



Meeting(s):	Pension Fund Committee Pension Board	7 March 2017
Report Title:	Presentation from Hymans Robertson LLP – Fund Actuary	
Reference Number:	F-029-F	
Author / Job Title:	Jonathan Belford Executive Manager - Finance	

1.0 Decisions / Action required:

- 1.1 The Pension Fund Committee and Pension Board are asked to NOTE the presentation.

2.0 High Level Summary:

- 2.1 Following a tender exercise, Hymans Robertson LLP, has recently been re-appointed as the Pension Fund's Actuary for the next 5 years.
- 2.2 Douglas Green, the appointed actuary to the Pension Fund, will give a presentation on the role of the actuary, complexities of the pension regulations and the risks to the fund where valuation debts occur. The purpose of which is to introduce the Board and Committee to the Fund Actuary and keep the Fund members more informed of pension matters for which they are responsible.

3.0 Corporate Priorities and Joint Working:

- 3.1 There is a specific objective within the Corporate Plan to ensure high standards of governance, that is, the rules on how we are governed, will mean that the Pension Fund is operating effectively and the decisions the Committee take are based on evidence and supported by effective options and potential effects.

4.0 Key Issues:

- 4.1 There are a number of changes to and increased complexity in administering new pension legislation.
- 4.2 There is a risk to the Pension Fund of employer valuation debts not being paid to the Pension Fund.
- 4.3 The Pension Fund is required to have a valuation carried out every three years. The actuary carries out this work, and 31 March 2017 is when the next Triennial Valuation of the Pension Fund is measured. The work to complete the valuation is carried out during the subsequent year.
- 4.4 This Triennial Valuation sets the Employers' contribution rates for the three years, commencing 1 April 2018.

5.0 Exempt and/or confidential information:
5.1 None

6.0 Implications :	
6.1 Service Users, Patients and Communities:	The presentation is designed to provide information to the members of the Pension Committee and Board on the role of the actuary and the impact that their role has on Scheduled and Admitted Bodies.
6.2 Human Resources and Organisational Development:	None.
6.3 Equality, Diversity and Human Rights:	None.
6.4 Legal:	As per Regulation 60 of the Local Government Pension Scheme (Scotland) Regulations 2014, the Council as a Pension Administering Authority must appoint a Fund Actuary.
6.5 Finance:	<p>The presentation is designed to provide information to the members of the Pension Committee and Board on the role of the actuary and the impact that their role has on Scheduled and Admitted Bodies.</p> <p>Failure to understand the consequences of Fund valuations can lead to consequences for the Pension Fund and could result in increased employer contributions.</p>
6.6 Assets and Property:	The role of the actuary includes taking into account the value of assets when arriving at conclusions on the overall value of the Pension Fund.
6.7 ICT and new technologies:	None.
6.8 Environmental:	None.
6.9 Risk Management:	<p>There are numerous risks involved in the operation of the Pension Fund.</p> <p>From a financial perspective, risks are an integral part of planning for the future, as assumptions are made, internal and external factors and demand and supply all have an impact throughout the financial year. These can lead to unplanned or unexpected costs, and may arise without warning.</p>

	<p>Awareness of valuation debt risks is critical to successful financial management.</p> <p>Going forward, as the fund reaches maturity, there could be a risk where contributions receivable are less than benefits payable.</p> <p>To mitigate this risk an investment strategy was approved with the aim to become fully funded by 2027, when the Fund is expected to mature. This strategy of diversification of fund managers is a significant element of mitigating the risk of investing for growth and income.</p>	
6.10 Policy and Delegated Authority:	<p>The Pension Fund Committee has delegated authority to discharge all functions and responsibilities relating to the Council's role as administering authority for the Shetland Islands Council Pension Fund (the Pension Fund) in terms of the Local Government (Scotland) Act 1994, the Superannuation Act 1972 and the Public Service Pensions Act 2014.</p> <p>The Pension Board is the body responsible for assisting the Scheme Manager in relation to compliance with scheme regulations and the requirements of the Pension Regulator.</p>	
6.11 Previously considered by:	This report has not been presented at any formal meeting.	

Contact Details:

Mary Smith, Team Leader – Expenditure, mary.smith@shetland.gov.uk, 18 February 2017

Appendices:

None

Background Documents:

None



Meeting(s):	Pension Fund Committee Pension Board	7 March 2017
Report Title:	Management Accounts for Pension Fund 2016/17 – Projected Outturn at Quarter 3	
Reference Number:	F-019-F	
Author / Job Title:	Executive Manager - Finance	

1.0	Decisions / Action required:
1.1	<p>The Pension Fund Committee and Pension Board RESOLVE to:</p> <ul style="list-style-type: none"> Review and NOTE the management accounts showing the projected outturn position at quarter 3.
2.0	High Level Summary:
2.1	This report sets out the projected financial position for the Pension Fund as at quarter 3, which is a reduction in the overall net contribution of £0.648m. See Appendix 1 for further detail.
3.0	Corporate Priorities and Joint Working:
3.1	There is a specific objective in the Corporate Plan to ensure that the Council is “continuing to keep a balanced and sustainable budget, and are living within our means” and that the Council continues to pursue a range of measures which will enable effective and successful management of its finances over the medium to long term.
3.2	By 2027, the investment strategy of the Pension Fund is targeted with achieving a 100% funding position in order to ensure that the scheme remains affordable and sustainable in the future.
4.0	Key Issues:
4.1	On 18 November 2015 (SIC Min Ref: 15/15) the Pension Fund Committee and Pension Board approved the 2016/17 Pension Fund budget. It is vital to the economic wellbeing of the Pension Fund that financial resources are managed effectively and that expenditure and income are delivered in line with the budget, as any overspends or underachievement of income will result in a reduction in the net contribution to the Pension Fund.
4.2	This report forms part of the financial governance and stewardship framework which ensures that the financial position of the Pension Fund is acknowledged, understood and quantified on a regular basis. It provides assurance to the Corporate Management Team and the Committee / Board that resources are being managed effectively and allows corrective action to be taken, where possible.
4.3	At quarter 3, the Pension Fund is predicting an under-achievement of income of £0.648m. This is largely due to more pension payments being paid out than budgeted, with a number of people retiring during the period up to quarter 3. The value of lump sums is also higher than budgeted.
4.4	The projected outturn has been calculated by assuming that pension payments

<p>and lump sums will continue to be paid out at the same rate for the rest of the year; however, lump sums, especially death benefits, are difficult to predict and it is possible that additional lump sum payments will be made, resulting in further under-achievement of income by the year end.</p>	
4.5	The above adverse variances are offset by an increase in new employees transferring previous pension benefits into the Pension Fund, estimated to achieve £0.837m more than originally budgeted.
5.0 Exempt and/or confidential information:	
5.1	None.
6.0 Implications :	
6.1 Service Users, Patients and Communities:	None.
6.2 Human Resources and Organisational Development:	None.
6.3 Equality, Diversity and Human Rights:	None.
6.4 Legal:	None.
6.5 Finance:	<p>The Pension Fund strategy, approved in 2015/16, seeks to address the prospect of falling income and rising expenditure projections over the longer term. The aim of the strategy is to ensure that the Pension Fund is 100% funded by 2027.</p> <p>It is therefore vital that the Pension Fund delivers its annual budget. Projections for 2016/17 show that this will not be achieved, with an anticipated shortfall of £0.648m. This may have a knock on effect in future years by either delaying the sustainability date, or by having to significantly increase contributions from Employers to meet any shortfall.</p>
6.6 Assets and Property:	None.
6.7 ICT and new technologies:	None.
6.8 Environmental:	None.
6.9 Risk Management:	<p>From a financial management perspective, risks are an integral part of planning for the future as assumptions must be made. These assumptions can be affected by many internal and external factors, such as demand, which could have a significant financial impact. The main financial risks facing the Pension Fund are:</p> <ul style="list-style-type: none"> • That the Fund's investments fail to deliver returns in line

	<p>with those required to meet the valuation of long-term liabilities;</p> <ul style="list-style-type: none"> • A fall in bond yields, leading to a rise in value placed on liabilities; • Employers leaving the scheme or the scheme closing to new members which could be due to several factors eg costs, liquidation or bankruptcy; • A failure to recover unfunded payments from employers, that could lead to other employers having to subsidise by increasing their employer contribution; • A global stock market failure; • Under-performance by active fund managers.
6.10 Policy and Delegated Authority:	<p>The Pension Fund Committee has been delegated authority to discharge all functions and responsibilities relating to the Council's role as administering authority for the Shetland Islands Council Pension Fund (the Pension Fund) in terms of the Local Government (Scotland) Act 1994, the Superannuation Act 1972 and the Public Service Pensions Act 2013.</p> <p>The Pension Board is the body responsible for assisting the Scheme Manager in relation to compliance with scheme regulations and the requirements of The Pension Regulator.</p>
6.11 Previously considered by:	<p>This report has not been presented at any formal meeting.</p>

Contact Details:

Hazel Tait, Team Leader – Accountancy, hazel.tait@shetland.gov.uk, 2 February 2017.

Appendices:

Appendix 1 – Projected Revenue Outturn Position 2016/17, Q3

Background Documents: Pension Fund Budget Proposals 2016/17, Pension Fund Committee/Pension Board, 18 November 2015

<http://www.shetland.gov.uk/coins/submissiondocuments.asp?submissionid=18593>

Pension Fund Committee / Pension Board

1. Projected Revenue Outturn Position Quarter 3 2016/17

Pension Fund	Revised Annual Budget £000	Projected Outturn £000	Budget v Projected Outturn at Q3 (Adv) / Pos £000	Year to date expenditure and income to 31 December 2016 £000
Employee Costs	223	223	-	142
Operating Costs	143	132	11	101
Investment Expenses	1,565	1,502	63	674
Benefits Payable	8,846	9,223	(377)	6,149
Transfers Out	100	109	(9)	109
Lump Sums	1,473	2,600	(1,127)	2,008
Total Expenditure	12,350	13,789	- 1,439	9,183
Other Income	(27)	(28)	1	(18)
Contributions Received	(15,974)	(15,942)	(32)	(10,654)
Investment Income	(3,065)	(3,050)	(15)	(2,040)
Transfers In	(100)	(937)	837	(759)
Total Income	(19,166)	(19,957)	791	(13,471)
				-
Net Income	(6,816)	(6,168)	(648)	(4,288)

An explanation for the main variances for the Pension Fund at quarter 3 is set out below.

1.1 Operating Costs – projected outturn underspend of £11k (7.7%)

This projected underspend relates to various minor savings in travel, licences, etc.

1.2 Investment Expenses – projected outturn underspend of £63k (4.0%)

This projected underspend is related to an expected decrease in investment income due to Brexit related market volatility, however the main change from Qtr 2 is due to a recent and significant decrease in fees from Black Rock (£96k).

1.3 Benefits Payable – projected outturn overspend of (£377k) (4.3%)

This projected overspend is due to more retirements during 2016/17 than anticipated when the budget was set. Members now have the option to retire between the ages of 55 and 75, and this age range is prevalent in the demographic of the Council's pension fund.

1.4 Lump Sums – projected outturn overspend of (£1.127m) (76.5%)

This projected overspend relates to more lump sums being paid out than budgeted, including higher than anticipated death benefits (£303k). The budget is based upon a rolling average of 5 year spend, but actual payments depend on members' salary and length of service.

1.5 Transfers Out – project outturn overspend of (£9k) (9.0%)

The budget is based on a rolling average of 5 year spend, but actual transfer values depends on salary and length of service and number of members leaving the fund.

1.6 Contributions Received – projected outturn under achievement of £32k (0.2%)

Some budgeted retirements have not materialised and therefore the anticipated strain income has not been received into the fund. The main change from Qtr 2 is a new under-recovery in Shetland Recreational Trust strain income of £150k.

1.7 Investment Income – projected outturn under achievement of £15k (0.5%)

Some investments are showing a projected increase in income, but the main change from Qtr 2 is an expected reduction in income for the overseas unit trust investment, which is being phased out (£357k).

1.8 Transfers In – projected outturn over achievement of £837k (837%)

There have been a number of high value transfers in, where new staff transfer existing pension benefits into the Pension Fund. Also included here is the excess of Additional Voluntary Contributions (AVC) cashed in over AVC lump sums taken. The budget is based upon a rolling average of 5 year income, as actual income receivable is difficult to predict. There was no budget set for AVC income, as it was anticipated that it would all be taken as lump sums.

1.9 Year to date spend v Projected outturn

As requested at Qtr 2, the table includes an additional column to show the year to date expenditure and income as at 31 December 2016.

It should be noted that year to date spend figures for Benefits Payable and Contributions Received reflect only eight months, as payments are made in arrears.

Transfers Out, Lump Sums and Transfers In are ad-hoc in nature and there is therefore little correlation between the year to date figures and the projected outturn.

Employee costs are projected to be on target based on a recharge due from the Council before year end.

Investment Expenses and Investment Income have been extrapolated to year end based on experience to date and all other known factors. The timing of these spending and income streams is variable, therefore the year to date figures do not yet reflect the full nine months.



Meeting(s):	Pension Fund Committee Pension Fund Board	7 March 2017
Report Title:	Annual Audit Plan 2016/17	
Reference Number:	F-018-F	
Author / Job Title:	Executive Manager - Finance	

1.0	Decisions / Action required:
1.1	That the Committee / Board NOTES the contents of the Audit Plan 2016/17 for Shetland Islands Council Pension Fund (Appendix 1) from external auditors, Deloitte LLP.
2.0	High Level Summary:
2.1	The Annual Audit Plan detailed at Appendix 1 provides valuable information on the work that external auditors will undertake to review and assess the governance and performance of the Pension Fund in 2016/17.
2.2	Appendix 2 is a 'Briefing on audit matters' provided by Deloitte LLP as a guide for those charged with governance on the audit services carried out each year.
3.0	Corporate Priorities and Joint Working:
3.1	The audit process plays a key role in helping the Pension Fund to maintain good governance, accountability and provides assurance around financial stewardship.
3.2	The key aim for the Pension Fund is to achieve a 100% funding position to ensure that the scheme remains affordable and sustainable in the future.
4.0	Key Issues:
4.1	<p>The Annual Audit Plan presents the planned audit work for the 2016/17 financial year by the Pension Fund's new external auditors, Deloitte LLP. The core audit work includes:</p> <ul style="list-style-type: none"> • providing the Independent Auditor's Report on the annual accounts; • providing the annual report on the audit addressed to the Audit Committee; • communicating audit plans to the Audit Committee; • providing reports to management, as appropriate, in respect of the auditor's corporate governance responsibilities in the Code; • preparing and submitting fraud returns to Audit Scotland, where appropriate; • identifying significant matters arising from the audit, alert the Controller of Audit and support Audit Scotland in producing statutory reports as required; • undertaking work requested by Audit Scotland or local performance audit work.
5.0	Exempt and/or confidential information:
5.1	None.
6.0	Implications :

6.1 Service Users, Patients and Communities:	None.	
6.2 Human Resources and Organisational Development:	None.	
6.3 Equality, Diversity and Human Rights:	None.	
6.4 Legal:	The Shetland Islands Council Pension Fund is required to prepare accounts in accordance with the Local Government (Scotland) Act 1973 and the Code of Practice on Local Authority Accounting 2016/17.	
6.5 Finance:	The audit fee for 2016/17 is £30,238.	
6.6 Assets and Property:	None.	
6.7 ICT and new technologies:	None.	
6.8 Environmental:	None.	
6.9 Risk Management:	The annual audit work is focused on identifying and assessing the key challenges and risks to the Pension Fund in order to mitigate future risk.	
6.10 Policy and Delegated Authority:	The Pension Fund Committee has responsibility for governance arrangements including regulatory compliance and implementation of audit recommendations in respect of the Pension Fund.	
6.11 Previously considered by:	n/a	n/a

Contact Details:

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7 March 2017

Appendices:

Appendix 1 – Shetland Islands Council Pension Fund Annual Audit Plan for 2016/17

Appendix 2 – Briefing on audit matters, Deloitte LLP



Shetland Islands Council Pension Fund

Planning report to the Audit Committee
on the 2016/17 audit

9 February 2017

Contents

Our planning report

3	Director introduction
5	Responsibilities of the Audit Committee
6	Our audit explained
7	Scoping
9	Wider Scope Requirements
11	Materiality
12	Significant audit risks and other areas of audit focus
17	Audit quality
18	Purpose of our report and responsibility statement

Appendices

20	Fraud responsibilities and representations
21	Your audit team and timetable
23	Independence and fees

Director introduction

The key messages in this report

Audit quality is our number one priority. We plan our audit to focus on audit quality and have set the following audit quality objectives for this audit:

A robust challenge of the key judgements taken in the preparation of the financial statements.

A strong understanding of your internal control environment.

A well planned and delivered audit that raises findings early with the Audit Committee.

I have pleasure in presenting our planning report to the Audit Committee for the 2016/17 audit of the Shetland Islands Council Pension Fund ("the Pension Fund"). I would like to draw your attention to the key messages of this paper:

Pension Fund changes

Following discussions with the Pension Fund's finance team we have not identified any significant changes to the Pension Fund itself during the year. We will continue to liaise with the finance team to identify any changes between the date of this report and the Pension Fund's year end, and will update our audit plan accordingly should any occur.

The Code of Practice on Local Authority Accounting in the UK ("the 2016/17 Code") has been amended for pension fund audits from financial year 2016/17, and requires additional disclosures to be included in the financial statements. As such we have identified this as an other area of audit focus below, with further details outlined on page 16.

Significant audit risk

We have identified management override of controls as our significant audit risk. Auditing Standards require us to assume that management override of controls is an audit risk for all of our audits.

Further details of this significant risk, including our proposed testing can be found on page 13.

Other areas of audit focus

The following areas of focus have not been identified as significant audit risks but will be considered as part of our audit:

1. Accuracy of contributions payable to the Pension Fund;
2. Valuation of investments; and
3. Compliance of the financial statements with the amendments made by the 2016/17 Code.

Further details of the other areas of audit focus, including our proposed testing are outlined on pages 14 to 16.

Director introduction (continued)

The key messages in this report (continued)

Audit quality is our number one priority. We plan our audit to focus on audit quality and have set the following audit quality objectives for this audit:

A robust challenge of the key judgements taken in the preparation of the financial statements.

A strong understanding of your internal control environment.

A well planned and delivered audit that raises findings early with the Audit Committee.

Audit Dimensions

- The 2016 Code of Audit Practice sets out four audit dimensions which set a common framework for all public sector audits in Scotland. Our audit work will consider how the Pension Fund is addressing these and we will report our conclusions in our annual report to the Audit Committee in September 2017. In particular, our work will focus on:
 - **Financial sustainability** – we will monitor the Pension Fund’s actions in respect of its short, medium and longer term financial plan to assess whether short term financial balance can be achieved, whether there is a long-term financial strategy and if the investment strategy is effective.
 - **Financial management** – we will review the budget and monitoring reports of the Pension Fund during the year to assess whether financial management and budget setting is effective.
 - **Governance and transparency** – from our review of the Pension Fund’s papers and attendance at Audit Committee meetings we will assess the effectiveness and scrutiny of governance arrangements. We will also share best practice examples, where it is deemed appropriate.
 - **Value for money** – we will gain an understanding of the Pension Fund’s self-evaluation arrangements to assess how it demonstrated value for money in the use of resources and the linkage between money spent and outputs and outcomes delivered.

Pat Kenny
Audit Director

Responsibilities of the Audit Committee

Helping you fulfil your responsibilities

The primary purpose of the Auditor's interaction with the Audit Committee is set out as follows:

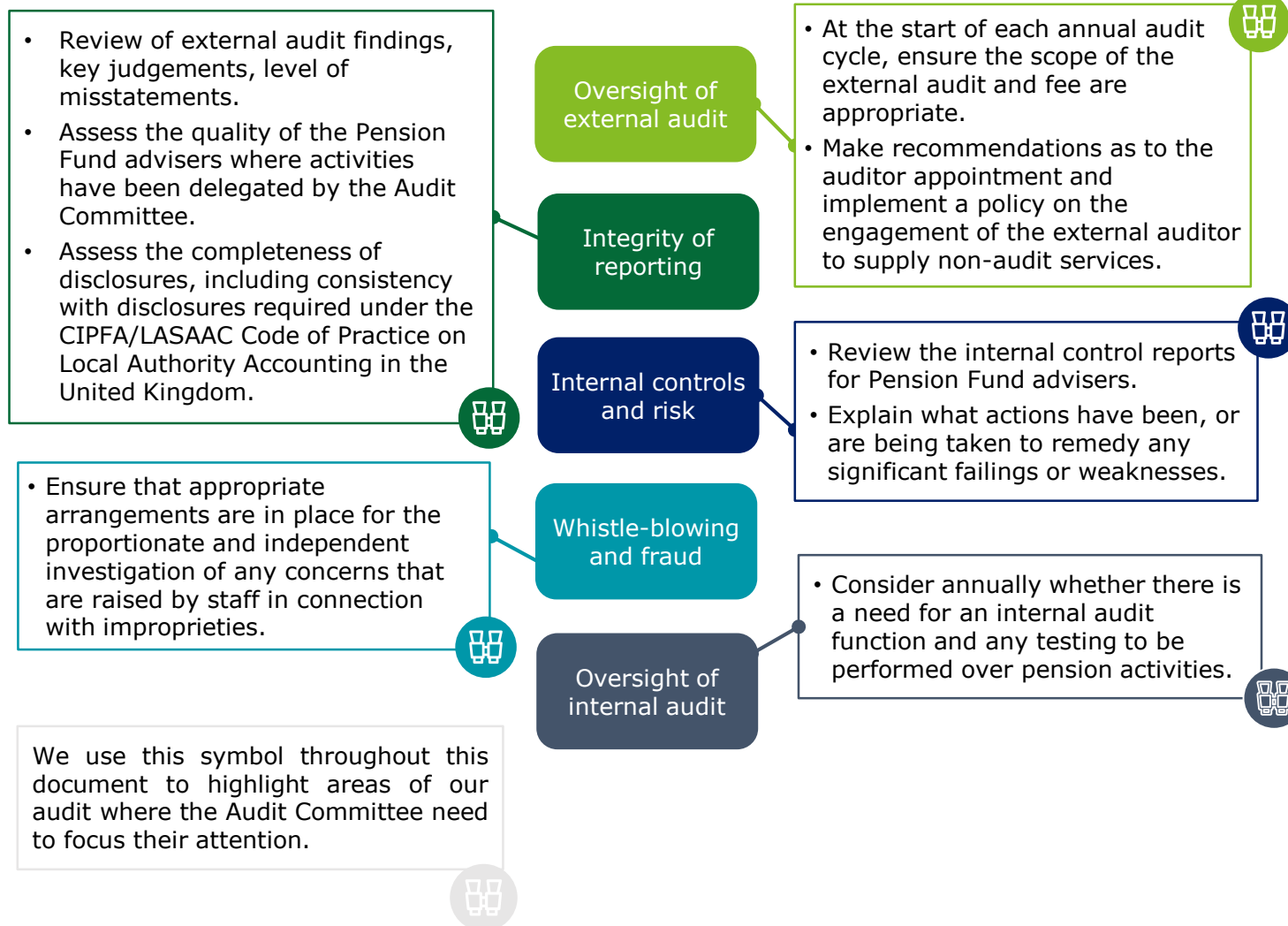
Clearly communicate the planned scope of the financial statements audit.

Provide timely observations arising from the audit that are significant and relevant to your responsibility to oversee the financial reporting process.

In addition, we seek to provide the Audit Committee with additional information to help them fulfil their broader responsibilities.

Provide assurance over the financial statements and compliance with the Pension Fund's Funding Strategy Statement.

As a result of regulatory change in recent years, the role of the Audit Committee has significantly expanded. We set out here a summary of the core areas of responsibility to provide a reference in respect of these broader responsibilities and highlight throughout the document where there is key information which helps the Audit Committee in fulfilling its remit.



Our audit explained

We tailor our audit to your business and your strategy

Identify changes in your business environment

We have not identified any significant changes to the Pension Fund during the year. The Code of Practice on Local Authority Accounting in the UK has been amended for pension fund audits from financial year 2016/17, and requires additional disclosures to be included in the financial statements.

Scoping

We have performed our initial scoping based on current requirements and Audit Scotland planning guidance. More details are given on pages 7 to 8. We will use specialists in the delivery of our work to support the audit team. A financial instrument specialist will be used to assist with the fair value of investment assets held by the Pension Fund.

In our final report

In our final report to you we will conclude on the significant audit risk and other areas of audit focus identified in this report, including how we have assessed them together with any misstatements or control observations identified.



Determine materiality

Financial statement materiality is based on 1% of net assets. Further information around our materiality calculation can be found on page 11.

Significant risk assessment

We have identified significant audit risk and other areas of audit focus based on our knowledge of the Pension Fund. Each of these is discussed in more detail on pages 12 to 16.

Quality and Independence

We confirm that we are independent of Shetland Islands Council Pension Fund. We take our independence and the quality of the audit work we perform very seriously. Audit quality is our number one priority.

Scoping

Our key areas of responsibility under the Code of Audit Practice



Core audit

Our core audit work as defined by Audit Scotland comprises:

- providing the **Independent Auditor's Report** on the annual accounts;
- providing the **annual report** on the audit addressed to the Pension Fund Audit Committee;
- communicating **audit plans** to the Audit Committee;
- providing **reports to management**, as appropriate, in respect of the auditor's responsibilities in the Code;
- preparing and submitting **fraud returns**, including nil returns, to Audit Scotland where appropriate;
- identifying significant matters arising from the audit, alert the Controller of Audit and support Audit Scotland in producing statutory reports as required; and
- undertaking work requested by Audit Scotland or local performance audit work.

Wider scope requirements

The Code of Audit Practice sets out four audit dimensions which set a common framework for all public sector audits in Scotland:

- **Financial sustainability** – looking forward to the medium and longer term to consider whether the body is planning effectively to continue to deliver its services or the way in which they should be delivered.
- **Financial management** – financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.
- **Governance and transparency** – the effectiveness of scrutiny and governance arrangements, leadership and decision making, and transparent reporting of financial and performance information.
- **Value for money** – using resources effectively and continually improving services.

Scoping (continued)

Our approach



Liaison with internal audit

The Auditing Standards Board's version of ISA (UK and Ireland) 610 "Using the work of internal auditors" prohibits use of internal audit to provide "direct assistance" to the audit. Our approach to the use of the work of Internal Audit has been designed to be compatible with these requirements.

We will review reports prepared by internal audit and meet with them to discuss their work. We will also discuss the work where they have identified specific material deficiencies in the control environment and we will consider adjusting our testing so that the audit risk is covered by our work.

Using these discussions to inform our risk assessment, we will work together with internal audit to develop an approach that avoids inefficiencies and overlaps, therefore avoiding any unnecessary duplication of audit requirements on the Council's staff.

Approach to controls testing

As set out in the "Briefing on Audit Matters" circulated separately to this document, our risk assessment procedures will include obtaining an understanding of controls considered to be 'relevant to the audit'. This involves evaluating the design of the controls and determining whether they have been implemented ("D & I").

We will consider the results of our procedures in respect of the Pension Fund's controls and the extent of any impact our findings have on our substantive audit procedures.

Obtain an understanding of the Pension Fund and its environment including the identification of relevant controls.

Identify risks and controls that address those risks.

Carry out "design and implementation" work on relevant controls.

If considered necessary, test the operating effectiveness of selected controls

Design and perform a combination of substantive analytical procedures and tests of details that are most responsive to the assessed risks.

Wider scope requirements

Audit dimensions

The Code of Audit Practice sets out four audit dimensions which set a common framework for all public sector audits in Scotland. We will consider how the Pension Fund addresses these areas, including any risks to their achievement, as part of our audit work as follows:

Audit dimension	Areas to be considered	Impact on the 2017 Audit
Financial sustainability looks forward to the medium and longer term to consider whether the Pension Fund is planning effectively to continue to deliver its services or the way in which they should be delivered.	<ul style="list-style-type: none">• The financial planning systems in place across the shorter and longer terms.• The arrangements to address any identified funding gaps.• The affordability and effectiveness of funding and investment decisions made.	<p>We will review the arrangements and financial planning systems in place by the Pension Fund to ensure that its services can continue to be delivered. This will include a review of the latest actuarial valuation of the Pension Fund and the plans in place to reduce the deficit over the shorter and medium term. In addition we will review the funding policy as set out in the Shetland Islands Council Pension Fund Investment Strategy 2014-2027, which aims to ensure the long-term solvency of the Pension Fund, so that there are sufficient funds available to meet all benefits as they fall due.</p>
Financial management is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.	<ul style="list-style-type: none">• Systems of internal control.• Budgetary control system.• Financial capacity and skills.• Arrangements for the prevention and detection of fraud.	<p>We will review the budget and monitoring reporting by the Pension Fund during the year to assess whether financial management and budget setting is effective.</p> <p>In addition we will also ensure that there is a proper officer and fund manager who have sufficient status to be able to deliver good financial management, that monitoring reports contain information linked to performance as well as financial data, and that members have the opportunity to provide a sufficient level of challenge around variances and under-performance.</p> <p>Our fraud responsibilities and representations are detailed on page 20.</p>

Wider scope requirements (continued)

Audit dimensions (continued)

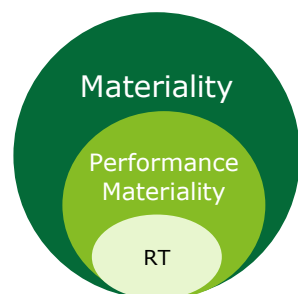
Audit dimension	Areas to be considered	Impact on the 2017 Audit
<p>Governance and transparency is concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision making, and transparent reporting of financial and performance information.</p>	<ul style="list-style-type: none"> • Governance arrangements. • Scrutiny, challenge and transparency on decision making and financial and performance reports. • Quality and timeliness of financial and performance reporting. 	<p>We will review the Pension Fund's papers and use our attendance at Audit Committee meetings to assess the effectiveness and scrutiny of governance arrangements.</p> <p>We will also review other aspects of governance around the Pension Fund including Codes of Conduct for officers and members, fraud and corruption arrangements, and arrangements for reporting regulatory breaches to the Pensions Regulator.</p> <p>In addition we will review the Annual Governance Statement and Governance Compliance Statement to confirm the governance arrangements observe the guidance issued by Scottish Ministers.</p>
<p>Value for money is concerned with using resources effectively and continually improving services.</p>	<ul style="list-style-type: none"> • Value for money in the use of resources. • Link between money spent and outputs and the outcomes delivered. • Improvement of outcomes. • Focus on and pace of improvement. 	<p>We will gain an understanding of the Pension Fund's self-evaluation arrangements to assess how it demonstrates value for money in the use of resources and the linkage between money spent and outputs and outcomes delivered.</p> <p>We will also the scrutiny that is in place to challenge the Pension Fund's investment managers on fees and performance.</p>

Materiality

Approach to materiality



Basis of materiality - benchmark



We set materiality for our opinion on the financial statements at 1% of net assets of the Pension Fund and performance materiality at 90% of materiality based on professional judgement, the requirements of auditing standards and the financial measures most relevant to users of the financial statements.

Using the 2015-16 Pension Fund Annual Report and Accounts, we estimate materiality to be £3.8m and performance materiality to be £3.4m.

We will update our materiality assessment following receipt of the draft 2016-17 financial statements and will communicate this to the Audit Committee in our final report.

The concept of materiality and its application to the audit approach are set out in our 'Briefing on audit matters' document which has been circulated separately to this report.

Reporting to the Audit Committee

We report to the Audit Committee any unadjusted misstatements greater than 5% of materiality ("reporting threshold") and other adjustments we consider to be qualitatively material. Based on the 2015-16 Annual Report and Accounts, we estimate the reporting threshold ("RT") to be £188k.

We will report to you misstatements below this threshold if we consider them to be material in nature.

Our audit report













The extent of our procedures is not based on materiality alone but also on the quality of systems and controls in preventing material misstatement in the financial statements, and the level at which known and likely misstatements are tolerated by you in the preparation of the financial statements.










Although materiality is the judgement of the audit director, the Audit Committee must satisfy themselves that the level of materiality chosen is appropriate for the scope of the audit.

Significant audit risks and other areas of audit focus

Risk dashboard

Significant risk area	Risk Level	Fraud Risk	Approach to Controls Testing	Level of Judgement
Management override of controls			D&I	
Other area of audit focus	Risk Level	Fraud Risk	Approach to Controls Testing	Level of Judgement
Accuracy of contributions			D&I	
Valuation of investments			D&I	
Compliance of the financial statements with the amendments made by the 2016/17 Code			D&I	

	Low levels of management judgement/involvement		Not a Fraud Risk		Significant Audit Risk
	Medium levels of management judgement/involvement		Fraud Risk		Other Area of Focus
	High degree of management judgement/involvement	D & I	Design and Implementation		

Significant audit risk

Management override of controls

Description

In accordance with ISA 240 (UK and Ireland), management override of controls is always a significant risk for financial statement audits. The primary risk areas surrounding the management override of internal controls are over the processing of journal entries and the key assumptions and estimates made by management.

Deloitte Response

In order to address this significant audit risk, we will perform the following audit procedures:

- Make enquiries of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments;
 - Perform testing on the design and implementation of controls surrounding the financial reporting process and the controls over journal entries and other adjustments posted in the preparation of the financial statements;
 - Test the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements. As part of our work in this area, we will perform an analysis of journal entries which will enable us to focus on journals meeting specific pre-determined parameters determined during our audit planning;
 - Review the financial statements for any accounting estimates which could contain management bias, and assess the judgements taken against supporting evidence;
 - Ensure that there is an appropriate level of segregation of duties over processing journal entries to the financial statements throughout the year;
 - Obtain an understanding of the rationale of any significant transactions that we become aware of that are outside the normal course of the Pension Fund's operations or that otherwise appear to be unusual given our understanding of the Pension Fund and its environment; and
 - Make enquiries of management in relation to the identification of related party transactions.
-

Other areas of audit focus

Accuracy of contributions

Description

The correct deduction of contributions depends on systems-based processing of membership data and salary details, together with a robust internal control framework. Errors in processing contributions can lead to issues such as non-compliance with the Funding Strategy Statement and deducting incorrect amounts from active members' payroll which can be costly to rectify and cause reputational damage.

Deloitte

Response

In order to address this area of audit focus we will perform the following audit procedures:

- Review the design and implementation of key controls over the contribution process;
 - Perform an analytical review of the employer and employee normal contributions received in the year, basing our expectation on the prior year audited balance, adjusted for the movement in active member numbers, contribution rate changes and any average pay rise awarded in the year;
 - For a sample of active members, we will recalculate individual contribution deductions to ensure that these are being calculated in accordance with the rates stipulated in the Local Government Pension Scheme (Benefits, Membership and Contributions) (Scotland) Regulations 2014 ("LGPS Regulations") for employee contributions and in the Funding Strategy Statement for employer contributions;
 - Test that the correct definition of pensionable salary is being used per the LGPS Regulations to calculate contribution deductions; and
 - Test the reconciliation of the total number of active members between the membership records and the employer payroll records.
-

Other areas of audit focus (continued)

Valuation of investments

Description

There is a risk that investments are not valued accurately in the Pension Fund's financial statements due to the levels of judgement involved in pricing such investments.

The Pension Fund holds investments primarily in pooled funds, pooled property unit trusts and fixed income unit trusts with a range of investment managers.

Deloitte

Response

In order to address this area of audit focus, we will perform the following audit procedures:

- Review the design and implementation of key controls over the valuation of these investments by obtaining investment manager internal control reports and evaluating the implications for our audit of any exceptions noted;
 - Agree year end valuations, sales proceeds and purchases in the financial statements to the reports received directly from the investment managers;
 - Perform valuation testing by using a range of techniques depending on the type of investment. Where the investment held is directly quoted on an exchange, we will obtain an independent price of the investment asset using our own internal pricing systems e.g. Bloomberg. Where the investment is not directly quoted on an exchange we will confirm if it is registered on the Financial Conduct Authority website and obtain an independent price, or use sales transactions close to year end as an estimate of the price. Where none of these options are available we will obtain audited financial statements and roll forward the audited value to the year end using benchmark data and Pension Fund transactions where the audited accounts are not coterminous with the Pension Fund's year end; and
 - Engage our financial instrument specialists to review the audit work performed in relation to these assets.
-

Other areas of audit focus (continued)

Compliance of the financial statements with the amendments made by the 2016/17 Code

Description

There is a risk that the Pension Fund's financial statements are not in compliance with the amendments made by the 2016/17 Code of Practice on Local Authority Accounting in the UK. These changes include:

- Amendments to the format of the accounts to be consistent with the new Financial Reports of Pension Schemes – A Statement of Recommended Practice 2015;
- Additional disclosure requirements for investments measured at fair value e.g. fair value hierarchy;
- Disclosure requirements in respect of investment management expenses; and
- An annex that provides an overview of how the other sections of the Code apply to pension funds.

Deloitte Response

In order to address this area of audit focus, we will perform the following audit procedures:

- Assess the design and implementation of key controls over the financial reporting process and, in particular, in relation to the implementation of the provisions of the revised Code;
 - Agree the classification of the investment assets within the fair value hierarchy to independently received investment manager reports and the reconciliation of those reports as prepared by the finance team;
 - Confirm that the recommended disclosures in respect of investment management expenses comply with the requirements of the Code; and
 - Obtain a copy of the annex to confirm that the other sections of the Code have been considered where they apply to the Pension Fund.
-

Audit quality

Our commitment to audit quality

Our objective is to deliver a distinctive, quality audit to you. Every member of the engagement team will contribute, to achieve the highest standard of professional excellence.

In particular, for your audit, we consider that the following steps will contribute to the overall quality:

- We will apply professional scepticism on the material issues and significant judgements identified, by using our expertise in the local government sector and elsewhere to provide robust challenge to management;
- We will obtain a deep understanding of your Pension Fund, its environment and of your processes in key areas – such as contributions, benefits and investments - enabling us to develop a risk-focused approach tailored to the Pension Fund;
- Our engagement team is selected to ensure that we have the right subject matter expertise and industry knowledge. The audit team for the Pension Fund will be made up of pensions specialist from our Pensions Audit Centre of Excellence, incorporating managers who have in depth experience of Local Government Pension Schemes, leading to high quality understanding and challenge; and
- In order to deliver a quality audit to you, each member of the core audit team has received tailored training to develop their expertise in audit skills which includes Local Government and Pensions Engagement Team Based Learning. This is a director led programme encouraging teams from across our practice to engage and discuss current sector and audit issues, sharing best practice and expertise.

Engagement Quality Control Review

We have developed a tailored Engagement Quality Control approach. Our dedicated Professional Standards Review (PSR) function will provide a 'hot' review before any audit or other opinion is signed. PSR is operationally independent of the audit team, and supports our high standards of professional scepticism and audit quality by providing a rigorous independent challenge.

Purpose of our report and responsibility statement

Our report is designed to help you meet your governance duties

What we report

Our report is designed to help the Audit Committee discharge its governance duties. It also represents one way in which we fulfil our obligations under ISA 260 to communicate with you regarding your oversight of the financial reporting process and your governance requirements. Our report includes our audit plan, key audit judgements and the planned scope of our work.

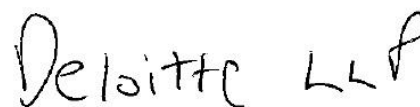
What we don't report

- As you will be aware, our audit is not designed to identify all matters that may be relevant to the Audit Committee.
- Also, there will be further information you need to discharge your governance responsibilities, such as matters reported on by management or by other specialist advisers.
- Finally, the views on internal controls and business risk assessment in our final report should not be taken as comprehensive or as an opinion on effectiveness since they will be based solely on the audit procedures performed in the audit of the financial statements and the other procedures performed in fulfilling our audit plan.

Other relevant communications

- This report should be read alongside the supplementary "Briefing on audit matters" circulated separately on 30 January 2017.
- We will update you if there are any significant changes to the audit plan.

We welcome the opportunity to discuss our report with you and receive your feedback.



Deloitte LLP

Chartered Accountants

Glasgow

30 January 2017

This report has been prepared for the Audit Committee, as a body, and we therefore accept responsibility to you alone for its contents. We accept no duty, responsibility or liability to any other parties, since this report has not been prepared, and is not intended, for any other purpose.

Appendices

Fraud responsibilities and representations

Our responsibilities explained



Your Responsibilities

The primary responsibility for the prevention and detection of fraud rests with management and the Audit Committee, and includes establishing and maintaining internal controls over the reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations.

Our Responsibilities

We are required to obtain representations from the Audit Committee regarding internal controls, assessment of risk and any known or suspected fraud or misstatement. As the Pension Fund's auditor, we obtain reasonable, but not absolute, assurance that the financial statements as a whole are free from material misstatement, whether caused by fraud or error. As set out in the significant risk section of this document, we have identified management override of controls as a significant audit risk for your Pension Fund.

Fraud Characteristics

Misstatements in the financial statements can arise from either fraud or error. The distinguishing factor between fraud and error is whether the underlying action that results in the misstatement of the financial statements is intentional or unintentional. Two types of intentional misstatements are relevant to us as auditor – misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets.

We will request the following to be stated in the representation letter signed on behalf of the Audit Committee:

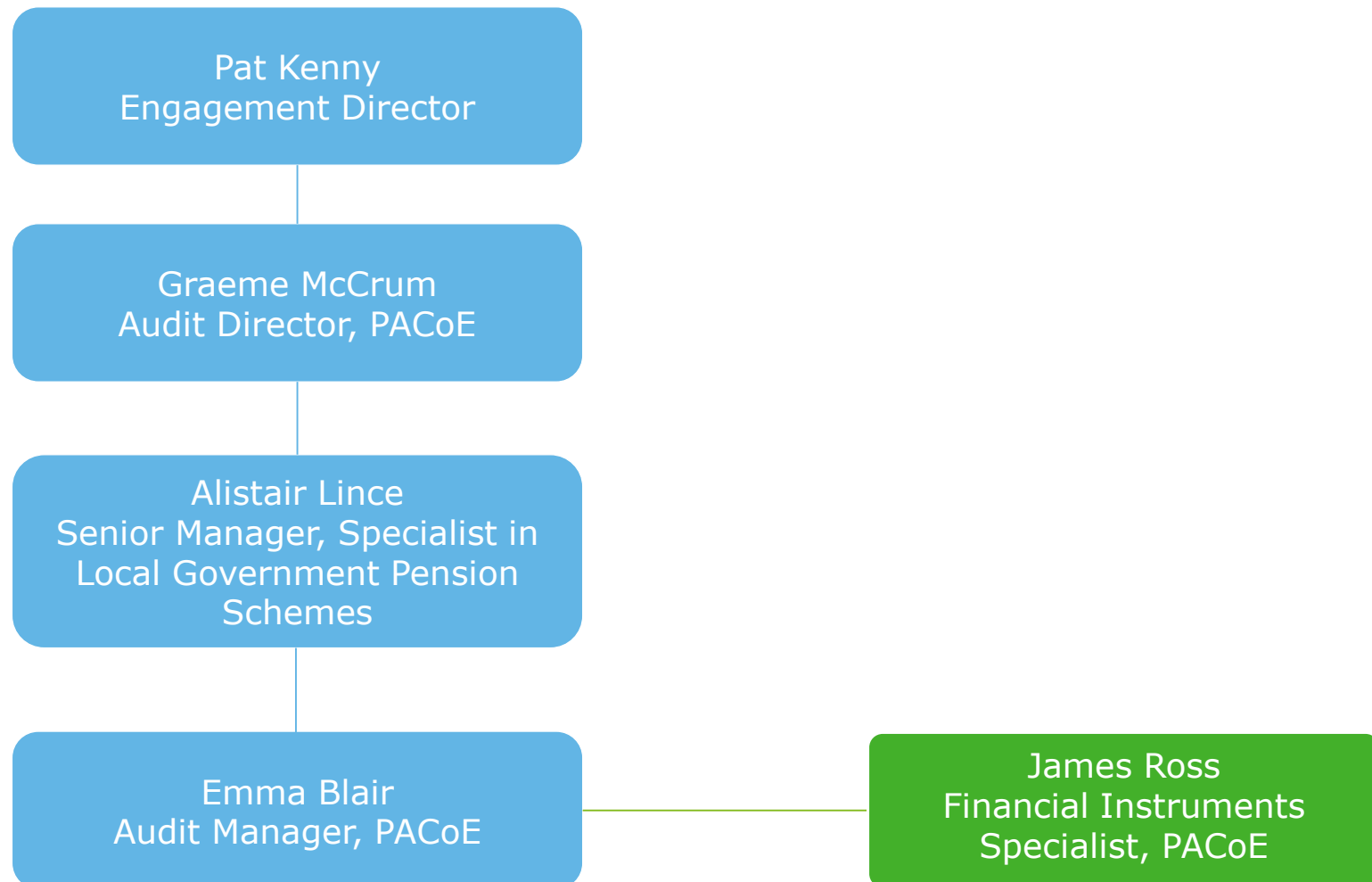
- We acknowledge our responsibilities for the design, implementation and maintenance of internal controls to prevent and detect fraud and error.
 - We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.
 - We are not aware of any fraud or suspected fraud / We have disclosed to you all information in relation to fraud or suspected fraud that we are aware of and that affects the Pension Fund and involves:
 - (i) management;
 - (ii) employees who have significant roles in internal control; or
 - (iii) others where the fraud could have a material effect on the financial statements.
 - We have disclosed to you all information in relation to allegations of fraud, or suspected fraud, affecting the Pension Fund's financial statements communicated by employees, former employees, analysts, regulators or others.
-

Your audit team and timetable

We have a highly experienced audit team

Your audit team

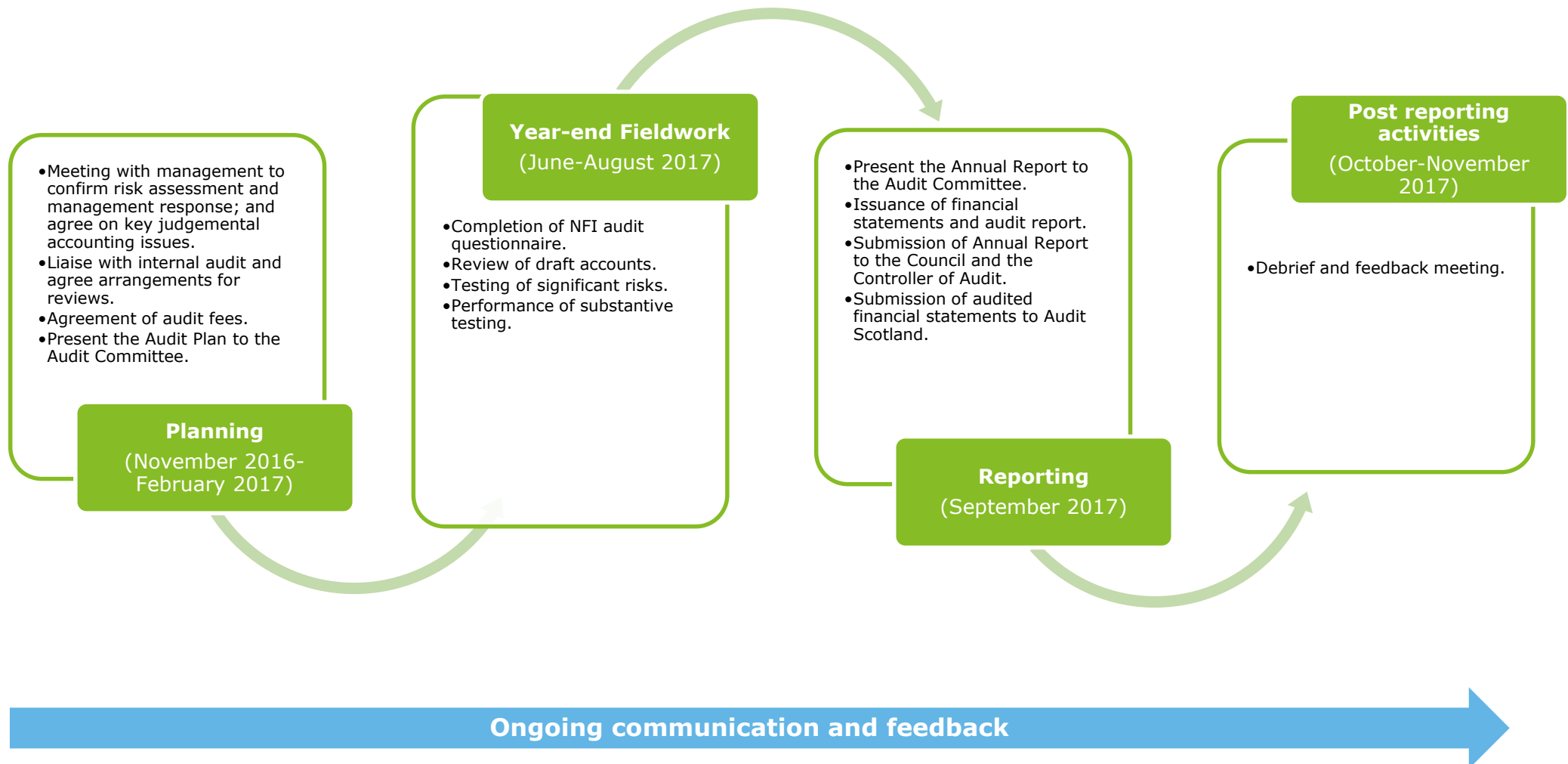
We set out below our audit engagement team, which includes pensions specialists from our Pensions Audit Centre of Excellence ("PACoE").



Your audit team and timetable (continued)

Audit Timetable

Set out below is the approximate expected timing of our reporting and communication with Shetland Islands Council Pension Fund and Audit Scotland.



Independence and fees



As part of our obligations under International Standards on Auditing (UK and Ireland), we are required to report to you on the matters listed below:

Independence confirmation

We confirm we are independent of the Shetland Islands Council Pension Fund and will reconfirm our independence and objectivity to the Audit Committee for the year ending 31 March 2017 in our final report to the Audit Committee.

Fees

The total audit fee for 2016/17, in line with the fee range provided by Audit Scotland in its letter of 12 December 2016, is £30,238, as analysed below. As agreed with management, we have applied a 10% increase to the auditor remuneration in 2016/17 to reflect the higher input required in year 1 of our appointment, which will be offset by reduced fees in future years on a like for like basis, as illustrated below. The average fee is a 14% reduction on the 2015/16 fee.

		For Illustrative purposes				
	+10%	+5%	-	-5%	-10%	
	2016/17	2018/19	2019/20	2020/21	2021/22	Average
Auditor remuneration	26,678	25,494	24,280	23,066	21,852	24,280
Audit Scotland fixed charges:						
Pooled costs	2,110	2,110	2,110	2,110	2,110	2,110
Audit support costs	1,450	1,450	1,450	1,450	1,450	1,450
Total Fee	30,238	29,054	27,840	26,626	25,412	27,840

Details of all non-audit services fees for the period will be presented in our final report.

Non-audit services

In our opinion there are no inconsistencies between APB Ethical Standards for Auditors and the company's policy for the supply of non-audit services or any apparent breach of that policy. We continue to review our independence and ensure that appropriate safeguards are in place including, but not limited to, the rotation of senior partners and professional staff and the involvement of additional partners and professional staff to carry out reviews of the work performed and to otherwise advise as necessary.

Other than as stated below, this document is confidential and prepared solely for your information and that of other beneficiaries of our advice listed in our engagement letter. Therefore you should not, refer to or use our name or this document for any other purpose, disclose them or refer to them in any prospectus or other document, or make them available or communicate them to any other party. If this document contains details of an arrangement that could result in a tax or National Insurance saving, no such conditions of confidentiality apply to the details of that arrangement (for example, for the purpose of discussion with tax authorities). In any event, no other party is entitled to rely on our document for any purpose whatsoever and thus we accept no liability to any other party who is shown or gains access to this document.

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Briefing on audit matters

Published for those charged with governance



This document is intended to assist those charged with governance to understand the major aspects of our audit approach, including explaining the key concepts behind the Deloitte Audit methodology including audit objectives and materiality.

Further, it describes the safeguards developed by Deloitte to counter threats to our independence and objectivity.

This document will only be reissued if significant changes to any of those matters highlighted above occur.

We will usually communicate our audit planning information and the findings from the audit separately. Where we issue separate reports these should be read in conjunction with this "Briefing on audit matters".

Approach and scope of the audit

Primary audit objectives

We conduct our audit in accordance with International Standards on Auditing (UK and Ireland) as adopted by the UK Financial Reporting Council (FRC). Our statutory audit objectives are:

- to express an opinion in true and fair view terms to the members on the financial statements;
- to express an opinion as to whether the accounts have been properly prepared in accordance with the IFRSs as adopted by the European Union, as interpreted and adapted by the Code of Practice on Local Authority Accounting in the United Kingdom;
- to express an opinion as to whether the accounts have been prepared in accordance with the requirements of the Local Government (Scotland) Act 1973, The Local Authority Accounts (Scotland) Regulations 2014, and the Local Government in Scotland Act 2003;
- for certain disclosures in the Remuneration Report, to form an opinion as to whether they are made in accordance with The Local Authority Accounts (Scotland) Regulations 2014; and
- to express an opinion as to whether the management commentary is consistent with the financial statements.

Other reporting objectives

Our reporting objectives are to:

- present significant reporting findings to those charged with governance. This will highlight key judgements, important accounting policies and estimates and the application of new reporting requirements, as well as significant control observations; and
- provide timely and constructive recommendations to management. This will include key business process improvements and significant controls weaknesses identified during our audit.

Materiality

The concept of materiality is fundamental to the preparation of the financial statements and the audit process and applies not only to monetary misstatements but also to disclosure requirements and adherence to appropriate accounting principles and statutory requirements.

"Materiality" is defined in the International Accounting Standards Board's "Conceptual Framework for Financial Reporting" in the following terms:

"Information is material if omitting it or misstating it could influence decisions that users make on the basis of financial information about a specific reporting entity. In other words, materiality is an entity-specific aspect of relevance based on the nature or magnitude, or both, of the items to which the information relates in the context of an individual entity's financial report."

We determine materiality based on professional judgment in the context of our knowledge of the audited entity, including consideration of factors such as shareholder expectations, industry developments, financial stability and reporting requirements for the financial statements.

We determine materiality to:

- determine the nature, timing and extent of audit procedures; and
- evaluate the effect of misstatements.

The extent of our procedures is not based on materiality alone but also the quality of systems and controls in preventing material misstatement in the financial statements, and the level at which known and likely misstatements are tolerated by you in the preparation of the financial statements.

Uncorrected misstatements

In accordance with International Standards on Auditing (UK and Ireland) (ISAs (UK and Ireland)) we will communicate to you all uncorrected misstatements (including disclosure deficiencies) identified during our audit, other than those which we believe are clearly trivial.

ISAs (UK and Ireland) do not place numeric limits on the meaning of 'clearly trivial'. The Audit Engagement Partner, management and those charged with governance will agree an appropriate limit for 'clearly trivial'. In our report we will report all individual identified uncorrected misstatements in excess of this limit.

We will consider identified misstatements in qualitative as well as quantitative terms.

Audit methodology

Our audit methodology takes into account the changing requirements of auditing standards and adopts a risk based approach. We utilise technology in an efficient way to provide maximum value to members and create value for management and the Council whilst minimising a “box ticking” approach.

Our audit methodology is designed to give members the confidence that they deserve.

For controls considered to be ‘relevant to the audit’ we evaluate the design of the controls and determine whether they have been implemented. The controls that are determined to be relevant to the audit will include those:

- where we plan to obtain assurance through the testing of operating effectiveness;
- relating to identified risks (including the risk of fraud in revenue recognition, unless rebutted and the risk of management override of controls);
- where we consider we are unable to obtain sufficient audit assurance through substantive procedures alone; and
- to enable us to identify and assess the risks of material misstatement of the financial statements and design and perform further audit procedures.

Other requirements of International Standards on Auditing (UK and Ireland)

ISAs (UK and Ireland) require we communicate the following additional matters:

ISA (UK and Ireland)	Matter
ISQC 1	Quality control for firms that perform audits and review of financial statements, and other assurance and related services engagements
240	The auditor’s responsibilities to consider fraud in an audit of financial statements
250	Consideration of laws and regulations in an audit of financial statements
265	Communicating deficiencies in internal control to those charged with governance and management
450	Evaluation of misstatements identified during the audit
505	External confirmations
510	Initial audit engagements – opening balances
550	Related parties
560	Subsequent events
570	Going concern
600	Special considerations – audits of group financial statements (including the work of component auditors)
705	Modifications to the opinion in the independent auditor’s report
706	Emphasis of matter paragraphs and other matter paragraphs in the independent auditor’s report
710	Comparative information – corresponding figures and comparative financial statements
720	Section A: The auditor’s responsibilities related to other information in documents containing audited financial statements

Independence policies and procedures

Important safeguards and procedures have been developed by Deloitte to counter threats or perceived threats to our objectivity, which include the items set out below.

Safeguards and procedures

- Every opinion (not just statutory audit opinions) issued by Deloitte is subject to an engagement quality control review by an independent member of our Professional Standards Review team.
- Where appropriate, review and challenge takes place of key decisions by the Engagement Quality Control Review Partner and ensures the objectivity of our judgement is maintained.
- We report annually to those charged with governance our assessment of objectivity and independence. This report includes a summary of non-audit services provided together with fees receivable.
- There is formal consideration and review of the appropriateness of continuing the audit engagement before accepting reappointment.
- Periodic rotation takes place of the audit engagement partner, the Engagement Quality Control Review Partner and other key partners involved in the audit in accordance with our policies and professional and regulatory requirements.
- In accordance with the Ethical Standards issued by the Auditing Practices Board (APB), there is an assessment of the level of threat to objectivity and potential safeguards to combat these threats prior to acceptance of any non-audit engagement. This includes particular focus on threats arising from self-interest, self-review, management, advocacy, over-familiarity and intimidation.
- In the UK, statutory oversight and regulation of auditors is carried out by the FRC. The Firm's policies and procedures are subject to external monitoring by both the Audit Quality Review Team (AQRT), which is part of the FRC's Conduct Division, and the ICAEW's Quality Assurance Department (QAD). The AQRT is charged with monitoring the quality of audits of economically significant entities and the QAD with monitoring statutory compliance of audits for all other entities. Both report to the ICAEW's Audit Registration Committee.

Independence policies

Our detailed ethical standards and independence policies are issued to all partners and employees who are required to confirm their compliance annually. We are also required to comply with the policies of other relevant professional and regulatory bodies.

Amongst other things, these policies:

- state that no Deloitte partner (or any closely-related person) is allowed to hold a financial interest in any of our UK audited entities;
- require that professional staff may not work on assignments if they (or any closely-related person) have a financial interest in the audited entity or a party to the transaction or if they have a beneficial interest in a trust holding a financial position in the audited entity;
- state that no person in a position to influence the conduct and outcome of the audit (or any closely related persons) should enter into business relationships with UK audited entities or their affiliates;
- prohibit any professional employee from obtaining gifts from audited entities unless the value is clearly insignificant; and
- provide safeguards against potential conflicts of interest.

Remuneration and evaluation policies

Partners are evaluated on roles and responsibilities they take within the firm including their technical ability and their ability to manage risk.

APB Ethical Standards

The APB issued five ethical standards for auditors that apply a 'threats' and 'safeguards' approach.

The five standards cover:

- maintaining integrity, objectivity and independence;
- financial, business, employment and personal relationships between auditors and their audited entities;
- long association of audit partners and other audit team members with audit engagements;
- audit fees, remuneration and evaluation of the audit team, litigation between auditors and their audited entities, and gifts and hospitality received from audited entities; and
- non-audit services provided to audited entities.

Our policies and procedures comply with these standards.



Meeting(s):	Pension Committee Pension Board	7 March 2017
Report Title:	Pension Fund – Administering Authority Discretions	
Reference Number:	F-038-F	
Author / Job Title:	Jonathan Belford Executive Manager - Finance	

1.0 Decisions / Action required:

1.1 That Pension Fund Committee and Pension Board RESOLVE to:

- Approve the administering authority discretions as detailed in Appendix 1 of this report.

2.0 High Level Summary:

- 2.1 The purpose of this report is to seek approval from the Pension Fund Committee for the discretionary administering authority provisions contained within the Local Government Pension Scheme (Scotland) Regulations 2014 and the Local Government Pension Scheme (Transitional Provisions and Savings) (Scotland) Regulations 2014.
- 2.2 Also to approve revisions to earlier administering authority provisions contained within the Local Government Pension Scheme (Scotland) Regulations 2008 (i.e. the Benefit Regs and the Administration Regs), the Local Government Pension Scheme (Transitional Provisions) (Scotland) Regulations 2008 and the Local Government Pension Scheme (Scotland) Regulations 1998 (as amended).
- 2.3 Discretionary provisions fall into two distinct categories, being as follows:
- **Administering Authority** – The policies apply to all employing authorities participating in the Shetland Islands Council Pension Fund.
 - **Employing Authority** – Employers participating in the Shetland Islands Council Pension Fund are required to formulate and publish specific policies best suited to their own organisational requirements.
- 2.4 This report is only considering the administering authority discretions with a future report being prepared and presented to the Council in respect of the employing authority discretions.
- 2.5 Shetland Islands Council is both an employing authority and the administering authority for the Shetland Islands Council Pension Fund.

2.6	The revised Policy will replace the administering authority discretionary provisions that have been in place since December 2010.
3.0	Corporate Priorities and Joint Working:
3.1	The administering authority discretions are an integral part of effectively managing and administering the Pension Fund on behalf of its members, at the same time as ensuring the Pension Fund remains affordable and sustainable into the future.
4.0	Key Issues:
4.1	The Pension Fund Committee is responsible for approving the pension administering authority discretionary provisions.
4.2	The Policy will apply to all employees, including admitted body employees, who are members of the Fund.
4.3	The majority of administering authority discretions available under the 2014 Regulations remain the same as were available under the 2008 Regulations.
4.3	<p>The most significant change to the revised administering authority discretions are:</p> <ul style="list-style-type: none"> • That under the 2014 LGPS Regulations the “Rule of 85” no longer automatically applies. This means that that when giving consent to a request for voluntary early retirement between age 55 – 59, where the employee meets the “Rule of 85” (i.e. the sum of their age and scheme membership equals at least 85, at date of retirement), the employer does not necessarily need to pay the strain costs (i.e. the cost to the Pension Fund) in full. The only exception is where an employer grants flexible retirement for staff over age 55 and under 60 and these staff are subject to the “Rule of 85”. More information on this change is detailed in Appendix 2. • The above change gives employers greater flexibility in dealing with requests for retirement for staff under the age of 60. • To introduce a £250 fee for Pension Sharing on Divorce cases.
5.0	Exempt and/or confidential information:
5.1	None.

6.0	Implications :
6.1 Service Users, Patients and Communities:	Effectively managing the discretionary administering authority provisions, safeguards the benefits payable to members of the Pension Fund through sound governance.
6.2	There are no direct Human Resource implications arising from

Human Resources and Organisational Development:	this report however HR advice will be sought when formulating the policy on the employing authority discretions.
6.3 Equality, Diversity and Human Rights:	By applying the discretionary provisions to all employees who are members of the Fund will ensure our members are being treated in a fair, equitable and consistent manner.
6.4 Legal:	There are no direct legal implications arising from this report, however legal advice and legal remedies will be sought and used whenever this is appropriate.
6.5 Finance:	There are no direct financial implications arising from this report. There will however be financial implications for Scheme Employers (including the Council) where costs occur due to them waiving actuarial reductions on retirement. Any Strain on Fund Cost requires to be paid, in full, at the time of retirement.
6.6 Assets and Property:	None.
6.7 ICT and new technologies:	None.
6.8 Environmental:	None.
6.9 Risk Management:	<p>There are many risks involved in the administration of the Pension Fund.</p> <p>From a financial perspective, risks are an integral part of planning for the future, as assumptions are made, internal and external factors and demand and supply all have an impact throughout the financial year. These can lead to unplanned or unexpected costs, and may arise without warning.</p> <p>Awareness of risks is critical to successful financial management. This report provides an assurance that discretionary provisions are being managed and therefore mitigate any chance of the Fund being placed in a financially challenging position.</p> <p>Going forward, as the fund reaches maturity, there could be a risk where contributions receivable are less than benefits payable.</p> <p>To mitigate this risk, a new investment strategy was approved, with the aim to become fully funded by 2027, when the Fund is expected to mature. This strategy of diversification of fund managers is a significant element of mitigating the risk of investing for growth and income.</p>

6.10 Policy and Delegated Authority:	<p>All functions and responsibilities relating to the Council's role as administering authority for Shetland Islands Council Pension Fund are now discharged by the Pension Fund Committee.</p> <p>The Pension Fund Committee has delegated authority to discharge all functions and responsibilities relating to the Council's role as administering authority for the Shetland Islands Council Pension Fund (the Pension Fund) in terms of the Local Government (Scotland) Act 1994, the Superannuation Act 1972 and the Public Service Pensions Act 2013.</p> <p>The Pension Board is the body responsible for assisting the Scheme Manager in relation to compliance with scheme regulations and the requirements of the Pensions Regulator. The Pension Board will determine the areas they wish to consider.</p>	
6.11 Previously considered by:	<p>This report has not been presented at any other formal meeting.</p>	

Contact Details:

Mary Smith – Team Leader - Expenditure, Finance Services mary.smith@shetland.gov.uk
20 February 2017

Appendices:

Appendix 1 – Policy on Administering Authority Discretions

Background Documents: None

SHETLAND ISLANDS COUNCIL PENSION FUND (SICPF)

Policy on Administering Authority's Discretions

Discretions from pre/post 1/04/2015 in relation to active members and pre/ post 31/03/2015 leavers, being discretions under:

- the Local Government Pension Scheme (Scotland) Regulations 2014 [prefix R]
- the Local Government Pension Scheme (Transitional Provisions and Savings) (Scotland) Regulations 2014 [prefix TP]
- the Local Government Pension Scheme (Administration) (Scotland) Regulations 2008 [prefix A]
- the Local Government Pension Scheme (Benefits, Membership and Contributions) (Scotland) Regulations 2008 (as amended) [prefix B]
- the Local Government Pension Scheme (Transitional Provisions) (Scotland) Regulations 2008 [prefix T]
- the Local Government Pension Scheme (Scotland) Regulations 1998 (as amended) [prefix L]

Discretion	Regulation	Policy Decision
<u>Admission Agreements</u> Whether to agree to an admission agreement with a body applying to be an admission body (including a NHS Scheme employing authority)	R4(5) (b) R3 (5) & RSch 2, Part 2, para 1	SICPF will only agree to an admission agreement with an admission body, provided it is satisfied about the long term financial security of the body (i.e. that it has tax raising powers) or it can provide an indemnity or bond.
<u>Transferee Admission Agreements</u> Whether to terminate a transferee admission agreement in the event of: <ul style="list-style-type: none"> ➤ Insolvency, winding up or liquidation of the body ➤ Breach by that body of its obligations under the admission agreement ➤ Failure by that body to pay over sums due to the Fund within a reasonable period of being requested to do so 	RSch2, Part 2, Para 9(d)	SICPF shall terminate in the event of: <ul style="list-style-type: none"> ➤ The insolvency, winding up or liquidation of the admission body ➤ A material breach by the admission body of any of its obligations under the admission agreement or these Regulations which has not been remedied within a reasonable time, or ➤ A failure by the admission agreement to pay any sums due to the fund within a reasonable period after receipt of a notice from the administering authority.

<u>Additional Pension Contributions (APC)</u> Whether to turn down a request to pay an APC over a period of time where it would be impractical to allow such a request (e.g. where the sum being paid is very small and could be paid as a single payment)	R16 (1)	SICPF will normally accept applications but reserve the right to refuse.
<u>Additional Pension Contributions (APC)</u> Whether to require a satisfactory medical before agreeing to an application to pay an APC	R16 (10)	SICPF will continue to require a member to provide satisfactory medical evidence to ensure that s/he is in reasonable good health and will not retire on health grounds due to a pre-existing medical condition. The cost of any medical examination will be undertaken at the member's own expense. No medical will be required if the member is paying by lump sum or buying "lost" pension due to absence from work.
<u>Additional Pension Contributions (APC)</u> Whether to turn down an application to pay an APC if not satisfied that the member is in reasonably good health.	R16 (10)	SICPF will continue to turn down an application if, upon receipt of a report from a registered medical practitioner, the member is believed not to be in good health.
<u>Additional Voluntary Contributions</u> Decide to whom any AVC monies (including life assurance monies) are to be paid on death of the member	R17 (12)	<p>Will continue to be delegated to a group of Officials comprising: Executive Manager - Finance Services, Executive Manager - Human Resources, Team Leader - Expenditure and an appointed Union Official. To be administered within SICPF in accordance with the following policy guidelines:</p> <ul style="list-style-type: none"> ➤ If there is a valid/up-to-date nomination, the monies will be paid to the nominated beneficiaries in the proportions specified but each case will be considered individually. ➤ If there is no valid/up-to-date nomination, the death grant may be paid to the personal representative(s)/estate or any person or persons

		appearing to have been the member's relative or dependant but each case will be considered individually.
<u>Members' Pension Accounts</u> Members' pension accounts may be kept in such a form as is considered appropriate	R22(3)(c)	Members' pension accounts will be kept in the format that is defined by the pension administration software.
<u>Concurrent Employments</u> Decide, in the absence of an election from the member within 12 months of ceasing a concurrent employment, which ongoing pension account the concurrent pension benefits will be aggregated to (where there is more than one ongoing employment)	TP10(9)	In the absence of an election from the member within 12 months of ceasing a concurrent employment SICPF will decide which pension account to aggregate concurrent pension benefits to.
<u>Flexible Retirement</u> Whether to waive, in whole or in part, actuarial reduction on benefits paid on flexible retirement (Rule of 85 does not apply)	R29(8) and TPSch 2, para 2(1)	SICPF will not have a general policy to waive, in whole or in part, actuarial reduction on benefits paid on flexible retirement and will only do so in exceptional circumstances, when there is a sound business case to do so.
<u>Voluntary Early Retirement Post 31/03/2015</u> Whether to waive, in whole or in part, actuarial reduction on benefits where a member voluntarily draws their benefits before normal pension age (where the member only has post 31/3/15 membership - Rule of 85 does not apply)	R29(8)	SICPF will not have a general policy to waive, in whole or in part, actuarial reduction on benefits which a member voluntarily draws benefits before normal pension age, (where the member only has post 31/3/15 membership) unless there are exceptional circumstances and sound business case to do so.

<p><u>Voluntary Early Retirement</u> Whether to waive, in whole or in part, any actuarial reduction on pre and post April 2015 benefits which a member voluntarily draws before normal pension age (where the member has both pre 1/4/15 and post 31/3/15 membership and is subject to the Rule of 85)</p>	<p>TPSch 2, paras 1(2) and 2(1), & TP3(1), (5) & TPSch 2, PARA 2(1)</p>	<p>SICPF will not have a general policy to waive in whole or in part, actuarial reduction on benefits paid on voluntary early retirement for a member voluntarily drawing benefits, with employer consent, on or after age 55 and before age 60 unless there are exceptional circumstances and a sound business case to do so.</p>
<p><u>Payment of Strain on Fund Costs</u> Whether to require any Strain on Fund costs to be paid “up front” by the employing authority following approval of retirements under:</p> <ul style="list-style-type: none"> ➤ benefits drawn on flexible retirement – Rule of 85 applies) R29(6), ➤ waivers actuarial reduction on benefits drawn on flexible retirement (Rule of 85 does not apply) ➤ benefits drawn on redundancy / business efficiency), R29(7) ➤ waivers (in whole or in part) under R29(8) any actuarial reduction that would otherwise have been applied to benefits which a member voluntarily draws before normal pension age(NPA) (55 to NPA) ➤ Waivers (in whole or part) any actuarial reduction that would otherwise be applied to benefits which a member voluntarily draws prior to age 60 (age 55 to 60), under the 2008 Scheme. 	<p>R66(2) & TPSch 2, para 2(1), 2(2) & B30(1)</p>	<p>SICPF continues to require payment for Strain on the Fund costs to be made, in full, at date of retirement.</p>
<p><u>Deferred Benefits on Compassionate Grounds</u> Whether to waive, on compassionate grounds, the actuarial reduction applied to deferred benefits being</p>	<p>TP3(1), TPSch2, para 2(1) and B30 (5)</p>	<p>SICPF will continue to not have a general policy to waive in whole or part an actuarial reduction on compassionate grounds unless there are exceptional circumstances</p>

paid early.		
<u>Commutation of Small Pensions</u> Decide whether to commute small pensions	R33 (1) & B39 & A98	Small pensions will continue to be commuted on the request of the member where the value is within HMRC limits.
<u>Independent Registered Medical Practitioner (IRMP)</u> Approve medical advisors used by all employers participating in the Fund (for assessing ill health benefits)	R35 (3) & A52(2)	The Council's Executive Manager - HR will continue to be responsible for approving the IRMP(s) and administering referrals on behalf to employers to certify ill health retirement.
<u>Ill Health Retirement - Deferreds</u> Decide whether deferred beneficiary meets criteria of being permanently incapable of former job because of ill health.	R36 (3) & B31	Where a request is received each case will continue to be considered individually and a decision will be made based on the medical evidence and opinion provided by the IRMP.
<u>Death Grants</u> Decide to whom death grant is paid	TP17(5) to (8) & R38(2), R41(2) & R44(2) B23(2), B32(2), B35(2), & A95 (4) & L37(1) & 150(4)	Will continue to be delegated to a group of Officials comprising: Executive Manager - Finance Services, Executive Manager - Human Resources, Team Leader - Expenditure and an appointed Union Official. To be administered within SICPF in accordance with the following policy guidelines: <ul style="list-style-type: none"> ➤ If there is a valid/up-to-date nomination, the monies will be paid to the nominated beneficiaries in the proportions specified but each case will be considered individually. ➤ If there is no valid/up-to-date nomination, the death grant may be paid to the personal representative(s)/estate or any person or persons appearing to have been the member's relative or dependant. Each case will be considered individually.
<u>Retirement Benefits - No Double Entitlement</u> Decide, in the absence of an election from the member, which benefit is to be paid where the member would be entitled to a benefit under 2 or more	R47(1)(c) & B43(1)(c)	SICPF will continue to calculate the benefits and notify the member of the payment that would provide the highest level of payment.

regulations in respect of the same period of Scheme membership		
<u>Funding Strategy Statement (FSS)</u> Decide on Funding Strategy for inclusion in Funding Strategy Statement.	R56	Following the valuation as at 31 March 2014, the FSS was formulated in conjunction with Hymans Robertson LLP, the Fund Actuary. The FSS will be revised again following the valuation as at 31 March 2017.
<u>Admission Agreement Fund</u> Whether to set up a separate admission agreement fund	R52(1)	The current FSS does not provide for a separate admission fund to be maintained.
<u>Governance Policy</u> Governance policy must state whether the pension administration authority delegates their function or part of their function in relation to maintaining a Pension Fund to a committee, a sub-committee or an officer of the administration authority and, if they do so delegate, state: > the frequency of any committee or sub - committee meetings. > the terms, structure and operational procedures appertaining to the delegation > whether representatives of employing authorities or members are included and, if so, whether they have voting rights The policy must also state : > the extent to which a delegation, or the absence of a delegation, complies with guidance from Scottish Ministers and, to the extent it does not so comply, state the reasons for not complying, and > the terms, structure and operational procedures appertaining to the local Pension Board	R53	The Governance Compliance Statement is published annually as part of the Pension Fund Annual Report and is accessible from the Finance Services website at http://devweb.shetland.gov.uk/finance
<u>Pensions Administration Strategy</u> Whether to have a written pensions administration strategy and, if so, the matters it should include	R57(1) & (2)	SICPF's current Pensions Administration Strategy is due for review.

<u>Communication Policy</u> Requires to set out the policy on the provision of information and publicity to, and communicating with, members, representatives of members, prospective members and Scheme Employers; the format, frequency and method of communications, etc	R59	A Policy is currently being formulated.
<u>Revised Employer Contribution Rate</u> Whether to obtain revision of employer's contribution rate if there are circumstances which make it likely a Scheme employer will become an exiting employer.	R62(4)	SICPF will continue to request a revised additional rate and adjustments certificate regarding employer contribution from the Fund Actuary where it appears to be appropriate to do so.
<u>Revised Rates & Adjustment Certificate - Cost Sharing</u> Decide whether to obtain a new rates and adjustment certificate if the Scottish Ministers amend the Regulations as part of the "cost sharing" under R61	R63	SICPF will request a new rates and adjustment certificate where it appears to be appropriate to do so.
<u>Payments by Scheme Employers</u> Decide frequency of payments to be made over to SICPF by employers and whether to make an administration charge	R67 (1)	Monthly payment and breakdown must continue to be received by the 19th of the month following deduction. Note – SICPF requires to report any material late payments to The Pension Regulator. The current admitted body administration charge of 5% + VAT of employees contributions will continue to apply.
<u>Information to be Provided by Scheme Employers</u> Decide form and frequency of information to accompany payments to the SICPF.	R67(4)	SICPF continues to request a monthly payment and accompanying pro- forma breakdown report detailing the employee, employer and (if applicable) added years/ARCS/APCs/50:50 contributions for the period in question.
<u>Employer Performance</u> Whether to issue employer with notice to recover additional costs incurred as a result of the employer's level of performance	R68 & TP22(2)	SICPF will continue to review as necessary whether to issue a notice but in the first instance will work with an employer to improve performance.
<u>Late Payment by Employers</u>	R69(1)	SICPF will continue to work with

Whether to charge employers interest on payments which are overdue		employers to resolve any issues regarding late payment but reserves its regulatory right to require interest to be paid when payments are overdue by 1 month.
<u>Appeals - IRDP</u> Whether to extend six month period to lodge a stage one Internal Dispute Resolution Procedure (IDRP) appeal	R72(7) & A54(7)(b)	SICPF's appointed person may extend the time limit for such applications depending upon the merits of each application submitted.
<u>Appeals - Employer Decisions</u> Whether the Pensions Administering Authority should appeal against an employer decision (or lack of a decision)	R77(2), A59 (2) 104(1)	SICPF will continue to consider any case on its merits and with regards to the facts of the case. SICPF will appeal to the Scottish Ministers if it believes an employer has made (or failed to make) a decision and the Fund has been unable to alter their actions.
<u>Information provided by Employers</u> Specify information to be supplied by employers to enable the Pension Administering Authority to discharge its functions	R78(1)(b) & TP22(1) & A60 (1) (b)	SICPF will continue to specify the information that is to be supplied by employers in line with regulatory requirements and best practice.
<u>Payments due - Deceased Members</u> Whether to pay death grant due to personal representatives or anyone appearing to be beneficially entitled to the estate without need for grant of probate / letters of administration where payment is less than amount specified in s6 of the Administration of Estates (Small Payments) Act 1965 (currently £5,000)	R80(2) & A48(2) & L94	SICPF will continue to delegate to the Executive Manager – Finance Services (or his/her nominee) to administer.
<u>Persons incapable of managing their affairs</u> Whether, where a person is incapable of managing their affairs, to pay the whole or part of that person's pension benefits to another person for their benefit.	R81	SICPF will delegate to the Executive Manager - Financial Services (or his/her nominee) to administer.
<u>Annual Benefit Statements (ABS)</u> Date to which benefits shown on ABS are calculated	R87(5) 105A(5)	Annual Benefit Statements for active members will continue to show benefits calculated as at 31st March each year. Annual Benefit Statements for deferred members will continue to be calculated as at the Pension

		Increase date (1 st Monday after 6 April).
<u>Bulk Transfer Payments</u> Agree to bulk transfer payment	R96(1)(b)	SICPF will continue that agreement to bulk transfer terms will be on the basis of actuarial advice from the Fund actuary.
<u>Transfers In – Time Limits</u> Extend normal time limit for acceptance of a transfer value payment(s) beyond 12 months from joining the LGPS	R98(6)	SICPF will continue to refuse to accept cases of late application for a transfer of benefits into the Fund, unless in exceptional circumstances (for example, ill health ensuing at time of dealing with pension transfer).
<u>Transfers Ins</u> Allow transfer of pension rights into the Fund	R98(7)	SICPF will continue to accept Transfers In from other HMRC registered pension arrangements.
<u>Certificate of Protection (CoP)– Deceased Members</u> Make election on behalf of deceased member with a CoP of pension benefits i.e. determine best pay figure to use in the benefit calculations (pay cuts / restrictions occurring pre 1.4.15.)	TP3(6), TP4(6)(c), TP8(4), TP10(2)(a), TP17(2)(b) & A43(10)	SICPF will continue to make an election on behalf of a deceased member with a CoP to determine the best pay figure to use in calculations for the benefit of the beneficiaries and dependants
<u>Childs Pensions</u> Decide to treat child as being in continuous full-time education or vocational training despite a break	RSch 1 & TP17(9)(a)	SICPF will continue to delegate to the Executive Manager - Finance Services (or his/her nominee) to administer.
<u>Co-habiting Partners Pensions</u> Decide evidence required to determine financial dependence of co-habiting partner on scheme member or financial interdependence of co-habiting partner and scheme member	RSch 1 & TP17(9)(b) B25	SICPF will continue to delegate to the Executive Manager – Finance Services(or his/her nominee) to collate the evidence to determine financial dependence or interdependence. Each case will be assessed and agreed on a case by case basis and will include but not be restricted to items such as evidence of a joint bank account, shared utility bills, joint mortgage arrangements, etc. The ultimate decision will rest with the Executive Manager - Finance Services (or his/her appointed nominee).
<u>Abatement of Pension upon Re-employment</u> Decide policy on abatement of pre 1 April 2015 element of pensions in payment following re-employment	TP3(11) & A64(1)* & A65(4)(c) & T12	SICPF will continue not to abate LGPS pensions of pensioner members on re-employment. However, pension benefits resulting from the award of additional service (CAYs) to a member by an

		employer under the Local Government (Discretionary Payments and Injury Benefits)(Scotland) Regulations 1998 where that member has been retired on efficiency or redundancy grounds are still subject to abatement on re-employment as abatement under these provisions is not discretionary.
<u>Pension on Divorce</u> Decide charges to be levied in Pension Sharing on Divorce cases	A101	SICPF to commence charging, with effect from 1 April 2017, £250 for Pension Sharing on Divorce cases.

RULE OF 85 – AS IT RELATES TO EARLY RETIREMENTS UNDER THE LOCAL GOVERNMENT PENSION SCHEME (SCOTLAND) REGULATIONS 2014

The 1998, 2008 and 2014 Local Government Pension Scheme Regulations afford scheme members varying levels of entitlement and protection depending on their age and scheme membership.

Under the 2014 pension regulations the 'Rule of 85' no longer automatically applies. This means that when giving consent to a request for early retirement between age 55 - 59, where the employee meets the 'Rule of 85' (i.e. the sum of their age and scheme membership equals at least 85, at date of retirement), the employer does not necessarily need to pay the strain costs (i.e. the cost to the Pension Fund) in full. This gives employers greater flexibility in dealing with requests for retirement under age 60 as follows:

1. The employer does not apply the 'Rule of 85' resulting in the employee meeting the strain costs in full by way of an actuarial reduction to their pension benefits, with no cost to the employer;
2. The employer applies the 'Rule of 85' resulting in the employer meeting the strain costs as they did under the 2009 & 1998 Scheme;
3. The employer does not apply the 'Rule of 85' but agrees that the strain costs are shared between employee and employer (there is no set apportionment) with a reduced cost to the employer and a partial reduction in the employee's pension benefits.

For leavers after 31 March 2015, the discretion to waive actuarial reductions, in whole or part, on any grounds is now extended to all types of retirement.

The only exception is where an employer grants flexible retirement for staff aged 55 and over and under age 60 and, at the date of flexible retirement, has either met the 85 year rule or would have met the rule before age 60, there will be a strain on fund cost to be met by, and paid to the Pension Fund by the employer. **No discretion exists in this regard.**



Meeting(s):	Pension Fund Committee Pension Board	7 March 2017 7 March 2017
Report Title:	Pension Fund - Quarter to December 2016 Investment Review Report	
Reference Number:	F-026-F	
Author / Job Title:	Report Presented by Executive Manager - Finance	

1.0	Decisions / Action required:
1.1	This report is a review of the Pension Fund's external investments over the quarter to December 2016, and as such the Pension Fund Committee and Pension Board should consider the outcome of this quarterly review and provide comments accordingly.
2.0	High Level Summary:
2.1	This report will allow the Pension Fund Committee and Board to review the investment position and performance of the Pension Fund's external investments, managed on their behalf by fund managers, for the quarter to December 2016.
2.2	The Pension Fund's investments increased in value by £17 million over the quarter and now have an overall value at the end of December of £434 million.
2.3	Over the quarter to December 2016 BlackRock were equal to the benchmark aim, KBI Global investors and M&G outperformed their respective benchmarks while Newton and Schroders underperformed their benchmarks. The combined investment return for the Pension Fund over the three month period was 3.7% which was 0.7% below the benchmark return. See additional information in Appendix 1.
3.0	Corporate Priorities and Joint Working:
3.1	The report links to the Council's corporate priorities, defined in its Corporate Plan, specifically in relation to assisting the Council in ensuring that financial resources are managed.
4.0	Key Issues:
4.1	This report is only a three month snapshot of how the markets and fund managers have performed. Over the financial year the performance of the Pension Fund's investments could easily increase or decrease depending on economic and investment circumstances.
5.0	Exempt and/or confidential information:

5.1	<i>None</i>
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6.0 Implications :	
6.1 Service Users, Patients and Communities:	<i>None</i>
6.2 Human Resources and Organisational Development:	<i>None</i>
6.3 Equality, Diversity and Human Rights:	<i>None</i>
6.4 Legal:	As required by The Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010, where investment managers have been appointed their performance must be kept under review.
6.5 Finance:	<p>The long term investments and their performance are important to the Pension Fund and the achievements of its outcomes and objectives.</p> <p>It is recognised that the actual investment performance each year will be different to what is expected or required however over the long term this will be monitored and reviewed to ensure that the Pension Fund is working towards meeting its long term objectives.</p> <p>It is not likely that the Pension Fund can expect a positive investment return from its investments every year but having robust governance and monitoring in place mitigates the financial risks and enables the Pension Fund to take action at appropriate times to address poor performance by the fund managers. This report is part of that governance and monitoring framework.</p>
6.6 Assets and Property:	Long term investments are assets of the Pension Fund and represent money given to fund managers to manage on its behalf for long term benefit. The Pension Fund relies upon each fund manager's fiduciary duty and to buy and sell appropriate assets in accordance with the mandate awarded to them and to report regularly on the value and performance of the fund in which Pension Fund money is invested. The value of long term investments under these mandates can go down as well as up.
6.7 ICT and new technologies:	<i>None</i>

6.8 Environmental:	<p>Whilst the fund managers have delegated powers for the acquisition and realisation of investments, fund managers are expected as part of their investment process 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 will also be expected to enter into dialogue with companies in which they invest, in relation to the pursuance of socially responsible business practices, and report on these activities.</p> <p>Corporate Governance is a key responsibility for institutional shareholders and as a matter of principle the Pension Fund will seek to exercise all of its voting rights in respect of its shareholdings. It is recognised however that in practical terms this may not always be possible for overseas holdings. However for UK stocks all voting rights will be exercised in a positive fashion, i.e. no abstentions.</p> <p>The fund managers, who will act in accordance with this policy, will exercise voting.</p> <p>All of the Pension fund managers have signed up to the United Nations Principles on Responsible Investment. The principles reflect the view that environmental, social and corporate governance (ESG) issues can affect the performance of investment portfolios, and therefore must be given appropriate consideration by investors, if they are to fulfil their fiduciary (or equivalent) duty. The Principles provide a voluntary framework by which all investors can incorporate ESG issues into their decision-making and ownership practices, and so better align their objectives with those of society at large.</p>	
6.9 Risk Management:	<p>All investments carry risk. Risks, such as market risk are mitigated and actively managed through diversification of fund managers, asset classes, markets, size of holdings and through performance monitoring against benchmarks.</p>	
6.10 Policy and Delegated Authority:	<p>The Pension Fund Committee has delegated authority to discharge all functions and responsibilities relating to the Council's role as administrating authority for the Shetland Islands Council Pension Fund (the Pension Fund) in terms of the Local Government (Scotland) Act 1994, the Superannuation Act 1972 and the Public Service Pensions Act 2013.</p> <p>The Pension Board is the body responsible for assisting the Scheme Manager in relation to compliance with scheme regulations and the requirements of the Pensions Regulator. The Pension Board will determine the areas they wish to consider.</p>	
6.11 Previously	<i>None</i>	

considered by:		
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Appendices:

Appendix 1 - Quarter to December 2016 Performance Review

Background Documents:

None

Quarter to December 2016 Performance Review

1.0 Investment Position and Market Performance

- 1.1 This quarterly report forms part of the Pension Fund's governance arrangements where the Pension Fund Committee and Board receive a quarterly investment report on the external investments.
- 1.2 This report concentrates on the three month period from October to December 2016. The report looks at the performance of the Pension Fund's managers, the overall investment performance relative to the markets, the physical movement of funds, any changes from the investment strategy, and any other relevant issues relating to the investments over the period.
- 1.3 The Pension Fund has five fund managers with total investments under management at the end of December 2016 of £434 million. The funds, type of mandate and market values at the end of December 2016 are as follows:

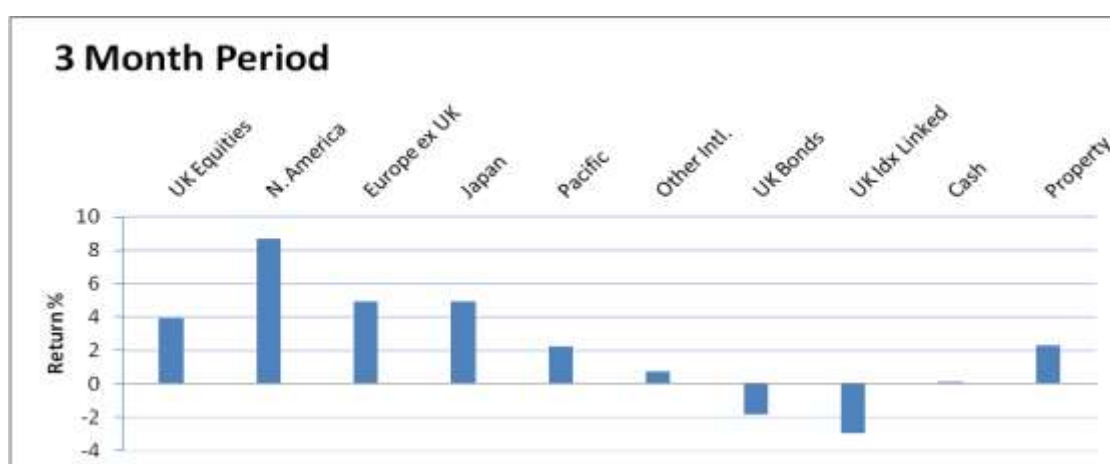
Manager	Mandate	% of Reserves	Market Value (£m)
BlackRock	Passive Equity	41%	180
KBI Global Investors	Active Equity	21%	93
Newton	Diversified Growth	17%	74
Schroders	Property	12%	50
M&G	Alternative Credit	9%	37

- 1.4 Individual fund manager performance is detailed later but there is the need to consider the effect of the markets themselves, and of any cash withdrawals or injections into the funds. The following table shows the effect on the overall investments of these factors during the three month period.

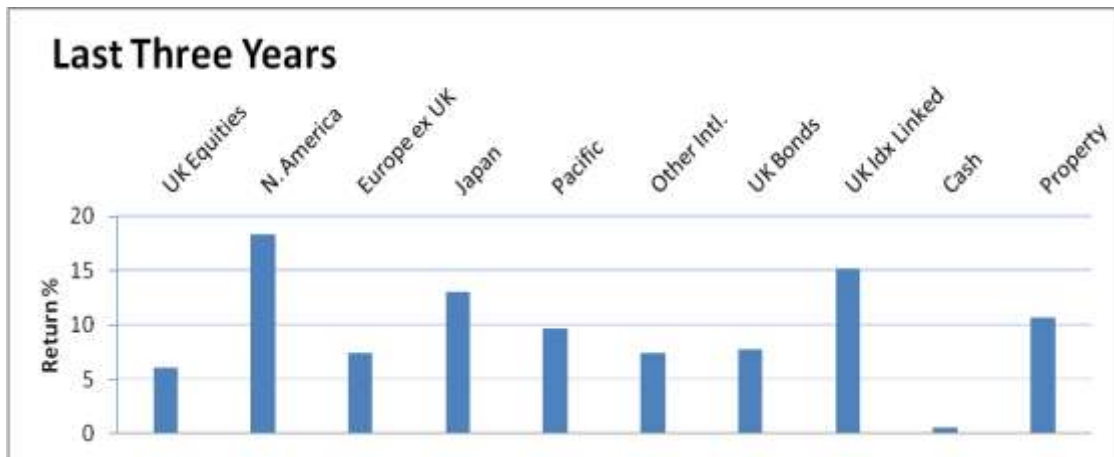
	£ Million
Market value as at 30/09/16	417
Additions / (Withdrawals)	2
Investment Return	15
Market value as at 31/12/16	<u>434</u>

- 1.5 The figures show a £15 million positive investment return over the three month period. The increase in investment returns is due mainly to the positive return from equity markets over the period.

- 1.6 There was an injection of £2 million into the investments during the three month period to December 2016. This was made up of two amounts, £1.6 million to M&G which was cash that had accumulated in the Pension bank account from excess contributions over pension payments. The other amount £574,000 was the final cash transfer to Schroders relating to the 2014 investment strategy review.
- 1.7 The Pension Fund's Investments have therefore increased in overall value by £17 million over the three month period to end December 2016.
- 1.8 Over the three month period to December most equity markets rose on improved economic news with the UK stock market benefitting from currency movements. Bond markets struggled over the quarter which was mainly due to North America increasing interest rates. Emerging markets also struggled due to uncertainty after the US Presidential election result. There was concern within the UK property market as it was reported that companies might relocate to mainland Europe because of the European Referendum result.
- 1.9 The investment markets performance, over the main asset classes the Pension Fund invests into, over the three month period looks like this:



- 1.10 This is only a three month snapshot of how the various investment classes and sectors have performed and it shows how, in the short term, values do fall as well as rise. History shows that investments in these asset classes over the long term are usually positive, which is the reason the investment strategy is based on a long term investment horizon. As an example of the differences in market returns over a slightly longer time period, the following graph shows the same asset classes returns per annum over the last three years.



- 1.11 The fund manager has negligible influence over the market return but they may be required by the mandate agreement to invest into these markets. The main constituent of a fund's performance is the market return, where the fund is invested. A fund manager with an active mandate is asked to outperform a benchmark made up of market indexes, or cash plus a percentage return, whereas a fund manager with a passive mandate is aiming to match the market return.

2.0 Fund Manager Performance

- 2.1 The Pension Fund invests in various asset classes for the long term, generally five years or more. This report looks at just the performance of the fund managers and the investment return over a three month period, which has predominately been in a rising equity but falling bond environment.
- 2.2 In this environment the Pension Fund's managers have, over the three month period to end December 2016, performed as follows:

Manager	Mandate	Fund Return	Benchmark Return	% Return Compared to Benchmark
BlackRock	Passive Equity	5.8%	5.8%	0.0%
KBI Global Investors	Active Equity	8.0%	7.1%	0.9%
Newton	Diversified Growth	-4.8%	1.1%	-5.9%
Schroders	Property	2.1%	2.3%	-0.2%
M&G	Alternative Credit	1.4%	0.8%	0.6%

- 2.3 The fund with BlackRock is invested passively in equities, so the fund is aiming to equal the benchmark return. BlackRock achieved this aim over the three month period.
- 2.4 The fund with BlackRock is split between UK equities 45% and global ex UK equities 55%. Over the three month period UK equities returned 3.9% compared to global ex UK equities which returned 7.4%. The positive equity markets had an uplifting impact on BlackRock's fund value with the fund returning 5.8% over the three month period, which is a reflection of the mixture of returns from the various markets the fund invests into.
- 2.5 BlackRock has stated that they are reducing their fund management fee scale for passive investing from the start of January 2017. The fee change based on the current valuation would reduce the quarterly management fee in the future by about £38,000. The fee reduction has occurred due to price competition within the industry and economies of scale with large fund managers.
- 2.6 The fund with KBI Global Investors is in active global equities. They invest using a strategy based on income generating shares. The fund returned 8.0% in positive equity markets outperforming the benchmark by 0.9%. The fund's main investment sector is North America, and this sector reacted well to the Presidential result as tax cuts and increased spending on US infrastructure are policies.
- 2.7 Newton has a diversified growth fund mandate, which over the three month period was 5.9% below their cash plus benchmark return. The diversified growth fund invests in various asset classes to spread risk and smooth returns. The main detractors from performance were equity holdings that underperformed global indices, gold and government bonds were negative and the depreciation of sterling hurt their currency hedging positions.
- 2.8 Newton continues to believe that a determined focus on the longer-term trends, rather than short-term market news, is in the best interests of their clients. The portfolio is therefore maintaining a cautious investment position.
- 2.9 Schroders invests into property via a fund of funds approach where they invest in various different property funds to spread investment risk. There are two main investment areas, UK and Europe. Over the three month period Schroders were 0.2% below the benchmark return. The UK equalled the benchmark return but it was the European investment which underperformed and pulled down the overall performance. There were additional transaction costs as Schroders repositioned some of the investments to reduce exposure to central London offices after the European Referendum result, which caused concern over financial companies possibly relocating from London to mainland Europe.
- 2.10 The fund with M&G is an alternative credit fund that invests in fixed income products such as corporate bonds, high yield bonds, asset backed securities etc. The fund outperformed the cash plus benchmark over the three month

period by 0.6%. The fund's industrial bond holdings were the largest contributor to the outperformance.

- 2.11 The overall Pension Fund investment return for the three month period to the end of December 2016 was 3.7%, which was 0.7% below the benchmark return. This was a quiet investment quarter compared to the period from April to September, which saw rising equity and bond markets. The overall investment return so far in 2016/17 over the nine month period to the end of December 2016 is 14.9%.

3.0 After the end of September 2016

- 3.1 Since the end of December 2016 North America has dominated the news and influenced the investment markets. The new US President was inaugurated in January 2017 and his policies and rhetoric have created much uncertainty within the world's investment markets.
- 3.2 The UK Government continues to debate how to proceed over Europe, which is creating uncertainty within investment markets along with ongoing inflation concerns.
- 3.3 The most up to date Pension Fund investment value is £436 million (unaudited) at the end of January 2017.



Meeting(s):	Pension Committee Pension Board	7 March 2017
Report Title:	Pension Fund – Risk Register	
Reference Number:	F-030-F	
Author / Job Title:	Jonathan Belford Executive Manager - Finance	

1.0	Decisions / Action required:
1.1	That Pension Fund Committee NOTE the content of the report and current risk register.
2.0	High Level Summary:
2.1	The purpose of this report is to provide up to date information on the risks associated with the Shetland Islands Council Pension Fund. (Risk Register is attached at Appendix 1)
2.2	Risks will be reviewed on a regular basis throughout the year, and reporting will ensure that the Pension Fund Committee and Pension Board are made aware of changes and actions being taken to mitigate risks
3.0	Corporate Priorities and Joint Working:
3.1	Management of risk is a fundamental aspect of good governance. The risk register is an integral part of effectively managing and administering the Pension Fund on behalf of its members
4.0	Key Issues:
4.1	The Council, as the administering authority for the Shetland Islands Council Pension Fund, is responsible for the governance and administration of the Pension Fund.
4.2	In addition to the wealth of regulation and legislation that surrounds the administration of the Fund there are key governance and control issues that require to be addressed in order to effectively fulfil the role to the expected and required standards.
4.3	One aspect of governance that continues to improve is the management of risk.
4.4	Attached at Appendix 1 is a copy of the Pension Fund risk register and the level of risk that has been assessed in respect of likelihood and impact. For reference purposes the risk matrix used by the Council is included in the Appendix, this is what has been used to determine the risk score and total value for each risk.

	These are then categorised as High, Medium and Low.
4.5	The right-hand column of the register identifies any change since the last report and the “are controls operating effectively” column provides comments reflecting current issues / actions in relation to the mitigation of the risks.
4.6	The register records 35 risks, of which 6 (6 last reported) are High; 14 (12 last reported) are Medium and 15 (17 last reported) are Low risks. This reflects the current control measures that are in place.
4.7	There is greater risk identified, following the latest review. This arise from the changes in accommodation that mean that information and staff are located in different locations, making data security at greater risk and a level of inefficiency has been introduced because access to the office at North Ness is restricted.
4.8	Other changes are detailed in the Appendix.
4.9	The risk register will be reviewed regularly and reported to the Pension Fund Committee and Pension Board as part of the performance reporting arrangements.
5.0	Exempt and/or confidential information:
5.1	None.

6.0 Implications :	
6.1 Service Users, Patients and Communities:	Effectively managing risk safeguards the benefits payable to members of the Pension Fund through sound governance.
6.2 Human Resources and Organisational Development:	None.
6.3 Equality, Diversity and Human Rights:	None.
6.4 Legal:	There are no direct legal implications arising from this report however legal advice and legal remedies will be sought and used whenever this is appropriate.
6.5 Finance:	There are no direct financial implications arising from this report. Where risks materialise they may result in financial implications for the Pension Fund, the Administering Authority (SIC) and/or the scheme employers.
6.6 Assets and Property:	Managing risks in relation to the governance and control of the assets held by the Pension Fund for the effective long term benefit of its members is crucial. Identification of the key risks

	and the controls is the basis of this report.
6.7 ICT and new technologies:	None.
6.8 Environmental:	<p>Whilst the fund managers have delegated powers for the acquisition and realisation of investments, fund managers are expected as part of their investment process 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 will also be expected to enter into dialogue with companies in which they invest, in relation to the pursuance of socially responsible business practices, and report on these activities.</p> <p>Corporate Governance is a key responsibility for institutional shareholders and as a matter of principle the Pension Fund will seek to exercise all of its voting rights in respect of its shareholdings. It is recognised however that in practical terms this may not always be possible for overseas holdings. However for UK stocks all voting rights will be exercised in a positive fashion, i.e. no abstentions. BlackRock, Newton, Kleinwort Benson, Schroders and M&G have all signed up to the United Nations Principles on Responsible Investment.</p> <p>The principles reflect the view that environmental, social and corporate governance (ESG) issues can affect the performance of investment portfolios, and therefore must be given appropriate consideration by investors, if they are to fulfil their fiduciary (or equivalent) duty. The Principles provide a voluntary framework by which all investors can incorporate ESG issues into their decision-making and ownership practices, and so better align their objectives with those of society at large.</p>
6.9 Risk Management:	There are many risks involved in the administration of the Pension Fund. These are set out in Appendix 1 of this report.
6.10 Policy and Delegated Authority:	<p>All functions and responsibilities relating to the Council's role as administering authority for Shetland Islands Council Pension Fund are now discharged by the Pension Fund Committee.</p> <p>The Pension Fund Committee has delegated authority to discharge all functions and responsibilities relating to the Council's role as administering authority for the Shetland Islands Council Pension Fund (the Pension Fund) in terms of the Local Government (Scotland) Act 1994, the Superannuation Act 1972 and the Public Service Pensions Act 2013.</p> <p>The Pension Board is the body responsible for assisting the Scheme Manager in relation to compliance with scheme regulations and the requirements of the Pensions Regulator. The Pension Board will determine the areas they wish to</p>

	consider.	
6.11 Previously considered by:	This update to the risk register has not been considered previously.	

Contact Details:

Jonathan Belford, Executive Manager – Finance, jonathan.belford@shetland.gov.uk
20 February 2017

Appendices:

Appendix 1 – Pension Fund Risk Register

Background Documents: *None*

Shetland Islands Council Pension Fund: Risk Register

Risk Assessment February 2017

Ref	Risk Description	Scope/potential consequences of risk	Risk Control Measures	Are controls operating effectively?	Assessment of Residual Risk (Likelihood x Impact)			
					Likelihood	Impact	Risk Score	Change since last report
1.	Operational – Pension Administration system failure	Staff downtime, loss of service delivery	System is hosted externally with back-up in separate location; budget approved appointment of a Systems Administrator & Development Officer post which will add to technological resilience	Y	(Rare) 1	(Significant) 3	3 Low	No Change. Additional control measure identified.
2.	Operational – Unable to access workplace	Staff downtime, loss of service delivery	Disaster recovery policy in place which is incorporated within SIC overall policy	Y	(Certain) 5	3	15 High	Low to High (3 to 15) Increased likelihood to 5 as out of 8NN but additional time spent retrieving files due to the volume and location.
3.	Operational – Overpayment of pension benefits	Audit criticism, legal challenge, reputational damage, cost and potential non-recovery	All pension payments signed off by a senior pensions officer – segregation of duties for staff processing lump sums	Y	(Unlikely) 2	(Minor) 2	4 Low	No change
4.	Operational – Failure to carry out annual check of member	Incorrect pension payments, incorrect	All employers required to submit annual data, which is checked	Y	1	2	2 Low	No change

Shetland Islands Council Pension Fund: Risk Register

Risk Assessment February 2017

	records	assessment of actuarial liabilities						
5.	Operational – Failure to carry out effective member tracing	Incorrect pension payments, incorrect assessment of actuarial liabilities	Tracing service in place – Faraday Mortality Tracing Service. Soon to commence using national “Tell us once” scheme.	Y	1	2	2 Low	No change
6.	Operational – Fraud/Negligence	Overpayment, unauthorised payments, system corruption, audit criticism, reputational damage	All pension payments signed off by a senior pensions officer – segregation of duties for staff processing pensions and lump sums	Y	2	2	4 Low	No change
7.	Operational – Failure to recruit, retain and develop staff	Reduction in service delivery, poor operation of risk management controls	On-going review of staffing requirements and training. Pension officers in the process of completing specific pensions exams	Y	2	3	6 Low	No change
8.	Operational – Poor record keeping	Undermines service delivery, incorrect assessment of actuarial liabilities	Annual check of all member records undertaken	Y	2	3	6 Low	No change
9.	Funding – Fund’s investments fail to deliver returns in line with anticipated returns required to meet the valuation of the long term	Increase in employer contributions	Quarterly assessment of investment performance of fund, triennial actuarial valuation and quarterly funding updates reported to pensions committee. Triennial investment strategy	Y	(Likely) 4	(Extreme) 5	20 High	No change

Shetland Islands Council Pension Fund: Risk Register

Risk Assessment February 2017

	liabilities		review.					
10.	Funding – Fall in bond yields, leading to risk in value placed on liabilities	Increase in employer contributions	Quarterly funding updates prepared by the Scheme actuary reported to Pensions Committee	Y	5	5	25 High	High to High (15 to 25) Bond Yields have fallen further and should be expected to impact on the triennial valuation and year end employer liabilities
11.	Funding - Pay and price inflation valuation assumptions, either higher or lower	Increase in employer contributions	Quarterly funding updates reported to Pensions Committee	Y	2	3	6 Low	No change
12.	Funding – information on longevity changes	Increase in employer contributions	Actuarial assessment every three years undertake scheme specific analysis	Y	2	3	6 Low	No change
13.	Funding – Employers leaving scheme/closing to new members due to cost or cessation	Residual liabilities could fall to other scheme employers	Monitor scheme employers, maintain regular dialogue and report as necessary	Y	5	(Major) 4	20 High	No change
14.	Funding – Failure to recover unfunded payments from employers, e.g. compensatory added years	Residual liabilities could fall to other scheme employers	Pensions team monitor payments received and will escalate failed employer payments to Executive Manager - Finance	Y	2	3	6 Low	No change

Shetland Islands Council Pension Fund: Risk Register

Risk Assessment February 2017

15.	Funding – Employee contributions incorrectly deducted	Increase in employer contributions to meet unfunded position	Annual check of active member records	Y	3	2	6 Low	No change
16.	Funding – delay in funding investment managers	Loss of investment return and impact on employer contribution rates	Control of Pension Fund cash management; Reporting quarterly to Pensions Committee	Y	2	5	10 Med.	No change
17.	Financial – Failure in world stock markets	Increase in employer contribution rates	Diversification of scheme assets, global approach, multiple fund managers, investment strategy review following outcome of triennial valuation	Y	4	5	20 High	No change
18.	Financial – Under performance by active managers	Increase in employer contribution rates	Quarterly assessment of investment performance of fund, triennial actuarial valuation and quarterly funding updates reported to Pensions Committee	Y	(Possible) 3	5	15 High	High to High (20 to 15) Positive growth during year would require significant financial turmoil to deliver poor fund management results in the current financial year
19.	Financial – Early retirement strategies by scheme employers	Pressure on cash flow	On-going discussions with scheme employers about Funding issues and organisational plans	Y	3	4	12 Med.	No change

Shetland Islands Council Pension Fund: Risk Register

Risk Assessment February 2017

20.	Financial – Negligence, fraud, default by investment managers	Loss of value of the Fund, reputational damage	Fund management monitoring, SAS 70 reports and appropriate clauses in all scheme documentation	Y	2	5	10 Med.	No change
21.	Financial – Failure of Global Custodian	Loss of investments or control of investment	Regular meetings with global custodian, receipt of SAS 70 reports and monitoring, through Global Custodian magazines. To be included in annual report to Pensions Committee on service providers	Y	2	5	10 Med.	No change
22.	Financial – Non-compliance with regulations	Error, audit criticism, legal challenge, reputational damage	Review of compliance with regulations - ongoing	Y	3	4	12 Med.	No change
23.	Financial –VAT breach	Loss of Council partial exemption	Ongoing discussion with SIC on exemption	Y	1	3	3 Low	No change
24.	Financial –Failure to monitor investment managers and assets	Audit criticism, legal challenge, reputational damage	Quarterly assessment of investment performance of fund, triennial actuarial valuation and quarterly funding updates reported to Pensions Committee	Y	3	3	9 Med.	No change
25.	Financial – Failure of internal control of fund suppliers	Audit criticism, legal challenge, reputational damage	Sign off by a senior officer for all purchases of goods, monitoring of supplier costs. Budget monitoring reports to Pensions Committee	Y	3	3	9 Med.	No change
26.	Regulatory and Compliance – Failure	Error, audit criticism, legal	Review of compliance with regulations - ongoing	Y	3	3	9 Med.	No change

Shetland Islands Council Pension Fund: Risk Register

Risk Assessment February 2017

	to comply with LGPS Regulations	challenge, reputational damage						
27.	Regulatory and Compliance - Failure to comply with Pensions Act disclosure requirements	Audit criticism, legal challenge, reputational damage	Review of compliance with regulations - ongoing	Y	3	3	9 Med.	No change
28.	Regulatory and Compliance – Failure to comply with HMRC and other overriding regulations	Audit criticism, legal challenge, reputational damage	Review of compliance with regulations - ongoing	Y	3	3	9 Med.	No change
29.	Governance – Potential risks and conflicts of interest between SIC and SIC Pension Fund	Audit criticism, legal challenge, reputational damage	Advice provided by EM – Governance & Law (Monitoring Officer)	Y	3	3	9 Med.	No change
30.	Governance - Breach of Data Protection – theft or loss of data	Audit criticism, legal challenge, reputational damage	Internal control and procedures for management of data; Management of records is the subject of further work	Y	3	3	9 Med.	Low to Med. (6 to 9) With staff records being remote from staff, additional travel / carriage between locations makes loss more likely
31.	Governance – Failure to comply with FOI requests	Audit criticism, legal challenge, reputational	Expenditure Team Leader/Treasury Accountant responsible for FOI requests	Y	2	2	4 Low	No change

Shetland Islands Council Pension Fund: Risk Register

Risk Assessment February 2017

		damage	and meeting deadline for information requests					
32.	Governance – Failure to meet annual audit deadlines	Audit criticism, legal challenge, reputational damage	EM – Finance responsible for all internal and external audit requirements	Y	2	3	6 Low	No change
33.	Governance – Failure to monitor AVC arrangements	Audit criticism, legal challenge, reputational damage	Maintain regular contact with AVC provider	Y	2	2	4 Low	No change
34.	Governance – Failure to monitor and assess advisors	Poor investment decisions leading to reduced investment returns	Regular contact with advisors, compare and contrast feedback from other specialists. 5 Yearly Tender for Advisory Services	Y	2	5	10 Med.	High to Med. (15 to 10) Recently appointed new advisors – actuarial and investment therefore assessment of suitability has recently been undertaken.
35.	Governance – Failure to monitor employer covenants	Residual liabilities could fall to other scheme employers	On-going discussions with scheme employer of funding issues	N EM-Finance not in a position to influence the actions of a scheme employer despite discussions	2	5	10 Med.	No change

Shetland Islands Council Pension Fund: Risk Register

Risk Assessment February 2017

				and under- standing of the situations				
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Shetland Islands Council Pension Fund: Risk Register

Risk Assessment February 2017

Estimating risk likelihood and severity: Shetland Islands Council Risk Matrix

Step One - Look at the text in the box below and decide which descriptor of likelihood best matches your estimation of this particular risk/event.

Descriptor	Description
5 Almost certain	I would not be at all surprised if this happened within the next twelve months; I would expect this to happen
4 Likely	It is probable that this will occur sometime in the coming year
3 Possible	I think this could maybe occur in the next year
2 Unlikely	I would be mildly surprised if this occurred in the next year; it is unlikely to happen
1 Rare	I would be very surprised to see this happen in the next twelve months; it is very unlikely to happen

Step Two - Find the most realistic outcome for the risk you have identified and move down the left hand column to establish its value. Most risks will have potential impacts under more than one column.

HAZARD	Personal Safety	Property loss or damage	Failure to provide Statutory Service or breach of legal requirements	Financial Loss or Increased cost of Working	Personal Privacy Infringement	Environmental	Community / stakeholders / organisation	Reputation
Insignificant 1	Minor injury or discomfort to an individual	Negligible property damage	Reported to HSE, Stage 2 complaint	<£10k	Isolated personal detail revealed	Licensable activity occurring without authorisation but not causing pollution	Inconvenience to an individual or small group	Contained within Service Unit
Minor 2	Minor injury or discomfort to several people	Minor damage to one property	HSE investigation Complaint requiring investigation	£10k to £100k	Isolated sensitive data revealed	Death of invertebrates/ >10 fish, minor visible pollution, minor damage to commercial activity	Impact on an individual or small group	Contained within Service

Shetland Islands Council Pension Fund: Risk Register

Risk Assessment February 2017

HAZARD	Personal Safety	Property loss or damage	Failure to provide Statutory Service or breach of legal requirements	Financial Loss or Increased cost of Working	Personal Privacy Infringement	Environmental	Community / stakeholders / organisation	Reputation
Significant 3	Major injury to an individual/ range of moderate injuries to more than one person	Significant damage to small building or minor damage to several properties from one source	Litigation, claim or fine to £250k HSE Improvement Notice served Complaint referred to Ombudsman	£100k to £500k	Several persons details revealed	Environmental damage to > 1km ² Death of 10-100 fish, long term localised harm/ widespread short-term harm to environment, Significant visible pollution/ damage to commercial activity	Impact on a local community. Impact on Council Service	Local public or press interested
Major 4	Major injury to several people or death of an individual	Major damage to critical building or serious damage to several properties from one source	Litigation, claim or fine £250k to £1m imposed HSE Prohibition Notice served Adverse report from External Advisor	£500k to £1m	Several persons' sensitive /personal details revealed	Death of animals, substantial harm to human health, wide-spread/ long-term harm, loss/ closure of shellfish/drinking/ bathing water, extensive damage/ closure of agriculture/ commercial	Impact on several communities. Impact on whole organisation	National public or press interest,

Shetland Islands Council Pension Fund: Risk Register

Risk Assessment February 2017

HAZARD	Personal Safety	Property loss or damage	Failure to provide Statutory Service or breach of legal requirements	Financial Loss or Increased cost of Working	Personal Privacy Infringement	Environmental	Community / stakeholders / organisation	Reputation
						activities		
Extreme 5	Death of several people	Total loss of critical building(s)	Multiple civil or criminal actions. Litigation, claim or fine above £1m or custodial sentence	>£1m	All personal details revealed for many	Permanent damage to a nationally significant population/ to site of special interest	Impact on the whole of Shetland	Senior officer(s) and /or members dismissed/ disqualified. Central takeover of authority

Overall Risk Score

Low = Score of 1 to 6 Medium = Score of 8 to 12 High = Score of 15 to 25

		Likelihood				
		1	2	3	4	5
Impact	1	1	2	3	4	5
	2	2	4	6	8	10
	3	3	6	9	12	15
	4	4	8	12	16	20
	5	5	10	15	20	25



Shetland Islands Council

Agenda Item

7

Meeting(s):	Pension Fund Committee Pension Board	7 March 2017
Report Title:	Local Government Pension Scheme 2015/16	
Reference Number:	F-034-F	
Author / Job Title:	Jonathan Belford Executive Manager – Finance	

1.0 Decisions / Action required:

- 1.1 That the Pension Fund Committee and Pension Board NOTE the content of the report and RESOLVE to take account of the key findings and messages.

2.0 High Level Summary:

- 2.1 Each year the Accounts Commission publishes a range of specific audit reports and a number of national reports covering topics that affect parts of Scottish public sector activity. It is normal practice for each of these national reports to be considered by the most appropriate committee and for the key findings to be identified and described in the context of the Pension Fund.
- 2.2 The purpose of this report is to provide an overview of the national reports under their series entitled “Local Government Pension Scheme 2015/16”. The Commission has taken a different approach this year, publishing a review of the 2015/16 annual accounts, ahead of publishing a more detailed report on service performance in Spring 2017.
- 2.3 A copy of the report is attached at Appendix 1 and the main points contained in the report are:
- There are eleven council administered Local Government Pension Scheme (LGPS) pension funds in Scotland. The Pension Funds are required by regulation to produce an annual report and accounts separate from the administering council. Auditors deemed the 2015/16 annual accounts of all eleven pension funds to be true and fair;
 - The pension funds have more liabilities than assets;
 - The pension funds had no reported breaches of the Pensions Regulator’s code of conduct in 2015/16;
 - 2015/16 was a challenging year for the LGPS with the introduction of the career average revalued earning (CARE) scheme from 1 April 2015, new governance arrangements and uncertainty in investment markets affecting investment returns;
 - The Scheme Advisory Board has a comprehensive programme of work and is planning to review the LGPC structure during 2016/17. Its review will include consideration of collective investment vehicles and asset pooling;

- At a local level all funds introduced pension boards. The role of pension boards is to support pension committees on compliance with regulations and codes. The role pension boards can play is developing, but it is clear they can also provide a useful scrutiny function. Auditors will be expected to monitor the operation of pension boards;
- The overall Scottish LGPS net pension deficit at 31 March 2016 was £7.3 billion. Pension fund deficits are included in employers' accounts. Pension funds have arrangements to recover deficits over periods of up to 20 years in some cases, depending on the risk status associated with individual employers.

2.4 A formal valuation of the Pension Fund is carried out every three years. The last valuation, at 31 March 2014, assessed the Shetland Islands Council Pension Fund to be 92% funded, with a net pension deficit of £30m. The next triennial valuation will be carried out at 31 March 2017.

2.5 Shetland Islands Council Pension Fund has an investment strategy to achieve a fully funded position by 2027.

2.6 The net assets of the Shetland Islands Council Pension Fund scheme increased by £8m in 2015/16 to £375.7m.

3.0 Corporate Priorities and Joint Working:

3.1 There is a specific objective within the Corporate Plan to ensure that the Council is "living within our means". The key aim for the Pension Fund is to achieve a 100% funding position to ensure that the scheme remains affordable and sustainable in the future.

4.0 Key Issues:

4.1 The report provides a high-level, independent view of pension funds' financial performance and position in 2015/16. It is a supplementary document to the Financial Overview of Local Government in Scotland 2015/16. It focuses on four main areas:

Exhibit 1 (page 1) presents the key numbers affecting pension funds, membership numbers, assets and liabilities and values of benefits paid and income from employee and employer contributions and return on investment.

Exhibit 2 (page 2) focuses on the new LGPS governance arrangements in Scotland in 2015.

Exhibit 3 (page 4) shows the net return on investments for the LGPS pension funds for 2015/16.

Exhibit 4 (page 4) reports the value of pension fund assets as a proportion of the present value of promised retirement benefits.

4.2 Key messages highlighted in the 2015/16 report are:

- **Career Average Revalued Earnings:** Pension funds have coped well with the introduction of the new CARE LGPS with only minor teething issues reported by auditors. However, there are ongoing challenges in relation to the

new scheme as record keeping is more complex than for final salary schemes and there is greater dependency on employers for complete and accurate information.

- **Cost Control:** The new LGPS 2015 includes a cost control mechanism designed to ensure that the LGPS remains affordable for employers. Under this arrangement, the Government's Actuary Department (GAD) has established a Scottish LGPS cost cap of 15.5% for employers (on a whole scheme basis). If the cost in relation to future service increases by more than two per cent above the employer cost cap, then employee contributions and/or benefits will be reviewed.
- **Investment returns and expenses:** A number of LGPS funds saw negative investment returns on their assets in 2015/16 (The Shetland Islands Council Pension Fund achieved a positive return on its assets during the period). This was influenced by increased uncertainty in global investment markets, low inflation and low growth. The outlook for investment management remains challenging with ongoing volatility and uncertainty in global markets following important events such as Brexit and the US presidential election.
- 2015/16 saw a divergence in approach by pension funds to the inclusion of investment management expenses in their annual accounts. Revised accounting guidance for 2016/17 emphasises that pension funds' financial statements should only include costs for which they are directly liable, or are within their control. The Accounts Commission is encouraged by the commitment of Scottish funds to full transparency around investment management costs charged and supports indirect expenses being reported in the wider annual report.
- **Present value of promised retirement benefits:** The value of this liability is an estimate made by actuaries based on a number of assumptions about the future and the figure is quite sensitive to changes to those assumptions. The liability can be compared with the assets of the pension fund at a point in time and the report shows that all funds improved this indicator in 2015/16.
- **Outlook:** At a time when councils are under increasing financial pressure, administrative workloads will remain high as councils: continue to reduce their workforces and deal with auto-enrolment; refine how they administer the new LGPS; embrace new online technologies to improve information flows with employers and members; deal with recent changes to pension scheme governance; and changes to the UK state pension arrangements.

4.3 Overall the findings are helpful in explaining at a high level the financial position of the LGPS pension funds for 2015/16 and the challenges they face. These messages should be considered in the context of local circumstances.

4.4 The Executive Manager – Finance will seek to incorporate the findings and conclusions of the Accounts Commission into the future work of the Pension Fund.

5.0 Exempt and/or confidential information:

5.1 None.

6.0 Implications :

6.1 Service Users, Patients and Communities:	None.
6.2 Human Resources and Organisational Development:	There are none arising directly from this report. However, the challenges described in this report will have an impact on employees of Pension Fund employers and members of the Fund and while appropriate consideration will be given to this in the future, much of the implications are prescribed at a national level.
6.3 Equality, Diversity and Human Rights:	None.
6.4 Legal:	The Shetland Islands Council Pension Fund is required to prepare accounts in accordance with the Local Government (Scotland) Act 1973 and the 2015 Code of Practice on Local Authority Accounting. It also has a duty in respect of community planning and best value under the Local Government in Scotland Act 2003.
6.5 Finance:	There are none arising directly from this report however the subject matter clearly has a financial basis and context and as such the key messages and recommendations will be considered in the course of the work of the Pension Fund by its officers.
6.6 Assets and Property:	None.
6.7 ICT and new technologies:	None.
6.8 Environmental:	None.
6.9 Risk Management:	The Accounts Commission report highlights a number of risks, which will be considered as part of the future work and strategies of the Pension Fund.
6.10 Policy and Delegated Authority:	<p>The Pension Fund Committee has been delegated authority to discharge all functions and responsibilities relating to the Council's role as administering authority for the Shetland Islands Council Pension Fund (the Pension Fund) in terms of the Local Government (Scotland) Act 1994, the Superannuation Act 1972 and the Public Service Pensions Act 2013.</p> <p>The Pension Board is the body responsible for assisting the Scheme Manager in relation to compliance with scheme regulations and the requirements of The Pension Regulator.</p>
6.11 Previously considered by:	None.

Contact Details:

Jonathan Belford, Executive Manager – Finance, jonathan.belford@shetland.gov.uk
Date

Appendices:

Background Documents:

None

Local Government Pension Scheme 2015/16



ACCOUNTS COMMISSION 

1. This supplement accompanies our Financial Overview of Local Government in Scotland 2015/16.
2. There are 11 council administered Local Government Pension Scheme (LGPS) pension funds in Scotland. They range from one of the biggest pension funds in the UK (Strathclyde) to one of the smallest (Orkney). Key LGPS facts are shown in [Exhibit 1](#).

Exhibit 1

Scottish Local Government Pension Scheme—key numbers

Membership



Active **226,000**
Deferred¹ **126,000**
Pensioner **169,000**

Assets and liabilities



Position
£34.5 billion assets
£41.8 billion liabilities
(estimate)

Transactions



£1.1 billion benefits paid
£0.94 billion employer contributions
£0.27 billion employee contributions
£0.68 billion return on investments

Note: 1 Deferred pensioners are members who have left the scheme but will be eligible for benefits upon reaching retirement age

3. It has been a challenging year for the LGPS in Scotland with the introduction of the new career average revalued earnings (CARE) scheme from 1 April 2005, new governance arrangements at UK, Scotland and local levels and uncertainty in investment markets affecting investment returns.

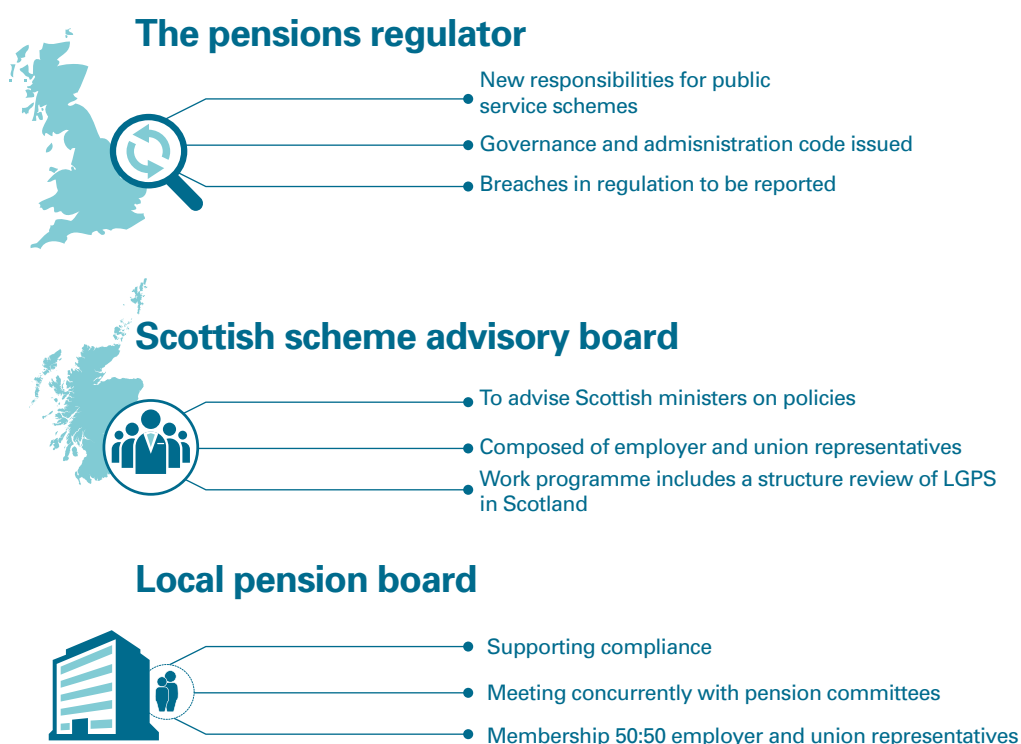
4. Pension funds are required by regulation to produce an annual report and accounts and these are audited separately from the accounts of the administering council. Auditors' deemed the 2015/16 annual accounts of all 11 pensions funds to be true and fair.

Governance arrangements

5. The Public Service Pensions Act 2013 introduced significant changes to the governance framework for public service pension schemes and for the LGPS in Scotland. [Exhibit 2](#) sets out the key changes to governance in 2015.

Exhibit 2

New LGPS governance arrangements in Scotland 2015



6. The Pensions Regulator has issued a code of practice for public sector schemes and pension funds in Scotland continue to monitor compliance with the new code assisted by local pension boards. Fund managers and advisors have a statutory responsibility to report significant breaches to the Pensions Regulator. We have not been made aware of any reports in respect of breaches in 2015/16.

7. The Scheme Advisory Board has a comprehensive programme of work and is planning to review of the LGPS structure in Scotland during 2016-17. Its review will include consideration of collective investment vehicles and the asset pooling model adopted in England and Wales.

8. At a local level all funds introduced pension boards. The role of pension boards is to support pension committees on compliance with regulations and codes. The role pension boards can play is developing, but it is clear they can also provide a useful scrutiny function. Auditors will be expected to monitor the operation of pension boards.

The new Career Average Revalued Earnings LGPS 2015

9. A new Scottish Local Government Pension Scheme was introduced on 1 April 2015. The key changes include:

- a move to benefits being worked out using career average (CARE) rather than final salary
- pension is built up at a rate of 1/49th of annual pensionable pay
- member's normal retirement age being linked to their own State Pension Age.
- A cost-control mechanism will be implemented to make sure the Scheme remains affordable and sustainable in the future.

10. Pension funds have coped well with the introduction of the new CARE LGPS with only minor teething issues reported by auditors. However, there are ongoing challenges in relation to the new scheme as record keeping is more complex than for final salary schemes and there is greater dependency on employers for complete and accurate information. Pension calculations for existing older members will be complex as many will have benefits accrued under the new 2015 scheme (based on CARE and 1/49ths) the previous 2009 scheme (based on final salary and 1/60ths) and the 1998 scheme (based on final salary and 1/80ths).

Cost control under the LGPS 2015

11. The new LGPS 2015 includes a cost control mechanism designed to ensure that the LGPS remains affordable for employers. Under this arrangement, the Government's Actuary Department (GAD) has established a Scottish LGPS cost cap of 15.5 per cent for employers (on a whole scheme basis). If the cost in relation to future service increases by more than two per cent above the employer cost cap, then employee contributions and/or benefits will be reviewed. We understand that employer cost cap costs will next be appraised by GAD following the 2017 triennial valuation and that the earliest cost sharing could start would be 2019.

Investment returns and expenses 2015/16

12. A number of LGPS funds saw negative investment returns on their assets in 2015/16, as shown in [Exhibit 3 \(page 4\)](#). This was influenced by increased uncertainty in global investment markets, low inflation and low growth. The outlook for investment management remains challenging with ongoing volatility and uncertainty in global markets following important events such as Brexit and the US presidential election.

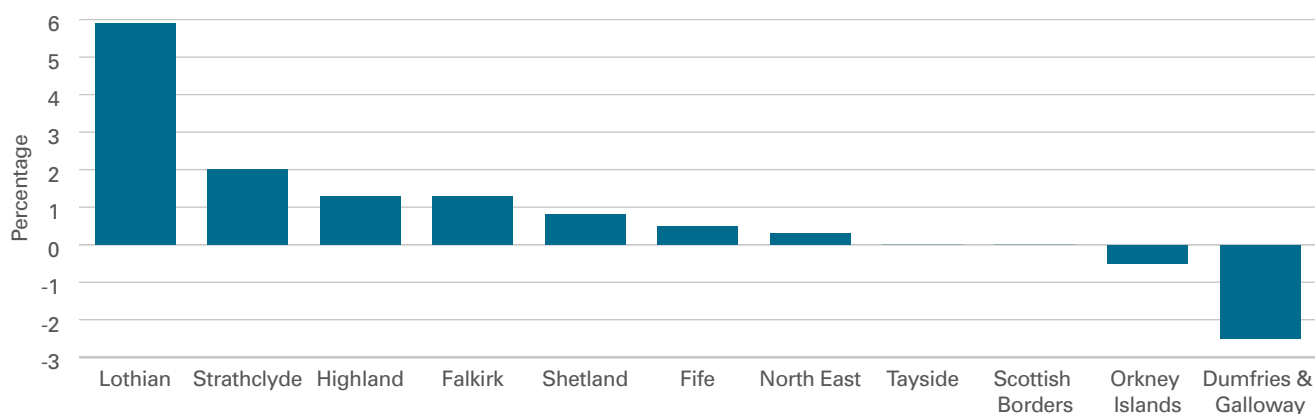
13. Although pension funds manage their investments in line with the same regulatory and governance regimes they have differing strategies and arrangements. Investment management is a complex area and funds make use of external advisers and managers. The full costs of investment management are not always fully transparent and there has been increased scrutiny and changes to guidance around accounting for these costs in recent years.

14. In 2015/16 we saw a divergence in approach by pension funds to the inclusion of investment management expenses in their annual accounts. Revised accounting guidance for 2016/17 emphasises that pension funds' financial statements should only include costs for which they are directly liable, or are within their control. The Accounts Commission is encouraged by the commitment of Scottish funds to full transparency around investment management costs charged and supports indirect expenses being reported in the wider annual report.

Exhibit 3

LGPS pension funds – Net return on investment 2015/16

In 2015/16, four funds saw negative returns on investments.



Source: Pension Fund accounts 2015/16

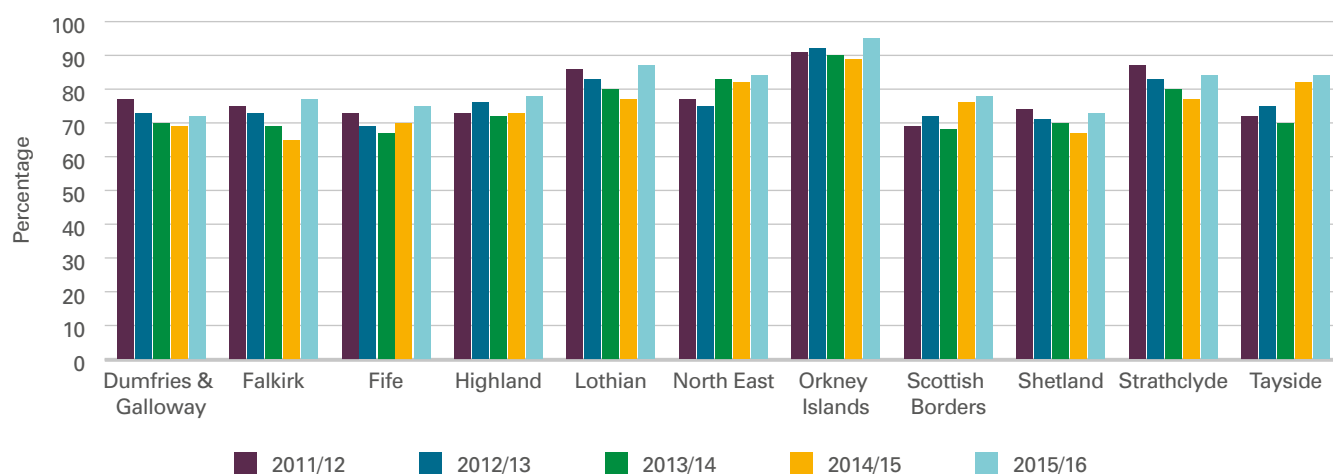
Present value of promised retirement benefits

15. Pension fund accounts include a disclosure of the present value of promised retirement benefits. This value of this liability is an estimate made by actuaries based on a number of assumptions about the future and the figure is quite sensitive to changes to those assumptions. The Liability can be compared with the assets of the pension fund at a point in time and [Exhibit 4](#) shows the valuation of pension fund assets as a proportion of liabilities for each of the last five years.

Exhibit 4

Pension fund assets as a proportion of the present value of promised retirement benefits

The position of all funds improved in 2015/16.



Note: The Scottish weighted average is close to that for Strathclyde which is by far the biggest pension fund in Scotland and one of the biggest in the UK.

Source: Pension Fund accounts 2011/12–2015/16

16. The percentages shown in [Exhibit 4](#) will typically be lower than those calculated by actuaries for the triennial funding valuations which are then used to set employer contributions. This is because the assumptions that can be used for accounting purposes are more tightly prescribed.

17. The overall Scottish LGPS net pension deficit at 31 March 2016 was £7.3 billion. Pension fund deficits are included in employers' accounts. Pension funds have arrangements to recover deficits over periods of up to 20 years in some cases, depending on the risk status associated with individual employers.

18. Pension deficits and employer contributions are complex areas and it can be difficult to establish differences between pension funds from their annual reports. Greater transparency and consistency of reporting in this an area would be beneficial to an understanding of the LGPS in Scotland.

Outlook

19. At a time when councils are under increasing financial pressure, administrative workloads will remain high as councils: continue to reduce their workforces and deal with auto enrolment; refine how they administer the new LGPS; embrace new online technologies to improve information flows with employers and members; deal with recent changes to pension scheme governance; and changes to the UK state pension arrangements.

20. The low inflation and low growth economic outlook together with uncertainty on the financial markets means that investment management will remain challenging at a time when investment performance is key.

21. The new cost control mechanism should help ensure that the LGPS remains affordable for employers in respect of active members although it does nothing to reduce the costs of pensions in payment and the associated deficits.

22. The Scottish Scheme Advisory Board is currently undertaking a structural review of the LGPS in Scotland. The outcome of this review is clearly of pivotal importance to the shape of the scheme and to administration costs going forward.



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