

# Pension Fund Unaudited Annual Report and Accounts **2017/18**



Shetland Islands Council

# Table of Contents

Management Structure .....	1
Management Commentary .....	2
Annual Governance Statement.....	9
Statement of Responsibilities for the Statement of Accounts .....	15
Pension Fund Account 2017/18.....	16
Net Assets Statement as at 31 March 2018.....	17
Note 1: Description of Pension Fund .....	18
Note 2: Basis of Preparation .....	19
Note 3: Accounting Standards Issued not Adopted.....	19
Note 4: Assumptions Made about the Future and Other Major Sources of Estimation Uncertainty .....	19
Note 5: Contributions Receivable .....	20
Note 6: Transfers in from Other Pension Funds.....	20
Note 7: Benefits Payable .....	20
Note 8: Payments to and on Account of Leavers .....	20
Note 9: Management Expenses.....	21
Note 10: Investment Income .....	21
Note 11: Investments.....	21
Note 12: Fair Value Hierarchy.....	23
Note 13: Financial Instruments .....	24
Note 14: Nature and Extent of Risks Arising from Financial Instruments .....	25
Note 15: Funding Arrangements.....	28
Note 16: Actuarial Present Value of Promised Retirement Benefits .....	30
Note 17: Current Assets .....	31
Note 18: Unfunded Pension.....	31
Note 19: Current Liabilities .....	31
Note 20: Additional Voluntary Contributions.....	31
Note 21: Related Party Transactions .....	32
Note 22: Changes in Actuarial Present Value of Promised Retirement Benefits .....	33
Note 23: Critical Judgements in Applying Accounting Policies .....	33
Note 24: Events after the Balance Sheet Date.....	33
Note 25: Accounting Policies .....	33
Actuarial Statement for 2017/18 .....	36

# Management Structure

## Administering Authority

Shetland Islands Council  
Town Hall  
Lerwick  
Shetland  
ZE1 0HB

## Fund Custodian

The Northern Trust Company

## Investment Advisor

KPMG

## Investment Managers

Blackrock  
Schroders  
M & G Investments  
KBI Global Investors Limited  
Newton

## Fund Actuary

Hymans Robertson LLP

## Banker

Bank of Scotland

## AVC Providers

Prudential  
Equitable Life (closed to new members)

## Independent Auditor

Deloittes LLP

# Management Commentary

Welcome to Shetland Islands Council Pension Fund's Annual Report and Accounts for the year ended 31 March 2018. The purpose of the Management Commentary is to present an overview of the Pension Fund's financial performance during the year 2017/18 and to help readers understand its financial position at 31 March 2018. In addition, it outlines the main uncertainties facing the Pension Fund for the financial year 2017/18 and beyond.

## Background

The Shetland Islands Council Pension Fund is a contributory defined benefit pension scheme administered by Shetland Islands Council. The Pension Fund is governed by the Superannuation Act 1972 and is administered in accordance with the Local Government Pension Scheme (Scotland) Regulations 2014 (as amended), the Local Government Pension Scheme (Transitional Provisions and Savings) (Scotland) Regulations 2014 and the Local Government Pension Scheme (Governance) (Scotland) Regulations 2015.

It provides pensions and other benefits for pensionable employees of scheduled bodies and admitted bodies within Shetland, as shown below. Teachers are not included as they are members of the Scottish Teachers Pension Scheme.

## Employers with active members at 31 March 2018

Scheduled Bodies:

- Shetland Islands Council
- Orkney & Shetland Valuation Joint Board

Admitted Bodies:

- Lerwick Port Authority
- Shetland Recreational Trust
- Shetland Fisheries Training Centre Trust
- Shetland Islands Tourism (Visit Scotland)
- Shetland Amenity Trust
- Shetland Seafood Quality Control
- Shetland Charitable Trust
- Shetland Arts Development Agency
- Shetland Care Attendant Scheme (previously Crossroads)

## Employers with no active members at 31 March 2018

Admitted Bodies:

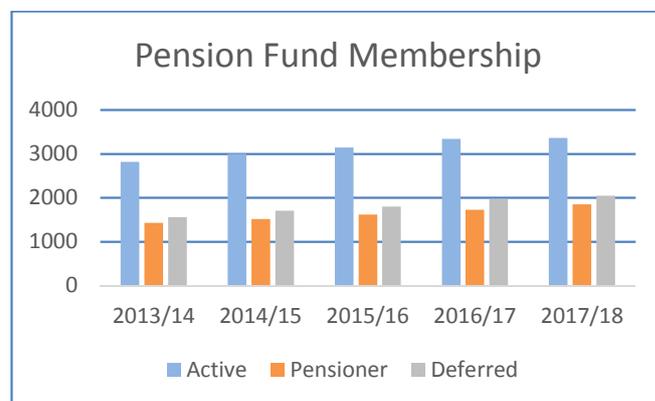
- Shetland Enterprise Co Ltd (Highlands & Island Enterprise)

Employers pay regular monthly contributions to the Pension Fund based on the salary costs of those staff who are Pension Fund members (active members). Where an employer has no active employees, but continues to participate in the Scheme, an annual monetary amount calculated by the actuary covers the cost of ongoing and future pension payments.

## Membership

The Pension Fund is made up of:

- Active member – a person who is employed with a Pension Fund Employer and is contributing to a pension;
- Pensioner member – a person who has retired and is in receipt of a pension, including dependants; and
- Deferred member – has a pension that has been left frozen and is payable at normal retirement date.



## Valuation

The triennial valuation was carried out at 31 March 2017, resulting in an actuarial value of the Pension Fund of £450m, an increase of £117m on the previous valuation at March 2014. This increase is due to better than expected assets returns and lower actual pay growth than anticipated.

The triennial valuation showed that the Pension Fund is 90% funded, with a deficit of £52m. This compares unfavourably to the 2014 valuation, which was 92% funded, with a deficit of £30m. The fall in funding level is due to a fall in real gilt

yields, which has the impact of increasing the value of the Pension Fund liabilities (i.e. pensions payable in the future). This was offset by better than expected asset returns and lower costs.

## Investment Policy

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

The Council, as the administering authority, has a fiduciary duty to obtain the best possible financial return on the Pension Fund investments against a suitable degree of risk. The Fund Managers, acting in the best financial interests of the Pension 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 Fund Managers have all signed up to the United Nations Principles on Responsible Investment Management. The principles reflect the view that environmental, social and corporate governance (ESG) issues can affect the performance of investment portfolios and must be given appropriate consideration by investors if they are to fulfil their fiduciary (or equivalent) duty. The focus of the Pension Fund's investment strategy is on achieving a 100% funding level before the Pension Fund's contributions equal benefits payable, within a maximum time horizon of 20 years. Beyond this point, it is expected that payments will exceed contributions made into the volatile approach with a more diversified asset base. It is estimated that the strategy will improve the level of return and be protected against the full negative impact of volatile and falling markets due to its increased diversity.

The Pension Fund asset allocation is diversified among equities, bonds, property and cash and is measured against a customised benchmark (which changed in 2015 when the new Investment Policy was approved) as follows:

Asset Class	Allocation from 1 January 2015 %	Allocation to 31 December 2014 %
UK Equities	18	40
Global Equities	40	40
UK Gilts	0	5
UK Corporate Bonds	0	5
Property	12	10
Alternative Bonds	10	0
Diversified Growth Fund	20	0
<b>Total</b>	<b>100</b>	<b>100</b>

The Pension Fund has five Fund Managers, as follows:

Manager	Mandate	% of Pension Fund at March 2018
Blackrock	Passive UK Global Equities	42
KBI Global Investors	Active Global Equities	21
M & G	Alternative Bonds	9
Newton	Diversified Growth Fund	16
Schroders	Active Property	12
<b>Total</b>		<b>100</b>

On 3 January 2018, the Markets in Financial Instrument Directive 2014/65 (MiFID II) was implemented. Local authorities were automatically categorised as retail investors; this meant that they had access to increased protections, but it restricted access to financial markets and investment managers, asset classes and products. During the year an exercise was carried out to 'opt up' to being a professional client and to lose the protections offered by MiFID II. This ensured that the Pension Fund had access to the investment products it needs to deliver the investment returns required to fund pensions.

## Investment Performance

Investment performance is monitored against this benchmark return on a quarterly and annual basis, however, the longer-term performance of the Fund Managers is the ultimate measure of achievement.

For the year to 31 March 2018, the Pension Fund had a return of 2.3% compared to the benchmark return of 3.3%. The Fund faced a difficult investment market throughout 2017/18 with unsettled global economics.

The Fund Manager's performance during the year was as follows:

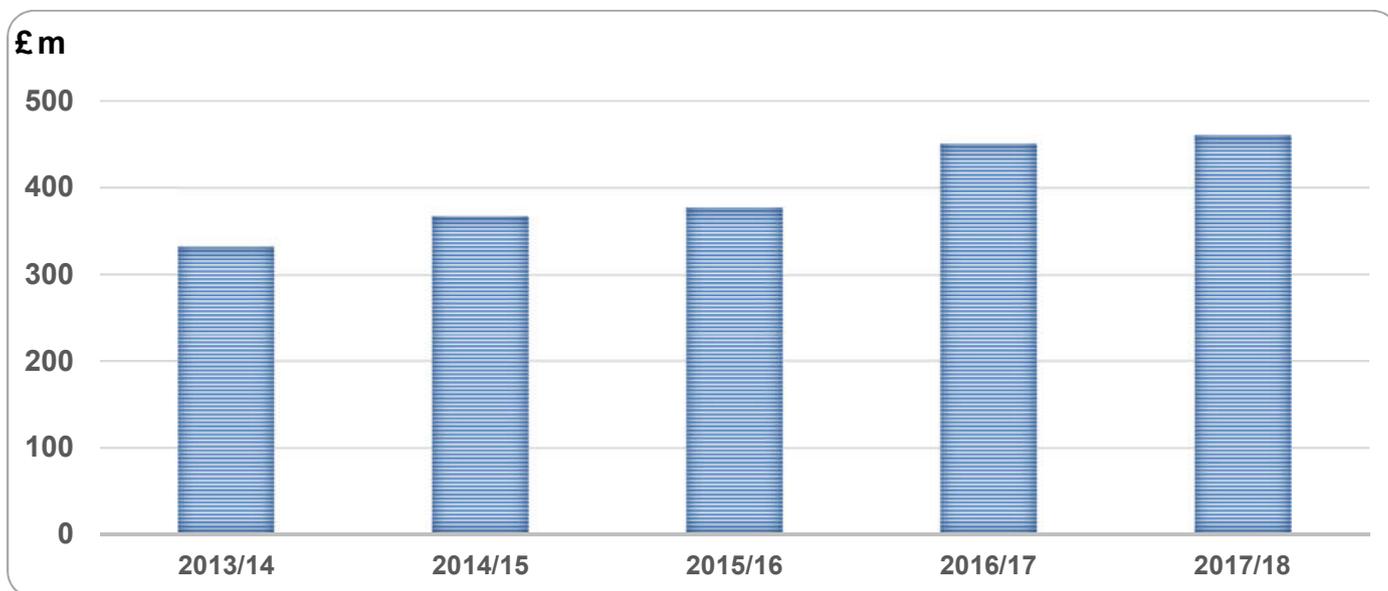
- Blackrock's passive equity fund returned 2.0%, which was above the benchmark return of 1.8%;
- Schroder's property fund returned 10.6% which was ahead of the benchmark return of 10.0%
- Newton's diversified growth fund returned - 1.4% which was below the benchmark return of 4.4%;
- M & G's alternative bonds fund returned 3.4% which equalled the benchmark return; and
- KBI's equity fund returned 0.5% which was below the benchmark return of 1.2%

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

	2013/14 %	2014/15 %	2015/16 %	2016/17 %	2017/18 %	Annualised	
						3 Year %	5 Year %
Fund Return	6.5	8.8	1.0	19.0	2.3	7.1	7.4
Benchmark	6.7	9.5	2.0	19.1	3.3	7.8	7.9
<b>Performance</b>	<b>(0.2)</b>	<b>(0.7)</b>	<b>(1.0)</b>	<b>(0.1)</b>	<b>(1.0)</b>	<b>(0.7)</b>	<b>(0.5)</b>

Over the longer term, the Pension Fund assets have grown in value at over 7% annually. The table above reveals a volatile period of five years, with returns fluctuating between 1.0% in 2015/16 and 19.0% in 2016/17.

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



## Risk

The Pension Fund risk register is updated regularly. There are a total of 35 risks, broken down into 6 High, 14 Medium and 15 Low. The key risks are summarised below:

- staff unable to access workplace leading to staff downtime and loss of service delivery;
- Fund's investments fail to deliver returns in line with anticipated returns required to meet the valuation of the long term liabilities;
- fall in bond yields, leading to risk in value placed on liabilities;
- employers leaving scheme/closing to new members due to cost/going into liquidation;
- failure in world stock markets; and
- under performance by active fund managers.

The Pension Fund Committee and Pension Board are made aware of any changes, so that action can be taken to mitigate the risks.

## Funding Strategy

The Net Assets Statement shows an increase in net assets of the Pension Fund to £460m. The Pension Fund Investment strategy aims to achieve a fully funded Pension Scheme within 20 years. The Funding Strategy and Investment Strategy are inextricably linked, in order for the Fund to meet all benefit payments as and when they fall due. Other objectives of the Pension Fund are:

- to secure and maintain sufficient assets to meet liabilities which fall due by the Pension Fund;
- to minimise the risk of assets failing to meet these liabilities, through an investment strategy, specifically tailored to the Pension Fund's requirements; and
- to maximise investment returns within an acceptable level of risk and providing stability in the level of employers' contribution rates.

## Funding Strategy Statement

The regulations on the management of the Pension Fund require the administering authority to prepare, maintain and publish a written Funding Strategy Statement. A revised Funding Strategy Statement was adopted in March 2018, as part of the triennial valuation process. Details

of the Funding Strategy Statement are found in Note 15: Funding Arrangements, on page 30.

The purpose of the Funding Strategy Statement is:

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

The most recent actuarial valuation was carried out as at 31 March 2017. It showed that the Pension Fund is valued at £450m and 90% funded, with a deficit of £52m. The triennial valuation includes setting the employer contribution rates for the next three years. The primary employer contribution rate across the whole fund is 22.1%, with additional secondary rates that make up the final contribution rates payable by individual employers.

## Statement of Investment Principles

The Pension Fund Committee and the Pension Board meetings on 26 October 2015 approved the current Shetland Islands Council Pension Fund Statement of Investment Principles. This statement includes administration details, the objective of the Pension Fund, types of investments, balance between different types of investment, risk, expected return on investments, realisation of investments, responsible investments, securities lending and compliance.

The Pension Fund also complies with the six Myners Principles, which were contained in a schedule to the Statement of Investment Principles. The Statement of Investment Principles is available to view at Finance Services, Montfield, Burgh Road, Lerwick, during normal working hours. It can also be found here: <http://www.shetland.gov.uk/coins/submissiondocuments.asp?submissionid=18529> – Appendix A.

The Statement of Investment Principles is due to be updated following the update of the Strategy Review, which will be undertaken during 2018/19.

## Performance Management

The Annual Accounts satisfy the requirements of the Local Government Pension Scheme (Scotland) Regulation 55 (1) of the Local Government Pension Scheme (Scotland) Regulations 2014 (as amended), to prepare a Pension Fund Annual Report for the financial year from 1 April 2017 to 31 March 2018. In addition, quarterly Management Accounts are presented to the Pension Fund Committee, which shows the year to date position and the projected year end outturn.

## Primary Financial Statements

The Annual Accounts summarise the Pension Fund's transactions for the year and its year-end position at 31 March 2018. The Annual Accounts are prepared in accordance with the International Accounting Standards Board (IASB) Framework for the Preparation and Presentation of Financial Statements (the IASB) Framework as interpreted by the Code of Practice on Local Authority Accounting in the United Kingdom (the Code).

The two primary statements, the Pension Fund Account and Net Assets Statement, as at 31

Description	2017/18 Annual Budget £000	2017/18 Draft Outturn £000	2017/18 Variance £000
Total Expenditure	13,857	15,650	(1,794)
Total Income	(20,278)	(21,775)	1,495
<b>Net Income</b>	<b>(6,421)</b>	<b>(6,125)</b>	<b>(299)</b>

The main difference between the draft outturn and the final accounts is that the Pension Fund Account includes the value of the growth of the fund and income automatically reinvested into the fund. This income is not included in the table above.

Expenditure was higher than budgeted due to a greater number of lump sums paid out during the year than had been estimated. More people than anticipated retired during 2017/18 resulting in an increase in benefits payable. Income was higher than budgeted due to a number of high value transfers in to the Fund.

Budgets were set for lump sums, transfers in and out, death benefits and all other income and expenditure. It is difficult to estimate these items accurately as there is a huge amount of personal choice or life events involved in what is received and paid out, and therefore these transactions cannot be fully predicted. Expenditure, such as lump sums and transfers are based on a number

March 2018, include a description of their purpose. Accompanying the two primary statements, are Notes to the Accounts, which set out the Accounting Policies adopted by the Pension Fund and provide more detailed analysis of the figures disclosed in the Primary Financial Statements.

The primary financial statements and notes to the accounts, including the accounting policies, form the relevant Annual Accounts for the purpose of the auditor's certificate and opinion.

## Financial Performance 2017/18

The Pension Fund account presents the full economic cost of providing Pension Fund services for 2017/18 and this shows a net income of £10.3m. This differs from the draft outturn position, shown below. The draft outturn was reported to the Pension Fund Committee and the Pension Board on 22 May 2018. The report can be found on Shetland Islands Council's website: <http://www.shetland.gov.uk/coins/submissiondocuments.asp?submissionid=22491>.

of variables, and will be different for each individual transaction.

## Administration Strategy

The Pension Fund's Pension Administration Strategy highlights the duties of, and sets the performance for, both the Fund and all of the participating employers.

Employers must provide accurate information to the Pension Fund in a timely manner, to ensure that information provided to Scheme members is also accurate and timely. The information received by employers to the Pension Fund, such as new starts, leavers, retirements and deaths was delivered in a timely manner during 2017/18.

With the exception of a couple of instances, all employer contributions were received by the 19<sup>th</sup> of the month following deduction.

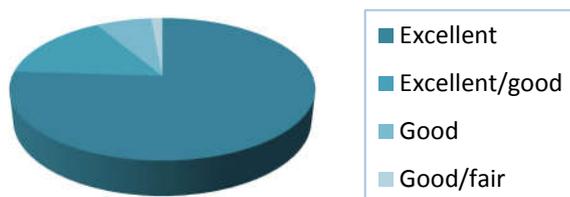
During 2017/18, a Pensions Employer Forum was held, bringing together all employers who contribute to the Fund. This gave employers a chance to ask questions and engage with the Pension Fund and the Fund Actuary, both on the subject of the triennial valuation and on a more general basis. This was welcomed by employers and the Pension Fund will seek to do more engagement of a similar nature in the future.

## Administration Performance

Shetland Islands Council, as a pension administering authority, is also committed to providing a high quality pension service to both members and employers and to ensure members receive their correct pension benefit entitlement.

To ensure excellent customer care is provided, retiring members and employers are requested to complete a customer satisfaction survey. Details of these surveys are summarised below:

### Member Satisfaction Survey (71 responses)



There were seven employer surveys returned, and responses received were 79% Excellent and 21% Good.

The feedback from these surveys is very positive for the year and will for a basis for identifying and implementing improvement.

Since January 2018, the Pensions section has been fully staffed, with a new ICT Systems Development Officer appointed in May 2018. This post is intended to provide ICT support to Pensions, Payroll and HR, with Payroll and HR reimbursing the Pension Fund for their share of the cost.

As well as administering employer contributions, retirements and pension payments, the Pension Section also process the pensioners' payroll.

The table below shows the summarised budget and spend for the Pension Fund administration costs for 2017/18. Staff Time Allocations were underspent due to vacancies, now filled. The Supplies, Services & Systems underspend relates to a training underspend. The Printing & Publications underspend is due to a budget set for mail shots, but no costs incurred during 2017/18.

	2017/18 Annual Budget £000	2017/18 Draft Outturn £000	2017/18 Variance £000
<b>Administration Expenses</b>			
Staff Time Allocations	280	221	59
Supplies, Services & Systems	92	87	5
Printing & Publications	5	1	4
Consultancy Costs	0	1	(1)
<b>Total</b>	<b>377</b>	<b>310</b>	<b>67</b>

CIPFA statistics show that for 2016/17 (the latest data available), Shetland Islands Council Pension Fund spent £46.45 per member, with the Scottish average being £21.27 per member. The ratio of staff to members is 1:1332, where Scottish average is 1:3172. Other than Orkney, Shetland has the smallest number of members in Scotland, which explains the differences above.

In addition to existing work, the Government Actuary's Department (GAD), requires that from April 2018 onwards, income and expenditure transactions, including employee contributions and member pensions are split for pre and post CARE (Career Average Revalued Earnings

scheme), to monitor the cost of the CARE scheme to ensure that it is value for money.

## Monitoring Arrangements

The Pension Fund Committee and Pension Board receive regular updates on performance and the Committee papers and minutes are available via the Council's committee management system website: <http://www.shetland.gov.uk/coins/>.

Reports are prepared on a quarterly basis for the Pension Fund Committee and Pension Board that give an overview of the position of the Pension Fund's external investments and present a

summary of each Fund Manager's performance for the quarter and over a three-year period.

In line with the Pension Fund's governance arrangements to monitor and review Fund Managers, the Pension Fund Committee and Pension Board invite Fund Managers to attend the quarterly meetings to give presentations on their mandates and investment performance. At the meeting of 6 December 2017, Schrodgers Investment Management gave a presentation on the management of a property fund and on 29 August 2017, KBI Global Investors gave a presentation on the equity fund they manage.

The annual visit to each Fund Manager took place in April 2018. Each Fund Manager also supplies a quarterly audited performance review report and monthly valuation report.

## Remuneration Report

There is no requirement for a remuneration report for the Pension Fund, as the Pension Fund does not directly employ any staff.

All staff are employed by Shetland Islands Council and its costs are reimbursed by the Pension Fund. The Councillors who are members of the Pension Fund Committee and Pension Board are also remunerated by Shetland Islands Council.

Details of Councillor and Senior Employee remuneration can be found in the accounts of Shetland Islands Council.

## Pension Fund Outlook

Following the triennial valuation, the interim investment strategy review will now be updated. The purpose of the investment strategy review undertaken in 2014 was to manage risk and have a fully funded Pension Scheme within 20 years; this latest review will consider the extent to which the current strategy is appropriate to deliver the investment returns assumed within the triennial valuation calculations.

A dedicated Pension Fund website is to be implemented during 2018/19. The Pension Fund currently has a page on the Shetland Islands Council website, with contact details and links to the accounts.

The Pension Fund records will be subject to GDPR regulations, coming into force on 25 May 2018. Work has been undertaken to ensure that the Pension Fund is fully compliant.



.....  
Steven Coutts  
Leader of the Council  
Chair of the Pension Fund Committee  
27 June 2018



.....  
Jonathan Belford, CPFA  
Executive Manager – Finance  
27 June 2018



.....  
Maggie Sandison  
Chief Executive  
27 June 2018

# Annual Governance 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 Pension Fund in terms of The Local Government Pension Scheme (Scotland) Regulations 2014 (as amended). The objectives are discharged through the Pension Fund Committee. The Administering Authority is assisted in its duties by the Pension Board.

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.

## 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 Pension 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 and 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 Funding Strategy Statement and Statement of Investment Principles);
- service planning arrangements;
- staff time allocations, appropriate to the scale of the Pension Fund;
- performance management arrangements, especially for Pension 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;
- the Governance Statement, reviewed annually;
- risk register and business continuity plans;
- support for cash and treasury management;
- training plans; and
- independent and objective scrutiny.

To this end, the Pension Fund is managed within the overall governance arrangements of Shetland Islands Council.

## 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 Pension 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 that are in place for Shetland Islands Council (which are internally and externally audited and assessed on an annual basis).

The effective arrangements include:

- an appropriate level of knowledge for Pension Fund Committee and Pension Board members to ensure that they have adequate 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 Pension Fund, as described in the Funding Strategy Statement 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 (risk register), 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, including appropriate segregation of duties for the Pension Fund staff.

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 Pension Fund has a responsibility for ensuring the continuing effectiveness of its governance framework and systems of internal control.

The Pension Fund approaches this with reference to the Council and its approach. This considers different layers of assurance, namely management assurance both internally through the Council and externally through the group entities; the assurance and recommendations provided by internal audit; external audit and other external scrutiny reports; and self-evaluation compliance.

## Management Assurance

As the administration of the Pension Fund is directly within the remit of the Director of Corporate Services, assurance has been sought from her in relation to the effectiveness of internal financial controls. This assurance provides the opportunity to highlight any weaknesses or areas of concern that should be considered. For 2017/18, no areas of weakness or concern were raised.

In relation to the effectiveness of the Council's arrangements to its statutory officers, both the Executive Manager – Finance (Chief Financial Officer) and Executive Manager – Governance & Law (Monitoring Officer) are full members of the Corporate Management Team and are in attendance at the Council, Audit Committee and Policy and Resources Committee to advise as appropriate.

The Council Committee structure supports the organisational and management structure of the Council, incorporating a culture of accountability that has been developed throughout. The Pension Fund Committee oversees the business of the Pension Fund; the Administering Authority being supported by the Pension Board. The Audit Committee remains responsible for ensuring the effectiveness of the internal audit function and also considering all reports prepared by the external auditor.

The Audit Committee's remit ensures that the work of the Council, from both a control and performance perspective, is checked and scrutinised. As well as an annual plan, the Committee can call for one-off reviews to investigate a particular issue. The Council's Executive Manager - Audit, Risk & Improvement reports directly to the Audit Committee.

## Assurance from Internal Audit

The Council provides internal audit arrangements to the Pension 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 the Public Sector Internal Audit Standards (PSIAS). The service works to an approved Annual Plan, based on the approved Audit Strategy, based on the Audit Universe and an annual assessment of the known and potential risks.

During the year Internal Audit carried out an audit of the Payroll and Pension Section. No areas of concern were identified.

## External Audit and Other External Scrutiny

Each year, the external auditors undertake an assessment of the internal controls in operation within 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.

## Investments

The Custodian for the Pension Fund is Northern Trust, who provide a global custody service. The custodian holds for safekeeping the Pension Fund's investment assets such as electronic certificates. The custodian also provides secure settlement of any global transactions that a Fund Manager may undertake, ensuring that all money and legal rights transfer to the appropriate customer as per the transaction in the correct timeframe. The custodian also provides other services such as reclaiming tax, short term cash investment, securities lending, collection of dividends and valuation reports.

All Fund Managers must be registered with, and comply with the Financial Conduct Authority. At the outset of any investment mandate an Investment Management Agreement is signed by both the fund management company and the Pension Fund. This agreement covers all aspects of the operation of the mandate, such as investment objectives and restrictions, custody and banking, fees and charges, reporting and communication and dealing arrangements. Any changes to the Investment Management Agreement must be agreed by both the fund management company and the Pension Fund.

## Self-Evaluation of Compliance

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

<b>Principle</b>	<b>Compliance and Comments</b>
<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 Pension Fund Committee has been delegated responsibility for overseeing the management and administration of the LGPS and managing the investments of the Pension Fund.
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, the Pension Board, which meets concurrently with the Pension Fund Committee, includes representatives from employers (Councillors), admitted bodies (a Board Member) and scheme members (Trade Unions).
That where a secondary committee or panel has been established, the structure ensures effective communication across both levels.	Yes, the Pension Fund Committee and Pension Board meet concurrently to aid easy and open communication.
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.	The Pension Board is not a secondary committee, both the Pension Fund Committee and Pension Board meet concurrently and have access to the same agenda papers. There is therefore no need for a Pension Board member to be on the Committee.
<b>Committee Membership and Representation</b>	
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 - Pension Fund Committee and Pension Board ii) Yes, Pension Board iii) Yes, e.g. engaging with the appointed actuary or investment manager when professional advice is required.
Where lay members sit on a main or secondary committee, they are treated equally in terms of access to papers, meetings and training and are given opportunities to contribute to the decision making process, with or without voting rights.	Yes, Pension Board members have the same access to information, papers and training.
<b>Selection and role of lay members</b>	
That committee or board members are made fully aware of the status, role and function they are required to perform on either a main or secondary committee.	Yes, training provided during 2017/18, following the Scottish Local Government elections.
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, 'Declarations of Interest' is a standing item on all agendas.
<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, these are contained in the Terms of Reference for both Pension Fund Committee and Pension Board.

<b>Training/Facility time/Expenses</b>	
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, an updated Member Development Programme was put in place, following the elections in May 2017.
<b>Meetings (frequency/quorum)</b>	
That an administering authority's main committee or committees meet at least quarterly.	Yes, the Pension Fund Committee and Pension Board meets at least four times per annum and are wholly focused on Pension Fund business.
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, the Pension Board sits concurrently with the Pension Fund Committee.
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.	Yes, lay members are included in formal governance arrangements.
<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, committee papers and all agenda items and subsequent minutes are available on the Shetland Islands Council Committee Information Pages (COINS) and can be accessed by all Pension Fund Committee and Pension Board members.
<b>Scope</b>	
That administering authorities have taken steps to bring wider scheme issues within the scope of their governance arrangements.	Yes, full scope of the Pension Fund Committee and Pension Board are found in their Terms of Reference
<b>Publicity</b>	
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. Governance and constitutional documents are available on the Council website.

## Significant Governance Issues

The system of governance can provide only reasonable (and not absolute) assurance that assets are safeguarded, transactions are authorised and properly recorded, material errors or irregularities are either prevented or would be detected within a timely period and all the significant risks impacting on the achievement of our objectives have been mitigated.

Following a review of the effectiveness of the code of governance there are no significant governance issues that require to be reported.



.....  
Steven Coutts  
Leader of the Council  
Chair of the Pension Fund Committee  
27 June 2018

## 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.



.....  
Maggie Sandison  
Chief Executive  
Shetland Islands Council  
27 June 2018

# Statement of Responsibilities for the Statement of Accounts

## The administering authority's responsibilities

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 (section 95 of the Local Government (Scotland) Act 1973). In this authority, that officer is the Executive Manager – Finance;
- manage its affairs to secure economic, efficient and effective use of resources and to safeguard its assets;
- ensure the Annual Accounts are prepared in accordance with legislation (The Local Authority Accounts (Scotland) Regulations 2014), and so far as is compatible with that legislation, in accordance with proper accounting practices (section 12 of the Local Government in Scotland Act 2003); and
- approve the Annual Accounts for signature.

I can confirm that these Annual Accounts were approved for signature by the Council on 27 June 2018.

Signed on behalf of Shetland Islands Council.



.....  
Steven Coutts  
Leader of the Council  
Chair of the Pension Fund Committee  
27 June 2018

## 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 required by legislation and as set out in the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom (the Accounting Code).

In preparing the Annual Accounts, the Executive Manager - Finance has:

- selected suitable accounting policies and then applied them consistently;
- made judgements and estimates that were reasonable and prudent;
- complied with legislation; and
- complied with the local authority Accounting Code (in so far as it is compatible with legislation).

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.

I certify that the Annual Accounts give a true and fair view of the financial position of the Pension Fund at the reporting date and the transactions of the Pension Fund for the year ended 31 March 2018.



.....  
Jonathan Belford, CPFA  
Executive Manager – Finance  
Shetland Islands Council  
27 June 2018

## Pension Fund Account 2017/18

The Pension Fund Account sets out all income and expenditure of the Pension Fund.

2016/17 £000		Notes	2017/18 £000	2017/18 £000
	<b>Dealings with members, employers and others directly involved in the scheme</b>			
(16,026)	Contributions	5	(16,917)	
(1,258)	Transfers in from other pension funds	6	(1,422)	
(28)	Other income		(28)	
<b>(17,312)</b>	<b>Total Additions</b>			<b>(18,367)</b>
12,785	Benefits payable	7	13,194	
363	Payments to and on account of leavers	8	567	
4	Other payments		49	
<b>13,152</b>	<b>Total Withdrawals</b>			<b>13,810</b>
<b>(4,160)</b>	<b>Net (additions)/withdrawals from dealings with members</b>			<b>(4,557)</b>
1,856	Management expenses	9		1,876
<b>(2,304)</b>	<b>Net additions including Fund Management Expenses</b>			<b>(2,681)</b>
	<b>Return on investments</b>			
(3,154)	Investment income	10	(3,407)	
(68,734)	(Profits) and losses on disposal of investments and changes in market value of investments	13b	(4,232)	
<b>(71,888)</b>	<b>Net return on investments</b>			<b>(7,639)</b>
<b>(74,192)</b>	<b>Net increase in the net assets available for benefits during the year</b>			<b>(10,320)</b>
<b>(375,707)</b>	<b>Opening net assets of the scheme</b>			<b>(449,899)</b>
<b>(449,899)</b>	<b>Closing net assets of the scheme</b>			<b>(460,219)</b>

## Net Assets Statement as at 31 March 2018

The Net Assets Statement sets out the value, as at the Statement date, of all assets and current liabilities of the Pension Fund. The net assets of the Pension Fund (assets less current liabilities) represent the funds available to provide for pension benefits at the statement date.

The financial statements summarise the transactions of the Pension Fund during the year and its net assets at the year-end. It should be noted, however, that they do not take account of the obligations to pay pensions and benefits that fall due after the end of the year. The actuarial position of the Pension Fund, which does take account of such obligations, is discussed in the Actuarial Statement. These financial statements should be read in conjunction with that information. In addition, as required by IAS26, the Actuarial Present Value of Promised Retirement Benefits is disclosed in the notes to these financial statements.

2016/17 £000	Notes	2017/18 £000
	<b>Investment Assets</b>	
448,957	Investment Assets 11	459,420
<b>448,957</b>	<b>Total Investment Assets</b>	<b>459,420</b>
	<b>Current Assets</b>	
1,345	Debtors 17	1,647
1,011	Bank current accounts 17	735
<b>2,356</b>	<b>Total Current Assets</b>	<b>2,382</b>
	<b>Current Liabilities</b>	
(366)	Sundry creditors 19	(470)
(1,048)	Benefits payable 19	(1,113)
<b>(1,414)</b>	<b>Total Current Liabilities</b>	<b>(1,583)</b>
<b>449,899</b>	<b>Net assets of the scheme available to fund benefits at the reporting period end</b>	<b>460,219</b>



.....  
Jonathan Belford, CPFA  
Executive Manager – Finance  
27 June 2018

## Notes to the Accounts

### Note 1: Description of Pension 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.

#### General

The Pension Fund is governed by the Superannuation Act 1972 and by the Public Service Pensions Act 2013. The Pension Fund is administered in accordance with the following secondary legislation:

- The Local Government Pension Scheme (Scotland) Regulations 2014 (as amended);
- The Local Government Pension Scheme (Transitional Provisions and Savings) (Scotland) Regulations 2014;
- The Local Government Pension Scheme (Governance) (Scotland) Regulations 2015; 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 are members of the Scottish Teachers' Pension Scheme.

The Pension Fund is overseen by the Pension Fund Committee and Pension Board.

#### Membership

Membership of the LGPS is automatic, but employees are free to choose to opt out of the Scheme and make their own personal pension arrangements outside the Scheme.

Organisations participating in the Shetland Islands Council Pension Fund include:

- Scheduled bodies, which are local authorities and similar statutory bodies whose staff are automatically entitled to be members of the Pension Fund; and
- Admitted bodies, which are other organisations that participate in the Pension Fund under an admission agreement between the Pension 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 11 employer organisations with active members within Shetland Islands Council Pension Fund including the Council itself; a summary of membership is shown below.

31 March 2017	Shetland Islands Council Pension Fund	31 March 2018
11	<b>Number of employers with active members</b>	11
	<b>Number of employees in scheme:</b>	
2957	Shetland Islands Council	2,976
385	Other employers	382
<b>3342</b>	<b>Total</b>	<b>3,358</b>
	<b>Number of pensioners/dependants</b>	
1583	Shetland Islands Council	1,702
145	Other employers	149
<b>1728</b>	<b>Total</b>	<b>1,851</b>
	<b>Deferred pensioners</b>	
1611	Shetland Islands Council	1,710
362	Other employers	334
<b>1973</b>	<b>Total</b>	<b>2,044</b>
<b>7043</b>	<b>Scheme Total</b>	<b>7,253</b>

## Funding

Benefits are funded by contributions and investment earnings. Contributions are made by active members of the Pension Fund in accordance with the Local Government Pension Scheme (Scotland) Regulations 2014 (as amended) and range from 5.5% to 12% of pensionable pay for the financial year ending 31 March 2018. Employee contributions are topped

up by employers' contributions, which are set, based on triennial actuarial funding valuations. The actuarial valuation as at 31 March 2017 set these employers' contribution rates, which range from 18.8% to 40.6% of pensionable pay.

## Benefits

Pension benefits under the LGPS are calculated as per the table below:

Service pre 1 April 2009	Service post 31 March 2009	Service Post 31 March 2015
Each year worked is worth 1/80 x final FTE pensionable salary	Each year worked is worth 1/60 x final FTE pensionable salary	Each year worked is worth 1/49 x actual pensionable salary
Automatic lump sum of 3 x salary	No automatic lump sum	No automatic lump sum
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	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	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, ill health retirement and death benefits. For more details, please refer to <http://www.scotlgps2015.org/> or contact Shetland Islands Council Pension Section on 01595 744644.

Benefits are index-linked in line with the consumer price index.

## Note 2: Basis of Preparation

The Statement of Accounts summarises the Pension Fund's transactions for the 2017/18 financial year and its position at year-end as at 31 March 2018. The accounts have been prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2017/18, which is based upon International Financial Reporting Standards (IFRS), as amended for the UK public sector.

The accounts summarise the transactions of the Pension 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 that 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 16.

## Note 3: Accounting Standards Issued not Adopted

There are no accounting standards issued but not adopted by the code in 2017/18 that relate to the Pension Fund.

## Note 4: 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 assumptions and estimates.

The items in the net assets statement at 31 March 2018 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. An actuary to the Fund is appointed 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, a 0.5% decrease in the real discount rate assumption would result in an increase in the pension liability of £69m. A 0.5% increase in salary increase rate assumption would increase the value of liabilities by approximately £10m, and a 0.5% increase in pension increase rate assumption would increase the liability by approximately £56m.

## Note 5: Contributions Receivable

### By category:

31 March 2017 £000		31 March 2018 £000
(12,190)	Employers - normal	(12,941)
(18)	Employers - augmentation	(86)
(3,818)	Members - normal	(3,890)
<b>(16,026)</b>	<b>Total</b>	<b>(16,917)</b>

### By authority:

31 March 2017 £000		31 March 2018 £000
(13,589)	Administering authority	(14,495)
(135)	Scheduled bodies	(135)
(2,302)	Admitted bodies	(2,287)
<b>(16,026)</b>	<b>Total</b>	<b>(16,917)</b>

## Note 6: Transfers in from Other Pension Funds

The total transfers received during the year are as follows:

31 March 2017 £000		31 March 2018 £000
(1,258)	Individual transfers in	(1,422)
<b>(1,258)</b>	<b>Total</b>	<b>(1,422)</b>

The Pension Fund received 46 transfers in during 2017/18 with an average value of £30,903, compared to 41 transfers in during 2016/17 with an average value of £30,683.

## Note 7: Benefits Payable

31 March 2017 £000	By category:	31 March 2018 £000
9,312	Pensions	10,006
2,671	Commutation and lump sum retirement benefits	2,965
802	Lump sum death benefits	223
<b>12,785</b>	<b>Total</b>	<b>13,194</b>

31 March 2017 £000	By authority:	31 March 2018 £000
11,410	Administering authority	12,029
111	Scheduled bodies	191
1,264	Admitted bodies	974
<b>12,785</b>	<b>Total</b>	<b>13,194</b>

## Note 8: Payments to and on Account of Leavers

31 March 2017 £000		31 March 2018 £000
17	Refunds to members leaving service	40
14	Payments for members joining state scheme	0
332	Individual transfers	527
<b>363</b>	<b>Total</b>	<b>567</b>

## Note 9: Management Expenses

31 March 2017 £000		31 March 2018 £000
318	Administration Expenses	310
51	Oversight and Governance Expenses	83
	<b>Investment Management</b>	
1,420	Management Fees	1,418
35	Performance Fees	33
32	Custody Fees	32
<b>1,856</b>	<b>Total</b>	<b>1,876</b>

## Note 10: Investment Income

31 March 2017 £000		31 March 2018 £000
(2,988)	Pooled investment vehicles	(3,042)
(4)	Interest on cash deposits	(5)
(162)	Other	(360)
<b>(3,154)</b>	<b>Total</b>	<b>(3,407)</b>

## Note 11: Investments

Fair Value As at 31 March 2017 (restated)		Fair Value As at 31 March 2018
172,562	Managed Funds	171,580
194,032	Unit Linked Insurance Policies	197,989
38,019	Fixed income unit trusts	39,157
42,889	Pooled property unit trusts	48,267
1,218	Cash deposits	2,319
237	Property income due	108
<b>448,957</b>	<b>Total investment assets</b>	<b>459,420</b>

## Note 11a - Reconciliation of movements in investments

	Market Value at 1 April 2017 £000	Purchases during the year £000	Sales during the year £000	Change in market value during the year £000	Market Value at 31 March 2018 £000
<b>Investment Assets:</b>					
Pooled funds - managed funds	171,376	78,941	(76,745)	(2,282)	171,290
- unit linked insurance policies	195,067	0	(1,071)	3,994	197,990
Fixed income unit trusts	38,019	701	0	437	39,157
Pooled property unit trusts	42,853	4,646	(1,315)	2,083	48,267
<b>Total Pooled Investment Vehicles</b>	<b>447,315</b>	<b>84,288</b>	<b>(79,131)</b>	<b>4,232</b>	<b>456,704</b>
<b>Other investment balances:</b>					
Fixed income due	187				289
Property income due	237				108
Cash income due	1,218				2,319
<b>Net investment assets</b>	<b>448,957</b>	<b>84,288</b>	<b>(79,131)</b>	<b>4,232</b>	<b>459,420</b>

Comparative movements in 2016/17	Market Value at 1 April 2016 £000	Purchases during the year £000	Sales during the year £000	Change in market value during the year £000	Market Value at 31 March 2017 £000
<b>Investment Assets:</b>					
Pooled funds - managed funds	146,051	0	(38)	25,363	171,376
- unit linked insurance policies	153,247	0	(35)	41,855	195,067
Fixed income unit trusts	33,926	2,571	0	1,522	38,019
Pooled property unit trusts	41,576	3,402	(2,119)	(6)	42,853
<b>Total Pooled Investment Vehicles</b>	<b>374,800</b>	<b>5,973</b>	<b>(2,192)</b>	<b>68,734</b>	<b>447,315</b>
<b>Other investment balances</b>					
Fixed income due	270				187
Property income due	35				237
Cash income due	44				1,218
<b>Net investment assets</b>	<b>375,149</b>	<b>5,973</b>	<b>(2,192)</b>	<b>68,734</b>	<b>448,957</b>

Indirect costs are incurred through the bid-offer spread on investments within pooled investment vehicles. The amount of indirect costs is not separately provided to the Scheme.

### Note 11b - Analysis of Pooled Investment Vehicles

As at 31 March 2017 (restated) £000	Additional analysis	As at 31 March 2018 £000
96,821	Managed Funds	95,995
194,032	Unit Linked Insurance Policies	197,989
75,554	Diversified Growth	75,295
38,019	Alternative Credit	39,157
41,508	Pooled property unit trust (UK)	47,770
1,381	Pooled property unit trust (Overseas)	498
<b>447,315</b>	<b>Total Pooled Investment Vehicles</b>	<b>456,704</b>

### Note 11c - Analysis by Fund Manager

Market Value 31 March 2017			Market Value 31 March 2018	
£000	%		£000	%
188,816	42	BlackRock	192,386	42
49,560	11	Schroders	56,297	12
75,554	17	Newton Asset Management	75,417	16
96,821	22	Kleinwort Benson	95,994	21
38,206	8	M & G Investments	39,326	9
<b>448,957</b>	<b>100</b>	<b>Total investment assets</b>	<b>459,420</b>	<b>100</b>

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

Market Value 31 March 2017			Market Value 31 March 2018	
£000	%		£000	%
81,933	18	Aquila Life UK equity index	83,049	18
38,019	8	M & G Alpha Opp Fd AGBP	39,157	9
96,821	22	KBI 1 Dividend Plus	95,994	21
75,554	17	Newton Real Rtrn X ACC NAV	75,295	16
106,875	24	Aquila Life World EX UK Fund Series 1	109,327	24

## Note 12: Fair Value Hierarchy

Asset and liability valuations have been classified into three levels according to the quality and reliability of information used to determine their fair values. Transfers between levels are recognised in the accounts in the year in which they occur.

### Level 1

Assets and liabilities at Level 1 are those where the fair values are derived from unadjusted quoted prices in active markets for identical assets or liabilities. Products classified as Level 1 comprise quoted equities, quoted fixed securities, quoted index linked securities and unit trusts.

### Level 2

Assets and liabilities at Level 2 are those where quoted market prices are not available, for example, where an instrument is traded in a market that is not considered to be active, or

where valuation techniques are used to determine fair value.

### Level 3

Assets and liabilities at Level 3 are those where at least one input that could have a significant effect on the instrument's valuation is not based on observable market data.

The following table provides an analysis of the financial assets of the pension fund, grouped into Levels 1 and 2, based on the level at which the fair value is observable. The Pension Fund has no Level 3 investments.

As at 31 March 2017 £000	Fair value through profit and loss	As at 31 March 2018 £000
470	Level 1	2,515
448,487	Level 2	456,905
<b>448,957</b>	<b>Net Investment assets</b>	<b>459,420</b>

## Basis of Valuation

The basis of valuation for each class of investment asset is set out below. There has been no change in the valuation techniques used during the year. All assets have been valued using fair value techniques that represent the highest and best price available at the reporting date.

Description of Asset	Valuation hierarchy	Basis of valuation	Observable / unobservable inputs	Key sensitivities affecting valuations
<b>Market quoted investments</b>	Level 1	Published bid market price ruling on the final day of the accounting period	Not required	Not required
<b>Exchange traded pooled investments</b>	Level 1	Closing bid value on published exchanges	Not required	Not required
<b>Pooled investments - overseas unit trusts and property funds</b>	Level 2	Closing bid price where bid and offer prices are published Closing single price where single price published	NAV-based pricing set on a forward pricing basis	Not required

## Note 13: Financial Instruments

### Note 13a - 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.

As at 31 March 2017 (restated)				As at 31 March 2018		
Fair value through profit and loss £000	Receivables £000	Financial liabilities £000		Fair value through profit and loss £000	Receivables £000	Financial liabilities £000
			<b>Financial assets</b>			
			<b>Pooled funds</b>			
172,562	0	0	- managed funds	171,580	0	0
194,032	0	0	- unit linked insurance policies	197,989	0	0
38,019	0	0	Fixed income unit trusts	39,157	0	0
42,889	0	0	Pooled property unit trusts	48,267	0	0
0	2,229	0	Cash	0	3,054	0
237	0	0	Property income due	108	0	0
0	1,345	0	Debtors	0	1,647	0
<b>447,739</b>	<b>3,574</b>	<b>0</b>	<b>Total Financial assets</b>	<b>457,101</b>	<b>4,701</b>	<b>0</b>
			<b>Financial liabilities</b>			
0	0	(1,414)	Creditors	0	0	(1,546)
<b>0</b>	<b>0</b>	<b>(1,414)</b>	<b>Total Financial liabilities</b>	<b>0</b>	<b>0</b>	<b>(1,546)</b>
<b>447,739</b>	<b>3,574</b>	<b>(1,414)</b>	<b>Total</b>	<b>457,101</b>	<b>4,701</b>	<b>(1,546)</b>

### Note 13b - Net gains and losses on financial instruments

As at 31 March 2017 £000	Financial assets	As at 31 March 2018 £000
(68,734)	Fair value through profit and loss	(4,232)
<b>(68,734)</b>	<b>Total</b>	<b>(4,232)</b>

### Note 13c - Value of financial instruments

As at 31 March 2017		Financial assets	As at 31 March 2018	
Book value £000	Market value £000		Book value £000	Market value £000
327,613	447,739	Fair value through profit and loss	339,325	457,102
<b>327,613</b>	<b>447,739</b>	<b>Total</b>	<b>339,325</b>	<b>457,102</b>

## Note 14: Nature and Extent of Risks Arising from Financial Instruments

### Risk and risk management

The Pension 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 Pension Fund and to maximise the opportunity for gains across the whole Pension Fund portfolio. The Pension 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 Pension Fund manages its liquidity risk to ensure there is sufficient liquidity to meet the Pension Fund's forecast cash flows. The Pension Fund manages these investment risks as part of its overall Pension Fund risk management programme.

Responsibility for the Pension 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 Pension 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 Pension 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 Pension Fund 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 Pension Fund's investment managers mitigate this price risk through diversification and the selection of investments, which is monitored by the Council, as the administering authority, and the Fund Managers to ensure it is within limits specified in the Pension Fund investment strategy.

### Other Pension Fund price risk - sensitivity analysis

In agreement with the Pension Fund's performance analyst and following analysis of historical data and expected investment return during the financial year, the Pension Fund has determined that the following movements in market price risk are deemed reasonably possible for the financial year 2017/18 reporting period:

Asset Type	Potential market movements (+/-)
UK Equities	16.8%
Overseas Equities	17.9%
Property	14.3%
Cash	0.5%
Diversified Growth	12.6%
Alternative Credit	6.7%

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 Pension 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 Pension 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 shown in the following table (the prior year comparator is shown below).

Asset Type	Value as at 31 March 2018 £000	Percentage Change %	Value on Increase £000	Value on Decrease £000
<b>Cash and cash equivalents</b>	2,319	0.50%	2,331	2,307
<b>Investment portfolio assets:</b>				
UK Equities	83,049	16.8%	97,001	69,097
Global Equities (ex UK)	205,321	17.9%	242,073	168,569
Property	53,988	14.3%	61,708	46,268
Diversified Growth	75,417	12.6%	84,920	65,914
Alternative Credit	39,326	6.7%	41,961	36,691
<b>Total assets</b>	<b>459,420</b>		<b>529,994</b>	<b>388,846</b>

Asset Type	Value as at 31 March 2017 £000	Percentage Change %	Value on Increase £000	Value on Decrease £000
<b>Cash and cash equivalents</b>	1,218	0.00%	1,218	1,218
<b>Investment portfolio assets:</b>				
UK Equities	81,933	15.80%	94,878	68,988
Overseas Equities	279,250	18.40%	330,632	227,868
Total Bonds & Index Linked	38,206	14.20%	43,631	32,781
UK Property	46,749	12.50%	52,593	40,905
Overseas Property	1,601	6.10%	1,699	1,503
<b>Total assets</b>	<b>448,957</b>		<b>524,651</b>	<b>373,263</b>

## Interest rate risk

The Pension 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 Pension Fund's direct exposure to interest rate movements are set out below:

As at 31 March £000		As at 31 March £000
	<b>Asset type</b>	
1,218	Cash and cash equivalents	2,319
1,011	Cash balances	735
<b>2,229</b>	<b>Total</b>	<b>3,054</b>

## Interest rate risk sensitivity analysis

The Pension Fund recognises that interest rates can vary and can affect both income to the Pension 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 Pension Fund under current interest rate circumstances. The Pension 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 the total Fund volatility takes into account the expected interactions between the different asset classes shown, based on the underlying volatilities and correlations of the assets, in line with mean variance portfolio theory.

Asset Type	Carrying amount as at 31 March 2018 £000	Change in year in the net assets available to pay benefits	
		+100 BPS £000	-100 BPS £000
Cash and cash equivalents	2,319	23	(23)
Cash balances	735	7	(7)
<b>Total change in assets available</b>	<b>3,054</b>	<b>30</b>	<b>(30)</b>

Asset Type	Carrying amount as at 31 March 2017 £000	Change in year in the net assets available to pay benefits	
		+100 BPS £000	-100 BPS £000
Cash and cash equivalents	1,218	12	(12)
Cash balances	1,011	10	(10)
<b>Total change in assets available</b>	<b>2,229</b>	<b>22</b>	<b>(22)</b>

## 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 Pension Fund is exposed to currency risk on financial instruments that are denominated in any currency other than the

functional currency of the Pension Fund (£ sterling). The Pension Fund holds both monetary and non-monetary assets denominated in currencies other than £ sterling.

The following table summarises the Pension Fund's currency exposure as at 31 March 2018 and as at the previous period end.

As at 31 March 2017 £000	Asset type	As at 31 March 2018 £000
279,250	Pooled Funds - overseas equities	205,321
1,601	Pooled Property Unit Trusts - overseas	39,326
<b>280,851</b>	<b>Total</b>	<b>244,647</b>

## Currency risk - sensitivity analysis

Following analysis of data provided by the Pension Fund's performance analysts, the Pension Fund considers the likely volatility associated with foreign exchange rate movements to be 10%.

This analysis assumes that all other variables, in particular interest rates, remain constant. A 10% strengthening/weakening of the pound against the various currencies in which the Pension Fund holds investments would increase/decrease the net assets available to pay benefits as follows:

Asset Type	Carrying amount as at 31 March 2018 £000	Change to net assets available to pay benefits	
		+10.0% £000	-10.0% £000
Pooled Funds - overseas equities	205,321	225,853	184,789
Pooled Property Unit Trusts - overseas	39,326	43,259	35,393
<b>Total change in assets available</b>	<b>244,647</b>	<b>269,112</b>	<b>220,182</b>

Asset Type	Carrying amount as at 31 March 2017 £000	Change to net assets available to pay benefits	
		+10.0% £000	-10.0% £000
Pooled Funds - overseas equities	279,250	307,175	251,325
Pooled Property Unit Trusts - overseas	1,601	1,761	1,441
<b>Total change in assets available</b>	<b>280,851</b>	<b>308,936</b>	<b>252,766</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 Pension 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 Pension Fund's financial assets and liabilities.

In essence, the Pension 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 placed 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 Pension Fund's cash holding under its treasury management arrangements at 31 March 2018 was £3.054m (31 March 2017: £2.229m). This was held with the following institutions:

As at 31 March 2017 £000		As at 31 March 2018 £000
1,211	<b>Fund manager deposits</b>	2,309
7	Schroders cash	10
	BlackRock cash	
	<b>Bank current accounts</b>	
1,011	Bank of Scotland Plc	735
<b>2,229</b>	<b>Total</b>	<b>3,054</b>

## Liquidity risk

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

The Pension Fund has immediate access to all its cash holdings. The Pension 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 Pension Fund's exposure to liquidity risk is considered negligible.

The Pension Fund defines liquid assets as assets that can be converted to cash within three months. Illiquid assets are those assets that will take longer than three months to convert into cash. As at 31 March 2018, the value of illiquid assets was £54.0m, which represented 11.8% of the Pension Fund assets (31 March 2017: £48.4m, which represented 10.8% of the Pension Fund assets).

## Refinancing risk

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

## Note 15: Funding Arrangements

In line with the Local Government Pension Scheme (Scotland) Regulations 2014 (as amended), the Pension 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 2017.

The funding policy is set out in the Pension Fund's Funding Strategy Statement (FSS), dated February 2018.

The key elements of the funding policy are:

- to ensure the long-term solvency of the Pension Fund using a prudent long-term view. This will ensure that sufficient funds are available to meet all members' / dependants' benefits as they fall due for payment;
- to ensure that employer contribution rates are reasonably stable where appropriate;
- to minimise the long-term cash contributions which employers need to pay to the Fund, by recognising the link between assets and liabilities and adopting an investment strategy which balances risk and return. This will also minimise the costs to be borne by Council Tax payers;
- to reflect the different characteristics of different employers in determining contribution rates. This involves the Fund having a clear and transparent funding strategy to demonstrate how each employer can best meet its own liabilities over future years; and
- 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.

Employee benefits are guaranteed and employee contributions are fixed, so employers need to pay the balance of the cost of delivering the benefits to members and dependants. The Funding Strategy Statement sets out how the Administering Authority has balanced the conflicting aims of affordability and stability of employer contributions and prudence in the funding basis with regard to employer liabilities.

## 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 2017. This valuation revealed that the Pension Fund's assets, which at 31 March 2017 were valued at £450m, were sufficient to meet 90% (£333m and 92% at 31 March 2014 valuation) of the liabilities (i.e. the present value of promised retirement benefits) accrued up to that date. The resulting deficit at the 2017 valuation was £51m (2014 valuation: £30m).

The common rate of contribution payable by each employing authority under regulation 32(4)(a) of the Administration Regulations for the period 1 April 2018 to 31 March 2021 is 22.1% of pensionable pay, (i.e. the rate which all employers in the Pension 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 2018 to 31 March 2021 were set in accordance with the Pension Fund's funding policy as set out in its Funding Strategy Statement.

During this period, the employers' rate due by Shetland Islands Council is 20.8% per annum for each of the three years.

Copies of the 2017 Valuation Report and Funding Strategy Statement are available on request from Shetland Islands Council, the Administering Authority to the Pension Fund.

## Principal actuarial assumptions and method used in the valuation

Full details of the method used are described in a valuation report from the actuaries, Hymans Robertson LLP, available on request from Shetland Islands Council, the Administering Authority to the Pension Fund, at Montfield, 28 Burgh Road, Lerwick.

## Method

The valuation approach recognises the uncertainties inherent in the valuation process. The actual cost of future benefits is unknown, due to the long time period. The first process in calculating the valuation is to set a funding target, which defines the target amount of assets to be held to meet future cashflows. Next, a time horizon is set over which the funding target is to be reached. Finally, a contribution is set to give a sufficiently high likelihood to meet the funding target over the time horizon. The calculations separately identify past service and future service costs.

## Assumptions

The assumptions are required to place value on the benefits earned to date and the benefits that will be earned in the future. To this end, the assumptions fall broadly into two categories; financial assumptions and demographic assumptions. Financial assumptions relate to the size of members' benefits, and information

affecting these assumptions are discount rate, price inflation, which affects benefit increases, and salary increases. Demographic assumptions relate to longevity of current pensioners and future pensioners.

The assets of the Fund have been accounted for at their market value, for the period ended 31 March 2017.

The key financial assumptions adopted for the 2017 valuation were as follows:

Financial assumptions	Nominal % per annum	Real % per annum
Discount rate	5.2%	2.5%
Pay increases	4.5%	1.8%
Price inflation/Pension increases	2.7%	0.0%

## Mortality assumptions

The key demographic assumption was the allowance made for longevity. The baseline longevity assumptions adopted at this valuation were based on the Fund's VitaCurves, and assumed that improvements have reached a peak of 1.25%. Based on these assumptions, the average future life expectancies at age 65 are as follows:

Mortality assumption at age 65	Males	Females
Current Pensioners	22.1 yrs	24.0 yrs
Future Pensioners	23.9 yrs	26.1 yrs

## Historic mortality assumptions

Life expectancies for the prior year-end are based on the PFA92 and PMA92 tables. The allowances for future life expectancies for the year ended 31 March 2016 are:

- **Prospective Pensioners:** Vita base curves with improvements in line with CMI 2012, assuming current rate of improvements have peaked with minimum underpin of 1.25% p.a.
- **Pensioners:** Vita base curves with improvements in line with CMI 2012, assuming current rate of improvements have peaked with minimum underpin of 1.25% p.a.

## Commutation assumption

An allowance is included for future retirements to elect to take 50% of the maximum additional tax-

free cash up to HMRC limits for pre-April 2009 service and 75% of the maximum tax-free cash post-April 2009 service.

## 50:50 Option

It is assumed that 1.0% of members (uniformly distributed across the age, service and salary range) will choose the 50:50 option. This is where members pay 50% of contributions in return for 50% of benefits. Employers still pay the full contribution.

## Note 16: Actuarial Present Value of Promised Retirement Benefits

In addition to the triennial funding valuation, the Pension 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 15). 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 2018 was £622m (31 March 2017: £693m). The Pension 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 2017.

## Assumptions

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:

As at 31 March 2017 % p.a.	Year ended	As at 31 March 2018 % p.a.
2.4	Inflation/pension increase rate	2.4
4.4	Salary increase rate	3.0
2.6	Discount rate	2.7

## Note 17: Current Assets

As at 31 March 2017 £000		As at 31 March 2018 £000
	<b>Debtors:</b>	
322	Contributions due - employees	324
1,020	Contributions due - employers	1,104
0	Transfer values receivable	163
2	Sundry debtors	3
1	Prepayments	53
1,011	Bank current accounts	735
<b>2,356</b>	<b>Total</b>	<b>2,382</b>

## Analysis of debtors

As at 31 March 2017 £000		As at 31 March 2018 £000
1	Central government bodies	0
1,162	Other local authorities	1,413
0	Public corporations & trading funds	1
182	Other entities and individuals	233
<b>1,345</b>	<b>Total</b>	<b>1,647</b>

## Note 18: Unfunded Pension

As at 31 March 2017 £000		As at 31 March 2018 £000
694	Added years pension	695

Local Government (Discretionary Payments and Injury Benefits) (Scotland) Regulations 1998 [Section 31] allows local authorities and admitted bodies 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 by the employer and not the Pension Fund.

## Note 19: Current Liabilities

As at 31 March 2017 £000		As at 31 March 2018 £000
(366)	Sundry creditors	(470)
(1,048)	Benefits payable	(1,113)
<b>(1,414)</b>	<b>Total</b>	<b>(1,583)</b>

## Analysis of creditors

As at 31 March 2017 (restated) £000		As at 31 March 2018 £000
(1)	Central government bodies	(41)
(1,075)	Other local authorities	(944)
(25)	Public corporations and trading funds	(24)
(313)	Other entities and individuals	(574)
<b>(1,414)</b>	<b>Total</b>	<b>(1,583)</b>

## Note 20: Additional Voluntary Contributions

As at 31 March 2017 £000		As at 31 March 2018 £000
5,164	Prudential	5,317
89	Equitable Life	45
<b>5,253</b>	<b>Total</b>	<b>5,362</b>

AVC contributions of £0.708m were paid directly to Prudential during the year (2016/17 £0.672m).

## Note 21: 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 £0.363m (2016/17 £0.338m) in relation to the administration of the Pension Fund and was subsequently reimbursed by the Pension Fund for these expenses.

The investments of the Pension Fund are overseen by the Council's Treasury Section; their costs are levied by staff time allocations. Costs incurred were £0.033m (2016/17 £0.032m) in relation to investment of the Pension Fund and the Council was subsequently reimbursed by the Pension Fund for these expenses.

The Council processed pensioner payments of £10.006m (2016/17 £9.312m). Such payments are reimbursed in full by the Pension Fund.

In addition, the Council is the single largest employer of Pension Fund members, and contributed £11.185m to the Pension Fund (2016/17 £10.350m).

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

## Governance

Four members of the Pension Fund Committee receive pension benefits from the Shetland Islands Council Pension Fund. Other committee members are active members of the Pension Fund.

Each member of the Pension Fund Committee and Pension Board is required to declare their interests at each meeting.

### Key management personnel

Key Management personnel for the Pension Fund include the Shetland Islands Council Councillors, who sit on the Pension Fund Committee and Pension Board. Following the local elections in May, the membership is as follows. All Committee and Board members are remunerated by Shetland Islands Council.

Pension Fund Committee Membership
Steven Coutts (Chair)
Alistair Cooper
Allison Duncan
Stephen Leask
Robbie McGregor
George Smith
Theodore G C Smtih
Ryan Thomson
Emma Louise Macdonald
Ian Scott
Pension Board Membership
Malcolm Bell
John Fraser
Amanda Westlake

In line with the training policy, two training sessions were organised for staff and Members. One of the training sessions was well attended by both Pension Fund Committee Members and Board Members.

Key management personnel also includes the Section 95 Officer of Shetland Islands Council; the Executive Manager – Finance. A recharge is made to the Pension Fund each year to reflect the cost of time spent. For 2017/18 this amounted to £0.021m (2016/17: £0.020m).

## Note 22: Changes in Actuarial Present Value of Promised Retirement Benefits

Actuarial Present Value of Promised Retirement Benefits	Vested Benefits £000	Total £000
<b>Balance at 31 March 2018</b>	<b>622</b>	<b>622</b>
Decrease in value during 2017/18	(71)	(71)
<b>Balance at 31 March 2017</b>	<b>693</b>	<b>693</b>
Increase in value during 2016/17	176	176
<b>Balance at 31 March 2016</b>	<b>517</b>	<b>517</b>

## Note 23: 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 15. This estimate is subject to significant variances based on changes to the underlying assumptions.

## Note 24: Events after the Balance Sheet Date

The annual accounts were authorised for issue on 27 June 2018. 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 2018, the figures in the financial statements and notes have been adjusted in all material respects to reflect the impact of this information.

## Note 25: Accounting Policies

### Pension 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 Pension 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 Pension Fund during the financial year and are calculated in accordance with the Local Government Pension Scheme Regulations (see notes 6 and 8).

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

#### C Investment income

- **Interest income** is recognised in the Pension Fund account as it accrues.
- **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.
- **Movement 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.

## Pension 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 Pension 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 Pension Fund expense as it arises.

### F Management 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 Pension Fund. Management, accommodation and other overheads are apportioned to the Pension Fund in accordance with Council policy.

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, is charged to the Pension Fund in accordance with Council policy.

## Net assets statement

### G Financial assets

Financial assets are included in the net assets statement on a fair value basis as at the reporting date. A financial asset is recognised in the net assets statement on the date the Pension 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 Pension Fund.

The values of investments shown in the net assets statement are outlined in the following paragraphs.

### H 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 Pension 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 an annual basis by the Fund actuary in accordance with the requirements of IAS 19 and relevant actuarial standards.

As permitted under IAS 26, the Pension 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 16).

## 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 Pension 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(1) (b) of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 but are disclosed as a note only (Note 20).

# Actuarial Statement for 2017/18

This statement has been prepared in accordance with Regulation 55(1)(d) of the Local Government Pension Scheme (Scotland) Regulations 2014. It has been prepared at the request of the Administering Authority of the Fund for the purpose of complying with the aforementioned regulation.

## Description of Funding Policy

The funding policy is set out in the Administering Authority's Funding Strategy (FSS), dated March 2018. In summary, the key funding principles are as follows:

- to ensure the long-term solvency of the Fund, using a prudent long term view. This will ensure that sufficient funds are available to meet all members'/dependants' benefits as they fall due for payment;
- to ensure that employer contribution rates are reasonably stable where appropriate;
- to minimise the long-term cash contributions which employers need to pay to the Fund, by recognising the link between assets and liabilities and adopting an investment strategy which balances risk and return (NB this will also minimise the costs to be borne by Council Tax payers);
- to reflect the different characteristics of different employers in determining contribution rates. This involves the Fund having a clear and transparent funding strategy to demonstrate how each employer can best meet its own liabilities over future years; and
- 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 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. Asset-liability modelling has been carried out which demonstrates that if these contribution rates are paid and future contribution changes are constrained as set out in the FSS, there is at least a 66% chance that the Fund will return to full funding over 14 years.

## Funding Position as at the last formal funding valuation

The most recent actuarial valuation carried out under Regulation 60 of the Local Government Pension Scheme (Scotland) Regulations 2014 was as at 31 March 2017. This valuation revealed that the Fund's assets, which at 31 March 2017 were valued at £450 million, were sufficient to meet 90% of the liabilities (i.e. the present value of promised retirement benefits) accrued up to that date. The resulting deficit at the 2017 valuation was £51 million.

Each employer had contribution requirements set at the valuation, with the aim of achieving full funding within a time horizon and probability measure as per the FSS. Individual employers' contributions for the period 1 April 2018 to 31 March 2021 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 2017 valuation report.

### 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 and inflation 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 2017 valuation were as follows:

Financial assumptions	31 March 2017
Discount rate	3.5%
Salary increase assumption	3.0%
Benefit increase assumption (CPI)	2.4%

The key demographic assumption was the allowance made for longevity. The life expectancy assumption was based on the Fund's Vita Curves alongside future improvements based on the CMI 2016 model with an allowance for smoothing of recent mortality experience and a long term rate of improvement of 1.25% p.a. Based on these assumptions, the average future life expectancies at age 65 are as follows:

	Males	Females
Current Pensioners	22.1 years	24.0 years
Future Pensioners*	23.9 years	26.1 years

\*Currently aged 45

Copies of the 2017 valuation report and Funding Strategy Statement are available on request from the Administering Authority to the Fund.

## Experience over the period since 31 March 2017

Asset returns over the period have been lower than the valuation discount rate and real bond yields at 31 March 2018 are at a similar level to 31 March 2017. As a result of this, the funding position has marginally decreased since the 31 March 2017.

The next actuarial valuation will be carried out as at 31 March 2020. The Funding Strategy Statement will also be reviewed at that time.



Douglas Green FFA  
For and on behalf of Hymans Robertson LLP  
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