar 2014 £000
	Debtors:	
311	• Contributions due - employees	307
965	• Contributions due - employers	1,059
35	• Transfer values receivable	59
7	• Sundry debtors	4
0	Prepayments	33
550	Bank current accounts	680
1,868	**Total**	**2,142**

The significant majority of debtors are other local authorities.

Analysis of debtors

31 Mar 2013 £000		31 Mar 2014 £000
9	Central government bodies	15
1,105	Other local authorities	1,184
204	Other entities and individuals	230
1,318	**Total**	**1,429**

20. Current Liabilities

31 Mar 2013 £000		31 Mar 2014 £000
(104)	Sundry creditors	(203)
(820)	Benefits payable	(1,019)
(924)	**Total**	**(1,222)**

Analysis of creditors

31 Mar 2013 £000		31 Mar 2014 £000
(1)	Central government bodies	(2)
(616)	Other local authorities	(729)
(32)	Public corporations and trading funds	(22)
(275)	Other entities and individuals	(469)
(924)	**Total**	**(1,222)**

21. Unfunded Pension

31 Mar 2013 £000		31 Mar 2014 £000
631	Added years pension	672

Local Government (Discretionary Payments and Injury Benefits) (Scotland) Regulations 1998 [Section 31] allows local authorities to pay additional pension on a voluntary basis. Additional pension in respect of added years' enhancement is awarded from the body or service where the employee retired and costs are paid directly.

22. Additional Voluntary Contributions

31 Mar 2013 £000		31 Mar 2014 £000
4,067	Prudential	4,040
107	Equitable Life	86
4,174	**Total**	**4,126**

AVC contributions of £0.484m were paid directly to Prudential during the year (2012/13 £0.598m).

23. Related Party Transactions

Shetland Islands Council

The Shetland Islands Council Pension Fund is administered by Shetland Islands Council. Consequently there is a strong relationship between the Council and the Pension Fund.

The Council incurred costs of £0.210m (2012/13 £0.175m) in relation to the administration of the Fund and was subsequently reimbursed by the Fund for these expenses.

The investments of the Fund are overseen by the Council's Treasury Section; their costs are levied by staff time allocations. Costs incurred were £0.017m (2012/13 £0.016m) in relation to investment of the Fund and was subsequently reimbursed by the Fund for these expenses.

The Council incurred costs of £7.858m (2012/13 £7.144m) in relation to pensioner payments, which was subsequently reimbursed by the Fund.

In addition the Council is the single largest employer of Pension Fund members, and contributed £12.212m to the Fund (2012/13 £11.830m).

All monies owed to the Council, and due from the Pension Fund to the Council, were paid in the year.

Governance

There is one member of the Pension Fund Consultative Panel who is in receipt of pension benefits from the Shetland Islands Council Pension Fund. In addition there are other committee members who are active members of the Pension Fund.

Each member of the Pension Fund Consultative Panel is required to declare their interests at each meeting.

Shetland Islands Council meetings include all Council Members, and every Councillor is required to declare their interests at each meeting.

Key management personnel

The disclosure requirements for key management personnel can be found in the accounts of the Shetland Islands Council.

Actuarial Statement for 2013/14

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 2013/14.

Description of Funding Policy

The funding policy is set out in the Shetland Islands Council's Funding Strategy Statement (FSS), dated March 2012. In summary, the key funding principles are as follows:

- to ensure the long-term solvency of the Fund and the solvency of individual employers' share of the Fund;
- 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 inform employers of the risks and potential costs associated with pension funding;
- 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 ceasing participation or defaulting on its pension obligations; and
- to address the different characteristics of the disparate employers or groups of employers to the extent that this is practical and cost-effective.

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. For employers whose covenant was considered by the Administering Authority to be sufficiently strong, contributions have been stabilised below the theoretical rate required to return their portion of the Fund to full funding over 20 years if the valuation assumptions are borne out.

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 £251 million, were sufficient to meet 91% of the liabilities (i.e. the present value of promised retirement benefits) accrued up to that date. The resulting deficit at the 2011 valuation was £25 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 the valuation report dated 8 February 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	6.0%	3.2%
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. The baseline longevity assumptions adopted at this valuation were in line with standard SAPS mortality tables, and included improvements based on medium cohort projections and a 1% p.a. underpin effective from 2008. 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 Shetland Islands Council, Administering Authority to the Fund.

Experience over the period since April 2011

Experience has been poorer than expected since the 2011 valuation (excluding the effect of any membership movements). Real bond yields have fallen considerably, leading to an increase in liabilities. This has been partially offset by stronger than expected asset returns meaning that the funding level is likely to have fallen since the 2011 valuation.

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

Douglas Green
Fellow of the Institute and Faculty of Actuaries
For and on behalf of Hymans Robertson LLP
2 June 2014

Hymans Robertson LLP
20 Waterloo Street
Glasgow
G2 6DB

Independent Auditor's Report

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

I certify that I have audited the financial statements of Shetland Pension Fund for the year ended 31 March 2014 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 2013/14 (the 2013/14 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 Responsible Financial Officer and auditor

As explained more fully in the Statement of Responsibilities, the Responsible Financial Officer 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 Responsible Financial Officer; 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 and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by me in the course of performing the audit. 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 2013/14 Code of the financial transactions of the fund during the year ended 31 March 2014, 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 2013/14 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 matter

In my opinion the information given in the Foreword 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.

David McConnell

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24 September 2014

Contact Details

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