



Shetland Islands Council

Agenda Item

1

Meeting(s):	Audit Committee Pension Fund Board Pension Fund Committee	20 September 2017
Report Title:	Annual Audit Report on the 2016/17 Audit – Shetland Islands Council Pension Fund	
Reference Number:	F-080-F	
Author / Job Title:	Executive Manager – Finance	

1.0 Decisions / Action required:

1.1 That the Audit Committee:

- a) NOTES the findings of the 2016/17 audit as contained in the external auditor's Annual Report at Appendix 1;
- b) CONSIDERS a verbal report by the external auditor;
- c) CONSIDERS the audited Annual Accounts for 2016/17 (Appendix 2) for Shetland Islands Council Pension Fund;

1.2 That Pension Fund Committee:

- a) NOTES the findings of the 2016/17 audit as contained in the external auditor's Annual Report at Appendix 1;
- b) APPROVES the agreed Action Plan as outlined in the Annual Report;
- c) APPROVES the audited Annual Accounts for 2016/17 (Appendix 2) for Shetland Islands Council Pension Fund for signature.

2.0 High Level Summary:

2.1 The Local Authority Accounts (Scotland) Regulations 2014 (“the Regulations”) require the Pension Fund to prepare and publish annual accounts that are subject to external audit. The appointed external auditor is Deloitte LLP.

2.2 Section 10 of the Regulations requires the Committee / Board to consider any report made by the appointed auditor before deciding whether to sign the audited accounts.

2.3 International Standard on Auditing 260 (ISA 260) requires the external auditors to communicate significant findings from the audit, including:

- the auditor’s views about significant qualitative aspects of the entity’s accounting practices, including accounting policies, accounting estimates and financial statement disclosures;
- significant difficulties encountered during the audit;
- significant matters arising from the audit that were discussed, or subject to correspondence with management;
- written representations requested by the auditor; and
- other matters which in the auditor's professional judgement, are significant to the oversight of the financial reporting process.

- 2.4 Deloitte LLP's ISA 260 findings are included in the Annual Audit Report at Appendix 1 and confirms their unmodified opinion, which means that the annual accounts are free from material misstatement and present a true and fair view of the Pension Fund's financial position at 31 March 2017.
- 2.5 The unaudited accounts for the year to 31 March 2017 were approved by the Pension Fund Committee on 19 June 2017 and there are no changes to the accounting deficit or net assets in the audited annual accounts.
- 2.6 There is an additional note (Note 11) in the audited accounts relating to the fair value of investments.

3.0 Corporate Priorities and Joint Working:

- 3.1 The preparation and presentation of the Audited Annual Accounts is a key element of the Pension Fund's overall governance and reporting arrangements.

4.0 Key Issues:

- 4.1 The Pension Fund's accounts for the year to 31 March 2017 were submitted to Deloitte LLP by the statutory deadline of 30 June 2017. The external auditor was required to complete the audit by 30 September 2017 and to report on certain matters arising to those charged with governance.
- 4.2 The Annual Audit Report (Appendix 1) highlights three significant risk areas that auditors reviewed, as follows:
- a) Accuracy of contributions payable to the Fund;
 - b) Valuation of investments; and
 - c) Compliance of the financial statement with the amendments made by the 2016/17 Code of Audit Practice.
- 4.3 Pages 6 to 10 of the report at Appendix 1 presents how, in each of these areas, the result of the audit control testing was satisfactory, with one exception being the absence of a note to the accounts disclosing a Fair Value Hierarchy in relation to investments.
- 4.4 As well as reviewing the annual accounts, the scope of the audit includes wider issues, such as governance, transparency and financial sustainability. Some of the key audit findings (detailed in Appendix 1) in these areas are:
- **Financial Sustainability:** The Fund has sufficient plans in place to continue to be financially sustainable in the medium and long term.
 - **Financial Management:** Appropriate financial reports are provided to the Pension Fund Committee to challenge variances and under-performance.
 - **Governance and Transparency:** The policies and procedures around governance, Codes of Conduct, etc are clear and transparent and available for all members to read on the Shetland Islands Council website.
 - **Value for money:** There is sufficient scrutiny over expenditure of the Fund, in particular investment management fees.

5.0 Exempt and/or confidential information:

- 5.1 None.

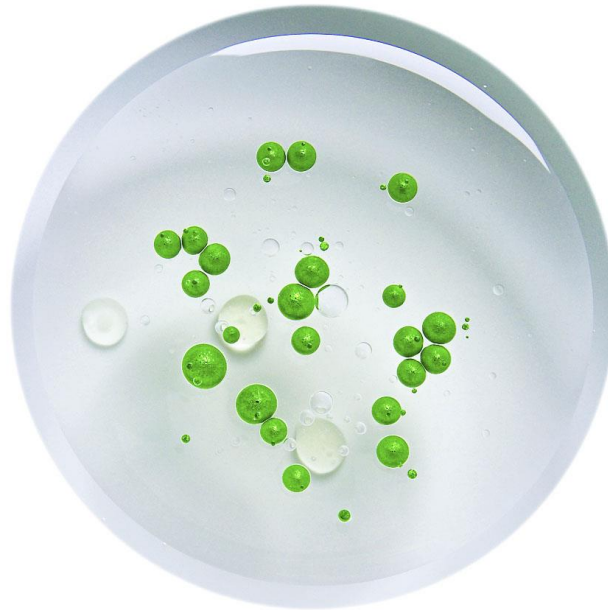
6.0 Implications :	
6.1 Service Users, Patients and Communities:	None
6.2 Human Resources and Organisational Development:	None
6.3 Equality, Diversity and Human Rights:	None
6.4 Legal:	The Local Authority Accounts (Scotland) Regulations 2014 require the Pension Fund to meet to consider and aim to approve the audited Annual Accounts for signature no later than 30 September each year, having regard to any report made on those accounts and any advice given by the proper officer or the auditor.
6.5 Finance:	None
6.6 Assets and Property:	None
6.7 ICT and new technologies:	None
6.8 Environmental:	None
6.9 Risk Management:	The Annual Audit Report includes the identification of key risks and internal control arrangements in place to manage those risks, together with any improvement actions required.
6.10 Policy and Delegated Authority:	The remit of the Audit Committee includes consideration of audit matters as well as overseeing and reviewing any action taken in relation to audit activity. The preparation and presentation of the Annual Accounts, is a key element of the Pension Fund's overall governance and reporting arrangements.
6.11 Previously considered by:	N/A

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12 September 2017

Background Documents: *The Local Authority Accounts (Scotland) Regulations 2014*



2016/17 Annual Audit Report to the Members and Controller of the audit

13 September 2017

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Director introduction

The key messages in this report

I have pleasure in presenting our Annual Audit Report to the Members and Audit Controller for the 2016/17 audit of the Shetland Islands Council Pension Fund ("the Fund"). I would like to draw your attention to the following key messages:

Audit quality is our number one priority. We plan our audit to focus on audit quality with the following objectives:

- A strong understanding of your internal control environment.
- A well planned and delivered audit that raises findings early with those charged with governance.
- Use of pension audit specialists where appropriate.
- A robust challenge of the key judgements taken in the preparation of the financial statements.

Audit scope

As communicated in our planning report dated 9 February 2017, our main reporting responsibilities are to:

- Provide the Independent Auditor's Report on the annual accounts;
- Provide the annual report on the audit addressed to the Members and Audit Controller; and
- To provide reports to management, as appropriate, in respect of the auditor's responsibilities in the 2016/17 Code of Audit Practice ("2016/17 Code").

We have also read the content of the draft annual report and the governance statement to confirm their consistency with the financial statements and our understanding of the business.

Significant audit risks and areas of audit focus

As communicated in our planning report we identified management override of controls as our significant audit risk. This is in line with Auditing Standards which require us to assume that management override of controls is an audit risk for all of our audits.

In addition we identified the following areas of audit focus:

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

We have not amended the significant audit risk and areas of audit focus during our testing and further details of our work performed and findings can be found on pages 6 to 10.

Wider Scope Requirements

The 2016/17 Code sets out four audit dimensions which set a common framework for all public sector audits in Scotland. These dimensions are:

1. Financial Sustainability;
2. Financial Management;
3. Governance and Transparency; and
4. Value for Money.

Our conclusions on the audit dimensions can be found on pages 11 and 12 of this report.

Director introduction (continued)

The key messages in this report (continued)

Insights	We have included in this report details of any uncorrected misstatements above our reporting threshold and material disclosure deficiencies on page 15. In addition we have included any insights found as a result of our audit testing. These can be found on page 16.
Status of the audit	<p>We are currently progressing the audit towards completion. The following procedures have still to be received/performed and our opinion is subject to their satisfactory completion:</p> <ul style="list-style-type: none">• Independent confirmation of the bank account balance at 31 March 2016;• Final technical review of the financial statements and audit file;• Receipt of a signed management representation letter; and• Satisfactory completion of our post-year end events review.
Our conclusion	Based on our work performed to date, and subject to the satisfactory completion of the outstanding items listed above, we anticipate issuing an unmodified audit opinion on the financial statements.

Pat Kenny
Audit Director

Our audit explained

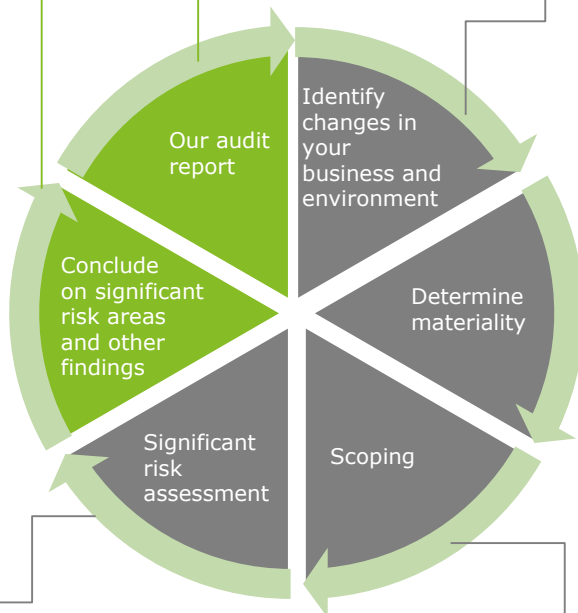
Area dimensions

In accordance with the 2016 Code of Audit Practice, we have considered how you are addressing the four audit dimensions, being:

- Financial sustainability
- Financial management
- Governance and transparency
- Value for money

Significant audit risks and areas of audit focus

Our risk assessment process is a continuous cycle throughout the year. Page 6 provides a summary of our risk assessment of your significant audit risk and areas of audit focus.



Final audit report

In this report we have concluded on the significant audit risk and areas of audit focus identified in our planning report and any other key findings from the audit.

Key developments in your Fund

As noted in our planning report, there have been no significant changes to the Fund itself during the year. The 2016/17 Code was amended for pension funds from financial year 2016/17 and requires additional disclosures to be included in the financial statements.

Materiality

We have determined materiality based on 1% of the Fund's net assets at 31 March 2017 to be £4,490,000. We have determined performance materiality as £4,041,000 based on total anticipated uncorrected misstatements amounting to 10% of materiality. Our reporting threshold of misstatements in the financial statements is £224,500 based on 5% of materiality.

Scope of the audit

We have audited the financial statements for the year ended 31 March 2017 of the Shetland Islands Council Pension Fund. The scope of our audit remains consistent with that in our planning report. We have embedded specialists into our audit team where appropriate, including a financial instruments specialist to review our work performed on the Fund's investment assets.

Quality and Independence

We confirm 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.

Timeline 2017

November 2016 – February 2017

Meetings with management and other staff to understand the processes and controls.

July – August 2017

Review of draft accounts, testing of significant risk and performance of substantive testing of results.













March 2017
Year end








20 September 2017
Audit committee meeting

20 September 2017
Accounts sign off

Significant audit risks and areas of audit focus

Dashboard

Significant audit risk	Risk Level	Fraud Risk	Approach to Controls Testing	Level of Judgement
Management override of key controls			D&I	
Areas of audit focus				
Accuracy of contributions payable to the Fund			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 judgement/management involvement		Not a Fraud Risk		Significant Audit Risk
	Medium levels of judgement/management involvement		Fraud Risk		Area of Audit Focus
	High degree of judgement/management involvement	D & I Design and Implementation			

Significant audit risk

Management override of controls

Description

International Standards on Auditing requires auditors to identify a presumed risk of management override of controls. This presumed risk cannot be rebutted by the auditor. This recognises that management may be able to override controls that are in place to present inaccurate or even fraudulent financial reports.

Deloitte Response

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

- Made enquiries of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments;
- Performed 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;
- Tested 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 performed an analysis of journal entries which enabled us to focus on journals meeting specific pre-determined parameters determined during our audit planning;
- Reviewed the financial statements for any accounting estimates which could contain management bias, and assessed the judgements taken against supporting evidence;
- Confirmed that there is an appropriate level of segregation of duties over processing journal entries to the financial statements throughout the year; and
- Made enquiries of management in relation to the identification of related party transactions.

Deloitte view

We have no issues to report to the Members and the Controller of the Audit from the testing we have performed.



Areas of audit focus

Accuracy of contributions payable to the Fund

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 performed the following audit procedures:

- Reviewed the design and implementation of key controls over the contribution process;
- Performed an analytical review of the employer 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 recalculated individual contribution deductions to ensure that these are being calculated in accordance with the rates stipulated in the Local Government Pension Scheme (Scotland) Regulations 2014 ("LGPS Regulations") for employee contributions and in the Funding Strategy Statement for employer contributions; and
- Tested that the correct definition of pensionable salary is being used per the LGPS Regulations to calculate contribution deductions.

Deloitte view

We have no issues to report to the Members and the Controller of the Audit from the testing we have performed.



Areas of audit focus

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.

Deloitte Response

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

- Reviewed the design and implementation of key controls over the valuation of these investments by obtaining investment manager and custodian internal control reports and evaluating the implications for our audit of any exceptions noted;
- Agreed year end valuations, sales proceeds and purchases in the financial statements to the reports received directly from the investment managers and the Fund's custodian;
- Agreed the valuations as at 31 March 2016 to the reports received directly from the investment managers and the Fund's custodian;
- Performed valuation testing on the valuation of the investments at 31 March 2016 and 2017 by using a range of techniques depending on the type of investment. Where the investment was not directly quoted on an exchange we confirmed if it is a registered fund and obtained an independent price. Where this was not the case we confirmed if the fund was structured as a unitised insurance policy or used sales transactions close to year end as an estimate of the price. Where none of these options are available we obtained audited financial statements and rolled forward the audited value to the year end using an appropriate benchmark and Pension Fund transactions where the audited accounts are not coterminous with the Pension Fund's year end; and
- Engaged our financial instrument specialists to review the audit work performed in relation to these assets.

Deloitte view

We have no issues to report to the Members and the Controller of the Audit from the testing we have performed.



Areas of audit focus

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 performed the following audit procedures:

- Assessed 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;
- Agreed the classification of the investment assets within the fair value hierarchy to independently received investment manager and custodian reports and the reconciliation of those reports as prepared by the finance team;
- Confirmed that the recommended disclosures in respect of investment management expenses comply with the requirements of the Code;
- Obtained a copy of the annex to confirm that the other sections of the Code have been considered where they apply to the Pension Fund; and
- Benchmarked the financial statements to the CIPFA checklist to confirm all appropriate disclosures were included.

Deloitte view

From our testing we noted that the first version of the accounts did not contain a Fair Value Hierarchy disclosure of the investment assets as required by the 2016/17 code and IFRS 13. This has since been updated in the final version of the financial statements.



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 have considered how the Pension Fund addresses these areas as part of our audit work as follows:

Audit dimension	Audit work completed	Audit Conclusion
<p>Financial sustainability considers the going concern assumption used in the financial statements to consider whether the Pension Fund is planning effectively to continue to deliver its benefit services over the medium to long term.</p>	<p>We reviewed the arrangements and financial planning systems in place by the Pension Fund to ensure that its services can continue to be delivered. This included:</p> <ul style="list-style-type: none"> • 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; and • A review of the funding policy as set out in the Shetland Islands Council Pension Fund Investment Strategy 2014-2027 ("Investment Strategy"), 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>From our work completed we are satisfied the Fund has sufficient plans in place to continue to be financially sustainable in the medium and long term. We did not identify any issues regarding non-payment of contributions due from the Scheduled and Admitted Bodies which would have an impact on the financial sustainability of the Fund. In addition from our review of the Investment Strategy, the Fund has taken investment advice on how best to use it's resources appropriately to ensure future benefits can be settled when the liability arises and the Fund will be 100% funded by 2027.</p>
<p>Financial management is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.</p>	<ul style="list-style-type: none"> • We reviewed the budget and monitoring reporting by the Pension Fund during the year to assess whether financial management and budget setting is effective; and • We ensured 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>From our testing completed we can confirm that an Executive Manager – Finance has been appointed who has the appropriate status to act in that role and complies with the five principles outlined in the CIPFA guidance. From our review of the budget process we are satisfied that appropriate financial reports are provided to the Pension Fund Committee to challenge variances and underperformance and that this is performed.</p>

Wider Scope Requirements (continued)

Audit Dimensions (continued)

Audit dimension	Audit work completed	Audit Conclusion
<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"> • We reviewed the Pension Committee meeting minutes to assess the effectiveness and scrutiny of governance arrangements. • We reviewed 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. • In addition we reviewed the Annual Governance Statement and Governance Compliance Statement to confirm the governance arrangements observe the guidance issued by Scottish Ministers. 	<p>From our testing performed we have no issues to note. The Annual Governance Statement and Governance Compliance Statement contains the required information.</p> <p>The procedures and policies around governance, Codes of Conduct, etc. are clear and transparent and available for all Members to read on the Shetland Island Council website.</p>
<p>Value for money is concerned with using resources effectively and continually improving services.</p>	<ul style="list-style-type: none"> • We gained an understanding of how the Pension Fund demonstrates value for money in the use of resources and the linkage between money spent and outputs and outcomes delivered. • We reviewed the scrutiny that is in place to challenge the Pension Fund's investment managers on fees and performance. 	<p>From our review of the budget process we are satisfied that there is sufficient scrutiny over expenditure of the Fund, in particular investment management fees. We noted, that despite an increase of £48k in investment management fees during the year, by in large the remainder of administration expenses for the Fund were in line with the prior year.</p> <p>In addition the Investment Strategy document outlines how the Fund will achieve value for money in where the assets are invested, ultimately aiming for 100% funding by 2027.</p>

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 Pension Fund Audit Committee to discharge their governance duties. It also represents one way in which we fulfil our obligations under ISA 260 (UK and Ireland) to communicate with you regarding your oversight of the financial reporting process and your governance requirements. Our report includes:

- Results of our work on key audit judgements and our observations on the quality of your Annual Report.
- Our internal control observations.
- Other insights we have identified from our audit

What we don't report

As you will be aware, our audit was not designed to identify all matters that may be relevant to the Fund.

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, our views on internal controls and risk assessment should not be taken as comprehensive or as an opinion on effectiveness since they have been based solely on the audit procedures performed in the audit of the financial statements and the other procedures performed in fulfilling our audit plan.

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

The scope of our work

Our observations are developed in the context of our audit of the financial statements.

We described the scope of our work in our audit plan and the supplementary "Briefing on audit matters" circulated to you in February 2017.

This report has been prepared for the Pension Fund 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.

Deloitte LLP

Statutory Auditor

Glasgow

13 September 2017

Appendices



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Audit adjustments

Corrected and uncorrected misstatements

We are required to report any corrected and uncorrected misstatements which are more than 5% of our materiality threshold to the Members and Controller of the Audit.

For the avoidance of doubt we have no corrected or uncorrected misstatements to report to the Members and the Controller of the Audit.

In addition we are required to report any material disclosure deficiencies in the financial statements. From our testing we noted that the first version of the accounts did not contain a Fair Value Hierarchy disclosure of the investment assets as required by the 2016/17 code and IFRS 13. This has since been updated in the final version of the financial statements and we have no further disclosure misstatements to report.

Insights

Recommendations for improvement

Area	Observation	Recommendation
Reporting to the Actuary	During our testing over the information that the Fund provides to the Actuary we noted that reviews are performed before any documentation is sent to the Actuary, however these reviews are not evidenced by way of signature.	We recommend that the reviews of the reports and information sent to the Actuary are signed by way of dated signature so that evidence of the control can be obtained.

Fraud responsibilities and representations

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 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 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 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.
-

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 that we comply with APB Ethical Standards for Auditors and that, in our professional judgement, we and, where applicable, all Deloitte network firms are independent and our objectivity is not compromised.

Fees

The audit fee for 2016/17 is £30,238 net of VAT and out of pocket expenses, as detailed in our Audit Plan.

No non-audit services fees have been charged by Deloitte in the period.

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.

Relationships

We are required to provide written details of all relationships (including the provision of non-audit services) between us and the organisation, its board and senior management and its affiliates, including all services provided by us and the DTTL network to the audited entity, its board and senior management and its affiliates, and other services provided to other known connected parties that we consider may reasonably be thought to bear on our objectivity and independence.

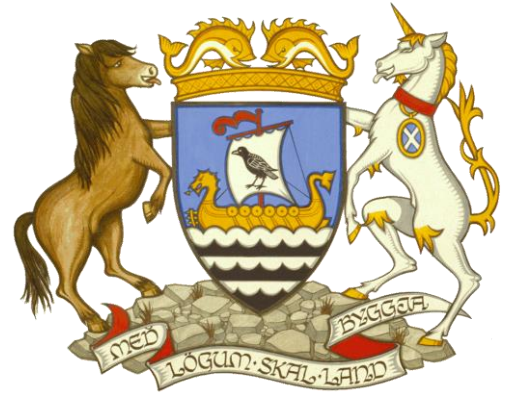
We are not aware of any relationships which are required to be disclosed.

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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Shetland Islands Council

Securing the Best for Shetland

Pension Fund Annual Report and Accounts 2016/17



Photo by Kevin Jones

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Management Commentary

The purpose of the Management Commentary is to inform all users of the accounts and help them understand the most significant aspects of the Pension Fund's financial performance during 2016/17 and year-end financial position as at 31 March 2017.

Background

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

It provides pensions and other benefits for pensionable employees of scheduled bodies and admitted bodies within Shetland, as shown below. Teachers are not included as they have a separate national pension scheme.

Employers with active members at 31 March 2017

Scheduled Bodies:

- Shetland Islands Council
- Orkney & Shetland Valuation Joint Board

Admitted Bodies:

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

Employers with no active members at 31 March 2017

Admitted Bodies:

- Shetland Enterprise Co Ltd
- ABA Services Ltd

Employers who have ceased to participate in the Scheme

Admitted Bodies:

- Shetland Youth Information Services
- Advocacy Shetland
- Atlantic Ferries
- Community Alcohol & Drugs Services Shetland (CADSS)

In general, employers pay regular monthly contributions to the Pension Fund based on the salary costs of those staff who are Pension Fund members (active members). Where an Employer continues to participate in the Scheme but has no active members, a lump sum is calculated by the actuary to cover the cost of ongoing and future pension payments.

Until 31 March 2015 the defined benefits were calculated based upon a member's final salary, however this changed with the implementation of The Local Government Pension Scheme (Scotland) Regulations 2014.

From 1 April 2015, the Pension Scheme moved away from a final salary pension scheme to a career average revalued earnings scheme (CARE). The changes were introduced to ensure the Pension Scheme is sustainable and affordable for the future.

Administering Authority Arrangements

The Council's Executive Manager - Finance is the officer with responsibility to ensure proper administration of the Council's financial affairs in terms of Section 95 of the Local Government (Scotland) Act 1973.

The Council's Executive Manager – Finance has responsibility for:

- the financial accounting of the Pension Fund;
- the preparation of the Pension Fund Annual Report; and
- being the principal adviser on investment management to the Council in its capacity as Trustee to the Pension Fund and as the Pension Fund's Administering Authority.

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

The day-to-day benefits administration for the Pension Fund is managed by the Expenditure Section within the Finance Service.

The Expenditure Section ensures that members of the Scheme are kept up-to-date with Scheme changes by means of regular mail-shots which includes relevant information, for example, revised tiered employee contribution rates, revised Pension Scheme booklets/factsheets, Pension Fund Accounts, etc.

Pension seminars, in conjunction with the Council's Additional Voluntary Contributions (AVC) provider, take place at least once a year. New employees are made aware of the benefits of the Local Government Pension Scheme (LGPS) with a leaflet included along with their contract. A Scheme Guide is also issued to new members of the scheme.

Investment Managers – Appointed

Blackrock - Nov 2008
Schroders - Mar 2007
M & G Investments - Nov 2014
KBI Global Investors Limited - Nov 2014
Newton - Nov 2014

Investment Advisor

KPMG

AVC Providers

Prudential
Equitable Life (closed to new members)

Banker

Bank of Scotland

Custodian

Northern Trust

Fund Actuary

Hymans Robertson LLP

The overview of the financial performance of the Pension Fund rests with the Pension Fund Committee. 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.

This includes overseeing the administration of the Pension Scheme, managing the Pension Fund's investments and preparing and maintaining the Funding Strategy Statement, Statement of Investment Principles, Governance Compliance Statement and Pension Administration Strategy. The Pension Fund Committee is made up of the Councillors who currently sit on the Council's Policy & Resources Committee.

The Pension Board is the body responsible for assisting the Scheme Manager (the Council) in relation to compliance with scheme regulations and the requirements of the Pensions Regulator. The Pension Board is made up of three Councillors, one Admitted Body employer and four union representatives.

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

During the year State Street ceased the provision of performance management services. The Pension Fund is in the process of looking for a new company to undertake independent performance management of fund managers.

Valuation and Membership

At 31 March 2017, the value of the Pension Fund stood at £450m, an increase of £74m on the previous year. The increase in the value of the Pension Fund is due to investment gains and an excess of employer and employee contributions over benefits payable.

The Pension Fund membership increased during the financial year by 476 to 7,043 members, this includes active members (197), deferred members (170) and pensioners (109). The increase in active members was primarily due to an increase in part-time employees in the Council.

The table below shows the breakdown of the 109 new pensioners following retirement during the year:

Retirement Type	Number
Normal	48
Early	17
Redundancy	6
Flexible	9
Ill health	7
Late	20
Efficiency	2
Total	109

Risk

The Pension Fund risk register was updated on 7 March 2017. There are a total of 35 risks, broken down into 6 High, 14 Medium and 15 Low. The key risks are summarised below:

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

Not all risk can be eliminated; however, every effort is made to mitigate the impact that risks present the Pension Fund, whether it be by active administration, diversification of investment mandates, engagement with employers, or implementation of policies and procedures.

Funding Strategy

The Net Assets Statement shows an increase in net assets of the Pension Fund to £450m. The Pension Fund investment strategy aims to achieve a fully funded Pension Scheme by 2027. Other objectives of the Pension Fund are:

- to secure and maintain sufficient assets to meet liabilities which fall due by the Pension Fund;
- to minimise the risk of assets failing to meet these liabilities, through an investment strategy, specifically tailored to the Pension Fund's requirements; and

- to maximise investment returns within an acceptable level of risk and providing stability in the level of employers' contribution rates.

Funding Strategy Statement

The Regulations on the management of the Pension Fund require the administering authority to prepare, maintain and publish a written Funding Strategy Statement. Details of the Funding Strategy Statement are found in Note 14: Funding Arrangements on page 29.

The purpose of the Funding Strategy Statement is to:

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

The most recent actuarial valuation carried out was at 31 March 2014. It showed that the Pension Fund is valued at £330m and 92% funded, with a deficit of £30m. The triennial valuation sets the employer contribution rates for the next three years. The total employer contribution rate, which is an average across the whole fund, has increased from 18.8% to 20.7%. The increased liability, recognising the value of future pension benefits, is the primary driver for this increase. The next triennial valuation will be as at 31 March 2017, and will be reflected in the 2017/18 accounts.

The Statement of Investment Principles

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

The Pension Fund also complied with the six Myners Principles, which were contained in a schedule to the Statement of Investment Principles.

The Statement of Investment Principles is available for viewing at the Finance Service, Montfield, Burgh Road, during normal working hours. It can also be found here: <http://www.shetland.gov.uk/coins/submissiondocuments.asp?submissionid=18529> – Appendix A.

Performance Management

The annual accounts summarise the Pension Fund's transactions for the year and satisfies the requirement of the Local Government Pension Scheme (Scotland) Regulation 55 (1) of The Local Government Pension Scheme (Scotland) Regulations 2014) to prepare a Pension Fund Annual Report for the financial year from 1 April 2016 to 31 March 2017.

Primary Financial Statements

The annual accounts summarise the Pension Fund's transactions for the year and its year-end position at 31 March 2017. The Annual Accounts are prepared in accordance with the International Accounting Standards Board (IASB) Framework for the Preparation and Presentation of Financial Statements (the IASB Framework) as interpreted by the Code of Practice on Local Authority Accounting in the United Kingdom.

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

March 2017 include a description of their purpose. These statements are accompanied by Notes to the Accounts, which set out the Accounting Policies adopted by the Pension Fund and provide more detailed analysis of the figures disclosed on the face of the primary financial statements.

The Primary Financial Statements and Notes to the Accounts, including the accounting policies, form the relevant Annual Accounts for the purpose of the auditor's certificate and opinion.

Financial Performance in 2016/17

The Pension Fund Account presents the full economic cost of providing Pension Fund services in 2016/17. This shows a net income of £74.192m. This differs from the draft outturn position, shown below, which was reported to the Pension Fund Committee and Pension Board on 19 June 2017, and which is on Shetland Islands Council's website.

The reason for the difference is that the Pension Fund Account includes growth in the value of the fund and income automatically reinvested into the fund, which is not included in the table below.

The table below shows the variance of actual against budget as shown in the draft outturn report:

Description	2016/17 Annual Budget £000	2016/17 Draft Outturn £000	2016/17 Variance £000
Total Expenditure	12,350	15,009	(2,659)
Total Income	(19,166)	(20,467)	1,301
Net Income	(6,816)	(5,458)	(1,358)

Expenditure was higher than budgeted due to a number of high value lump sum payments, including death benefits. More people than anticipated have retired during 2016/17 resulting in an increase in benefits payable. Income was higher than budgeted due to a number of high value transfers in from other pension funds.

Budgets were set for death benefits, lump sums and transfers in, along with all other expenditure and income. However, it is difficult to estimate these items, due to the variable nature of them. Lump sums and transfers in are based on a person's length of service and salary, which is variable for each individual, and death benefits are directly related to a person's salary.

Administration Strategy

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

It is vital that employers provide prompt information to the Pension Fund so that timely and accurate information can be provided to the Scheme members. Performance is monitored on a regular basis. The information that the Pension Fund received during the year was delivered in a timely manner by all employers. This included information on new starts, leavers, normal retirements, early retirements and deaths in service. With the exception of a couple of occasions, all employer contributions were

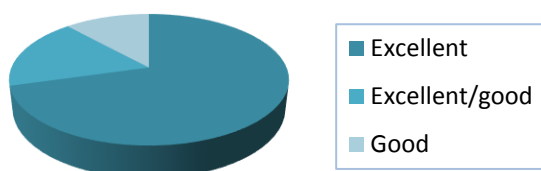
received by the 19th of the month following deduction.

Administration Performance

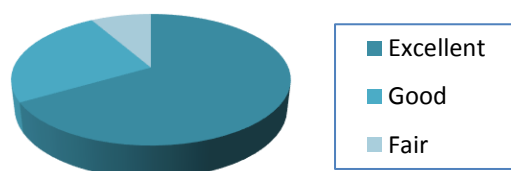
Shetland Islands Council, as a pension administering authority, is also committed to providing a high quality pension service to both members and employers and to ensure members receive their correct pension benefit entitlement.

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

Member Satisfaction Survey (68 responses)



Employer Satisfaction Survey (6 responses)



The customer feedback is very positive for the year and specific comments received will form a basis for identifying and implementing improvement.

Monitoring Arrangements

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

Reports are prepared on a quarterly basis for the Pension Fund Committee and Pension Board that give an overview of the position of the Pension Fund's external investments and present a summary of each fund manager's performance for the quarter and over a three-year period.

In line with the Pension Fund's governance arrangements to monitor and review fund managers, the Pension Fund Committee and Pension Board invite fund managers to attend the quarterly meetings to give presentations on their mandates and investment performance. At the meeting on 24 May 2016, KBI Global Investors Limited (previously Kleinwort Benson) and M & G gave presentations. At the meeting on 30 August 2016, Schroders gave a presentation, and at the meeting on 7 March 2017, Hymans Robertson, the Pension Fund's actuary, gave a presentation.

Annual visits are made to each fund manager to review the six monthly investment position. For 2016/17, these meetings took place in December 2016. The Pension Fund also receives quarterly audited performance review reports and monthly valuation reports from each fund manager. This Annual Report and Accounts is available via the Council's website

http://www.shetland.gov.uk/about_finances. A full version of this report is provided to the scheduled and active admitted bodies of the Scheme and a summary of the review is provided to all Pension Fund members, via a newsletter.

Remuneration Report

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

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

Details of Councillor and Senior Employee remuneration can be found in the accounts of Shetland Islands Council on the Council's website <http://www.shetland.gov.uk/>.

Pension Fund Outlook

Administrative

Following "Brexit", a question of how this will affect the Local Government Pension Scheme has been raised. Most of EU legislation that impacts on the LGPS is already written into UK legislation. The scheme will need to continue to comply with such legislation until such time as Britain leaves the EU. Future UK Governments could seek to repeal some or all of this legislation, subject to the terms of any new trade arrangements made with the EU.

With regard to UK government policy and legislative plans for the LGPS, the situation is 'no change'. Regulatory changes, policy objectives and the timescales for implementing them remain as they were before the vote.

Investment

The recent investment strategy review in 2014 was undertaken on the basis of managing risk while investing to achieve the Funding Strategy of having a fully funded Pension Scheme by 2027. During 2016/17, there were some major events such as the US Presidential election and the European Referendum. These events caused volatility within the investment markets but over the financial year, the main markets were higher and the Pension Fund investments benefitted as a result.

The Pension Fund remains cash positive, with income from contributions and investment return exceeding pensions and administrative costs. While this remains the case, the Pension Fund seeks to take advantage of this and grow the assets, while taking an appropriate view on the risks. As the Fund matures and expenditure begins to exceed income then work will have to be undertaken to address the requirement for cash to be achieved from the assets so that the cost of pensions can be met for the long term. It is estimated that the Pension Fund will remain cash positive until 2027, which is the basis for the Investment Strategy.

.....
Cecil Smith
Leader of the Council
Chair of the Pension Fund Committee
20 September 2017

.....
Jonathan Belford, CPFA
Executive Manager – Finance
20 September 2017

.....
Mark Boden
Chief Executive
20 September 2017

Investment Policy and Performance Report

Investment Policy

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

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

The Fund Managers have all signed up to the United Nations Principles on Responsible Investment Management. The principles reflect the view that environmental, social and corporate governance (ESG) issues can affect the performance of investment portfolios, and must be given appropriate consideration by investors, if they are to fulfil their fiduciary (or equivalent) duty.

The focus of the Pension Fund's investment strategy is on achieving a 100% funding level before the Pension Fund's contributions equal benefits payable, which is expected to be 2027. Beyond this point, it is expected that payments will exceed contributions made into the Pension Fund. The strategy proposes a less volatile approach with a more diversified asset base. It is estimated that the strategy will improve the level of return, and be protected against the full negative impact of volatile and falling markets due to its increased diversity.

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

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

The Pension Fund has five Fund Managers as follows:

Manager	Mandate	% of Pension Fund at March 2017
Blackrock	Passive UK Global Equities	42
Schroders	Active Property	11
Newton	Diversified Growth Fund	17
M & G	Alternative Bonds	22
Kleinwort Benson	Active Global Equities	8
Total		100

Investment Performance

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

For the year to 31 March 2017, the Pension Fund had a return of 19.0% compared to the benchmark return of 19.1%.

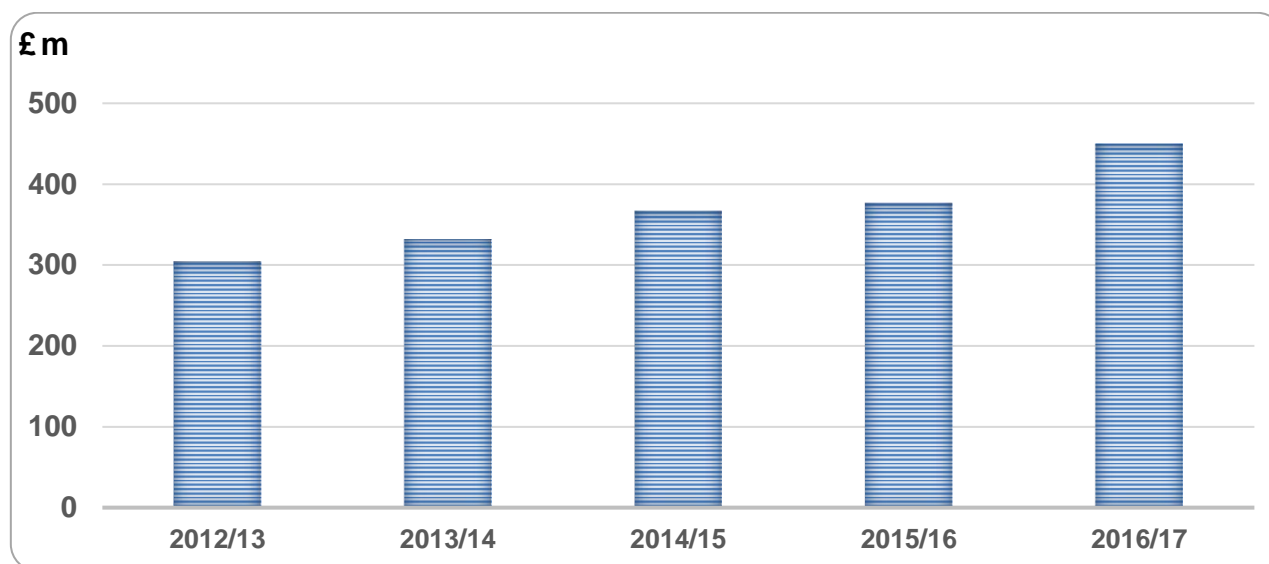
The table below shows the Pension Fund performance over the last five years, and the annualised return over three and five years:

	2012/13 %	2013/14 %	2014/15 %	2015/16 %	2016/17 %	Annualised	
						3 Year %	5 Year %
Fund Return	15.0	6.5	8.8	1.0	19.0	9.4	9.9
Benchmark	14.6	6.7	9.5	2.0	19.1	9.9	10.2
Performance	0.4	-0.2	-0.7	-1.0	-0.1	-0.5	-0.3

Over the longer term, the Pension Fund assets have grown in value at over 9% annually. The table above reveals a volatile period of five years, with very strong returns in 2016/17 and in 2012/13.

At the end of 2014/15, the revised Investment Strategy was put in place and this may have been a factor in failing to meet the benchmark in that and the subsequent year.

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



Annual Governance Statement

Introduction

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

Administering Authority

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

Regulatory Framework

The Scottish Public Pensions Agency (SPPA) is responsible for regulating the LGPS in Scotland and the Council administers the pension scheme in accordance with these regulations.

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

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

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

Scope of Responsibility

The Council is responsible for ensuring that the Pension Fund:

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

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

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

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

To this end, the Pension Fund is managed within the overall governance arrangements of Shetland Islands Council. The Council has recently refreshed its decision-making arrangements and the governance of the Pension Fund is included within those arrangements. The Shetland Islands Council meeting of 8 March 2017 refreshed the Code of Corporate Governance to ensure compliance with best practice.

Governance Framework

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

Critical to the success of a well-managed Pension Fund is appropriate internal control arrangements.

The systems of internal financial control are intended to ensure that:

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

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

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

The effective arrangements include:

- an appropriate level of knowledge for Pension Fund Committee and Pension Board members to ensure that they have adequate knowledge to oversee the governance of the Pension Fund business;
- clear objectives, good decision making at committee level, clear delegations to committee and staff, with appropriate, independent scrutiny of decision making and performance;
- a clear set of objectives for the Pension Fund, as described in the Funding Strategy Statement and Investment Principles;
- good performance monitoring arrangements, with committee members being able to directly question those responsible for all aspects of the business on a regular basis;
- a clear statement of risk (risk register), combined with effective risk management arrangements;
- an annual review of compliance against regulation, guidance and best practice arrangements;
- the Monitoring Officer ensuring compliance with regulation and guidance;
- clear monitoring arrangements;
- compliance with LGPS Investment Regulations;

- compliance with the CIPFA / Myners investment principles;
- appropriate custodian arrangements for investments;
- codes of conduct to support good relationships between committee members and staff who support the work of the Pension Fund;
- a demonstrable best value service, including good use of benchmarking data on the cost and quality of service provided; and
- effective internal control arrangements.

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

Review of Effectiveness

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

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

Management Assurance

As the administration of the Pension Fund is directly within the remit of the Director of Corporate Services, assurance has been sought from her in relation to the effectiveness of internal financial controls. This assurance provides the opportunity to highlight any weaknesses or areas of concern that should be considered. For 2016/17, no areas of weakness or concern were raised.

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

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

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

Assurance from Internal Audit

The Council provides internal audit arrangements to the Pension Fund both as a tool of management and with direct reporting to the Council's Audit Committee. The Internal Audit service operates in accordance with the Public Sector Internal Audit Standards (PSIAS). The service works to an approved Annual Plan, based on the approved Audit Strategy, based on the Audit Universe and an annual assessment of the known and potential risks.

During the year there were no specific internal audits carried out for the Pension Fund, and the controls work undertaken across the Council systems by internal audit were found to be generally adequate.

External Audit and Other External Scrutiny

Each year, the external auditors undertake an assessment of the internal controls in operation in the Council, to determine whether they can place reliance on them in the preparation of the final accounts. Recent reports by Audit Scotland identified a limited number of minor recommendations in the area of internal control and these are being addressed by management in order to ensure weaknesses are strengthened.

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

Self-Evaluation of Compliance

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

Principle	Compliance and Comments
Structure	
The management of the administration of benefits and strategic management of fund assets clearly rests with the main committee established by the appointing council.	Yes, the Pension Fund Committee has been delegated responsibility for overseeing the management and administration of the LGPS and managing the investments of the Pension Fund.
That representatives of participating LGPS employers, admitted bodies and scheme members (including pensioner and deferred members) are members of either the main or secondary committee established to underpin the work of the main committee.	Yes, the Pension Board, which meets concurrently with the Pension Fund Committee, includes representatives from employers (Councillors), admitted bodies (a Board Member) and scheme members (Trade Unions).
That where a secondary committee or panel has been established, the structure ensures effective communication across both levels.	Yes, the Pension Fund Committee and Pension Board meet concurrently to aid easy and open communication.
That where a secondary committee or panel has been established, at least one seat on the main committee is allocated for a member from the secondary committee or panel.	The Pension Board is not a secondary committee, both the Pension Fund Committee and Pension Board meet concurrently and have access to the same agenda papers. There is no need for a Pension Board member to be on the Committee.
Committee Membership and Representation	
All key stakeholders are afforded the opportunity to be represented within the main or secondary committee structure. These include: i) employing authorities (including non-scheme employers, e.g., admitted bodies); ii) scheme members (including deferred and pensioner scheme members); iii) where appropriate, independent professional observers; and expert advisors (on an ad-hoc basis).	i) Yes - Pension Fund Committee and Pension Board ii) Yes, Pension Board iii) Yes, e.g. engaging with the appointed actuary or investment manager when professional advice is required.
Where lay members sit on a main or secondary committee, they are treated equally in terms of access to papers and meetings, training and are given full opportunity to contribute to the decision making process, with or without voting rights.	Yes, Pension Board members have the same access to information, papers and training
Selection and role of lay members	
That committee or board members are made fully aware of the status, role and function they are required to perform on either a main or secondary committee.	Yes, training provided during 2015/16
That at the start of any meeting, committee members are invited to declare any financial or pecuniary interest related to specific matters on the agenda.	Yes, 'Declarations of Interest' is a standing item on all agendas.

Principle	Compliance and Comments
Voting	
The policy of individual administering authorities on voting rights is clear and transparent, including the justification for not extending voting rights to each body or group represented on main LGPS committees.	Yes, these are contained in the Terms of Reference for both Pension Fund Committee and Pension Board.
Training/Facility time/Expenses	
That in relation to the way in which statutory and related decisions are taken by the administering authority, there is a clear policy on training, facility time and reimbursement of expenses in respect of members involved in the decision-making process.	Yes A Member Development Programme is in place. The Constitution clearly sets out the scope of approved duties. There is supplementary guidance to ensure Members' expenses are reimbursed in line with regulatory requirements.
That where such a policy exists, it applies equally to all members of committees, sub-committees, advisory panels or any other form of secondary forum.	No The policies for employer representatives and staff representatives are necessarily different and cannot be equally applied.
That the administering authority considers the adoption of annual training plans for committee members and maintains a log of all such training undertaken.	Yes A Member Development Programme was implemented. All member development is being monitored and logged centrally. Personal development plans are in place for 18 out of 22 Members.
Meetings (frequency/quorum)	
That an administering authority's main committee or committees meet at least quarterly.	Yes, the Pension Fund Committee and Pension Board meets at least four times per annum and is wholly focused on Pension Fund business.
That an administering authority's secondary committee or panel meet at least twice a year and is synchronised with the dates when the main committee sits.	Yes, the Pension Board sits concurrently with the Pension Fund Committee.
That an administering authority that does not include lay members in their formal governance arrangements, must provide a forum outside of those arrangements by which the interests of key stakeholders can be represented.	Lay members are included in formal governance arrangements.
Access	
That subject to any rules in the Council's constitution, all members of main and secondary committees or panels have equal access to committee papers, documents and advice that falls to be considered at meetings of the main committee.	Yes, committee papers are sent out to all Pension Fund Committee and Pension Board members, and all agenda items and subsequent minutes are available on the Shetland Islands Council Committee Information Pages (COINS).

Principle	Compliance and Comments
Scope	
That administering authorities have taken steps to bring wider scheme issues within the scope of their governance arrangements.	Yes, full scope of the Pension Fund Committee and Pension Board are found in their Terms of Reference
Publicity	
That administering authorities have published details of their governance arrangements in such a way that stakeholders with an interest in the way in which the scheme is governed, can express an interest in wanting to be part of those arrangements.	Yes The Annual Newsletter is available to all Members. The Annual Report and Accounts will be made available on-line.

Significant Governance Issues

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

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

Certification

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

.....
Cecil Smith
Leader of the Council
Chair of the Pension Fund Committee
20 September 2017

.....
Mark Boden
Chief Executive
Shetland Islands Council
20 September 2017

Statement of Responsibilities for the Statement of Accounts

The administering authority's responsibilities

The Authority is required to:

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

I can confirm that these Annual Accounts were approved for signature by the Council on 20 September 2017.

Signed on behalf of Shetland Islands Council

.....
Cecil Smith
Leader of the Council
Chair of the Pension Fund Committee
20 September 2017

The Executive Manager – Finance's responsibilities

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

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

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

The Executive Manager - Finance has also:

- kept proper accounting records which were up to date; and
- taken reasonable steps for the prevention and detection of fraud and other irregularities.

I certify that the Annual Accounts give a true and fair view of the financial position of the Pension Fund at the reporting date and the transactions of the Pension Fund for the year ended 31 March 2017.

.....
Jonathan Belford, CPFA
Executive Manager – Finance
Shetland Islands Council
20 September 2017

Pension Fund Account 2016/17

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

2015/16 £000		Notes	2016/17 £000	2016/17 £000
	Dealings with members, employers and others directly involved in the scheme			
(16,627)	Contributions	4	(16,026)	
(529)	Transfers in from other pension funds	5	(1,258)	
(886)	Other income		(28)	
(18,042)	Total Additions			(17,312)
11,890	Benefits payable	6	12,785	
133	Payments to and on account of leavers	7	363	
946	Other payments		4	
12,969	Total Withdrawals			13,152
(5,073)	Net (additions)/withdrawals from dealings with members			(4,160)
1,736	Management expenses	8		1,856
(3,337)	Net additions including Fund Management Expenses			(2,304)
	Return on investments			
(2,887)	Investment income	9	(3,154)	
(1,645)	(Profits) and losses on disposal of investments and changes in market value of investments	12b	(68,734)	
(4,532)	Net return on investments			(71,888)
(7,869)	Net increase in the net assets available for benefits during the year			(74,192)
(367,838)	Opening net assets of the scheme			(375,707)
(375,707)	Closing net assets of the scheme			(449,899)

Net Assets Statement as at 31 March 2017

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

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

2015/16 £000	Notes	2016/17 £000	2016/17 £000
	Investment Assets		
375,149	Investment Assets 10	448,957	
375,149	Total Investment Assets		448,957
	Current Assets		
1,102	Debtors 16	1,345	
1,178	Bank current accounts	1,011	
2,280	Total Current Assets		2,356
	Current Liabilities		
(1,497)	Sundry creditors 18	(366)	
(225)	Benefits payable	(1,048)	
(1,722)	Total Current Liabilities		(1,414)
375,707	Net assets of the scheme available to fund benefits at the reporting period end		449,899

The audited accounts were authorised for issue on 20 September 2017.

.....
Jonathan Belford, CPFA
Executive Manager – Finance
20 September 2017

Notes to the Accounts

Note 1: Description of Pension Fund

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

The following description of the Pension Fund is a summary.

General

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

- The Local Government Pension Scheme (Scotland) Regulations 2014;
- The Local Government Pension Scheme (Transitional Provisions and Savings) (Scotland) Regulations 2014;
- The Local Government Pension Scheme (Governance) (Scotland) Regulations 2015; and
- the LGPS (Management and Investment of Funds) Regulations 2010.

It is a contributory defined benefit pension scheme administered by Shetland Islands Council to provide pensions and other benefits for pensionable employees of scheduled bodies,

Shetland Islands Council, Orkney and Shetland Valuation Joint Board and admitted bodies within Shetland. Teachers are not included as they have a separate national pension scheme.

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

Membership

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

Organisations participating in the Shetland Islands Council Pension Fund include:

- Scheduled bodies, which are local authorities and similar statutory bodies whose staff are automatically entitled to be members of the Pension Fund; and
- Admitted bodies, which are other organisations that participate in the Pension Fund under an admission agreement between the Pension Fund and the relevant organisation. Admitted bodies include voluntary, charitable and similar bodies or private contractors undertaking a local authority function following outsourcing to the private sector.

There are 11 employer organisations with active members within Shetland Islands Council Pension Fund including the Council itself, a summary of membership is shown below:

31 March 2016	Shetland Islands Council Pension Fund	31 March 2017
12	Number of employers with active members	11
	Number of employees in scheme:	
2,763	Shetland Islands Council	2,957
382	Other employers	385
3,145	Total	3,342
	Number of pensioners/dependants	
1,493	Shetland Islands Council	1,583
126	Other employers	145
1,619	Total	1,728
	Deferred pensioners	
1,538	Shetland Islands Council	1,611
265	Other employers	362
1,803	Total	1,973
6,567	Scheme Total	7,043

Funding

Benefits are funded by contributions and investment earnings. Contributions are made by active members of the Pension Fund in accordance with the Local Government Pension Scheme (Scotland) Regulations 2014 and range from 5.5% to 12% of pensionable pay for the financial year ending 31 March 2017. Employee contributions are matched by employers'

contributions, which are set, based on triennial actuarial funding valuations. The actuarial valuation as at 31 March 2014 set these employers' contribution rates, which range from 17.2% to 33.8% of pensionable pay.

Benefits

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

Service pre 1 April 2009	Service post 31 March 2009	Service Post 31 March 2015
Each year worked is worth 1/80 x final FTE pensionable salary	Each year worked is worth 1/60 x final FTE pensionable salary	Each year worked is worth 1/49 x actual pensionable salary
Automatic lump sum of 3 x salary.	No automatic lump sum.	No automatic lump sum
In addition, part of annual pension can be exchanged for a one-off tax-free cash payment. A lump sum of £12 is paid for each £1 of pension given up.	Part of the annual pension can be exchanged for a one-off tax-free cash payment. A lump sum of £12 is paid for each £1 of pension given up.	Part of the annual pension can be exchanged for a one-off tax-free cash payment. A lump sum of £12 is paid for each £1 of pension given up.

There are a range of other benefits provided under the scheme including early retirement, ill health retirement and death benefits. For more details, please refer to <http://www.scotlgps2015.org/> or contact Shetland Islands Council Pension Section on 01595 744644.

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

Note 2: Basis of Preparation

The Statement of Accounts summarises the Pension Fund's transactions for the 2016/17 financial year and its position at year-end as at 31 March 2017. The accounts have been prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2016/17, which is based upon International Financial Reporting Standards (IFRS), as amended for the UK public sector.

The accounts summarise the transactions of the Pension Fund and report on the net assets available to pay pension benefits. The accounts do not take account of obligations to pay pensions and benefits that fall due after the end of the financial year. The actuarial present value of promised retirement benefits, valued on an International Accounting Standard (IAS) 19 basis, is disclosed at Note 15 on page 31 of these accounts.

Accounting Standards Issued, not Adopted

Accounting standards issued but not adopted by the code in 2016/17 are:

- Amendments to IAS 19 Employee Benefits (Defined Benefit Plans: Employee Contributions);
- Annual Improvements to IFRSs 2010-2012 Cycle;
- Annual Improvements to IFRSs 2012-2014 Cycle;
- Amendment to IAS 1 Presentation of Financial Statements (Disclosure Initiative);
- The changes to the format of the Comprehensive Income and Expenditure Statement, the Movement in Reserves Statement and the introduction of the new Expenditure and Funding Analysis;
- The changes to the format of the Pension Fund Account and the Net Assets Statement.

The Code requires implementation from 1 April 2017 and there is therefore no impact on the 2016/17 financial statements.

Note 3: Assumptions Made about the Future and Other Major Sources of Estimation Uncertainty

The Statement of Accounts contains estimated figures that are based on assumptions made by the Council about the future, or that are otherwise uncertain. Estimates are made taking into account historical experience, current trends and other relevant factors.

However, because balances cannot be determined with certainty, actual results could be materially different from the assumptions and estimates.

The items in the net assets statement at 31 March 2017 for which there is a significant risk of material adjustment in the forthcoming financial year are as follows:

Item	Uncertainties	Effect if actual results differ from assumptions
Actuarial present value of promised retirement benefits	Estimation of the net liability to pay pensions depends on a number of complex judgements relating to the discount rate used, the rate at which salaries are projected to increase, changes in retirement ages, mortality rates and expected returns on pension fund assets. An actuary to the Fund is appointed to provide the fund with expert advice about the assumptions to be applied.	The effects on the net pension liability of changes in individual assumptions can be measured. For instance, 0.5% decrease in the real discount rate assumption would result in an increase in the pension liability of £83m. A 0.5% increase in salary increase rate assumption would increase the value of liabilities by approximately £30m, and a 0.5% increase in pension increase rate assumption would increase the liability by approximately £50m.

Note 4: Contributions Receivable

By category:

31 March 2016 £000		31 March 2017 £000
(12,781)	Employers - normal	(12,190)
(186)	Employers - augmentation	(18)
(3,660)	Members - normal	(3,818)
(16,627)	Total	(16,026)

By authority:

31 March 2016 £000		31 March 2017 £000
(14,160)	Administering authority	(13,589)
(129)	Scheduled bodies	(135)
(2,338)	Admitted bodies	(2,302)
(16,627)	Total	(16,026)

Note 5: Transfers in from Other Pension Funds

The total transfers received during the year are as follows:

31 March 2016 £000		31 March 2017 £000
(529)	Individual transfers in	(1,258)
(529)	Total	(1,258)

The Pension Fund received 41 transfers in during 2016/17 with an average value of £30,683 compared to 35 transfers in during 2015/16 with an average value of £15,100.

Note 6: Benefits Payable

By category:

31 March 2016 £000		31 March 2017 £000
8,920	Pensions	9,312
2,690	Commutation and lump sum retirement benefits	2,671
280	Lump sum death benefits	802
11,890	Total	12,785

By authority:

31 March 2016 £000		31 March 2017 £000
10,353	Administering authority	11,410
191	Scheduled bodies	111
1,346	Admitted bodies	1,264
11,890	Total	12,785

Note 7: Payments to and on Account of Leavers

31 March 2016 £000		31 March 2017 £000
20	Refunds to members leaving service	17
31	Payments for members joining state scheme	14
82	Individual transfers	332
133	Total	363

Note 8: Management Expenses

31 March 2016 £000		31 March 2017 £000
256	Administration Expenses	318
38	Oversight and Governance Expenses	51
	Investment Management Expenses	
1,346	Management Fees	1,420
64	Performance Fees	35
32	Custody Fees	32
1,736	Total	1,856

Note 9: Investment income

31 March 2016 £000		31 March 2017 £000
(2,729)	Pooled investment vehicles	(2,988)
(6)	Interest on cash deposits	(4)
(152)	Other	(162)
(2,887)	Total	(3,154)

Note 10: Investments

Market Value As at 31 March 2016 £000		Market Value As at 31 March 2017 £000
294,476	Pooled funds	361,371
33,926	Fixed income unit trusts	38,019
46,668	Pooled property unit trusts	48,112
44	Cash deposits	1,218
35	Property income due	237
375,149	Total investment	448,957

Note 10a - Reconciliation of movements in investments

	Market Value at 1 April 2016 £000	Purchases during the year £000	Sales during the year £000	Change in market value during the year £000	Market Value at 31 March 2017 £000
Investment Assets:					
Pooled funds - managed funds	146,051	0	(38)	25,363	171,376
- unit linked insurance policies	153,247	0	(35)	41,855	195,067
Fixed income unit trusts	33,926	2,571	0	1,522	38,019
Pooled property unit trusts	41,576	3,402	(2,119)	(6)	42,853
Total Pooled Investment Vehicles	374,800	5,973	(2,192)	68,734	447,315
Investment Income Due:					
Fixed income income due	270				187
Property income due	35				237
Total Investment Income Due	375,105				447,739
Other investment balances:					
Cash deposits	44				1,218
Net investment assets	375,149	5,973	(2,192)	68,734	448,957

	Market Value at 1 April 2015 £000	Purchases during the year £000	Sales during the year £000	Change in market value during the year £000	Market Value at 31 March 2016 £000
Investment Assets:					
Pooled funds - managed funds	142,922	2,000	(1,000)	2,129	146,051
- unit linked insurance policies	154,858	0	0	(1,611)	153,247
Fixed income unit trusts	34,059	825	0	(958)	33,926
Pooled property unit trusts	33,663	7,263	(1,435)	2,085	41,576
Total Pooled Investment Vehicles	365,502	10,088	(2,435)	1,645	374,800
Investment Income Due:					
Fixed income due	170				270
Property income due	5				35
Total Investment Income Due	365,677				375,105
Other investment balances:					
Cash deposits	511				44
Net investment assets	366,188	10,088	(2,435)	1,645	375,149

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

Note 10b - Analysis of Pooled Investment Vehicles

31 March 2016 £000		31 March 2017 £000
	Additional analysis	
67,159	Pooled funds (UK)	81,933
153,482	Pooled funds (Overseas)	203,697
73,565	Diversified Growth	75,554
33,926	Alternative Credit	38,019
45,021	Pooled property unit trust (UK)	46,731
1,647	Pooled property unit trust (Overseas)	1,381
374,800	Total Pooled Investment Vehicles	447,315

Note 10c - Analysis by Fund Manager

Market Value 31 March 2016			Market Value 31 March 2017	
£000	%		£000	%
147,159	39	BlackRock	188,816	42
46,774	12	Schroders	49,560	11
73,566	20	Newton Asset Management	75,554	17
73,454	20	Kleinwort Benson	96,821	22
34,196	9	M & G Investments	38,206	8
375,149	100	Total investment assets	448,957	100

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

Market Value 31 March 2016			Market Value 31 March 2017	
£000	%		£000	%
67,128	18	Aquila Life UK equity index	81,933	18
33,926	9	M & G Alpha Opp Fd AGBP	38,019	8
73,454	20	KBI 1 Dividend Plus	96,821	22
73,566	20	Newton Real Rtrn X ACC NAV	75,554	17
80,028	21	Aquila Life World EX UK Fund Series 1	106,875	24

Note 11: Fair Value Hierarchy

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

Level 1

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

Level 2

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

Level 3

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

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

As at 31 March 2016 £000	Fair value through profit and loss	As at 31 March 2017 £000
349	Level 1	470
374,800	Level 2	448,487
375,149	Net Investment assets	448,957

Basis of Valuation

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

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

Note 12: Financial Instruments

Note 12a - Classification of financial instruments

Accounting policies describe how different asset classes of financial instruments are measured, and how income and expenses, including gains and losses, are recognised.

The following table analyses the carrying amounts of financial assets and liabilities (excluding cash) by category and net assets statement heading. No financial assets were reclassified during the accounting period.

31 March 2016				31 March 2017		
Fair value through profit and loss £000	Receivables £000	Financial liabilities £000		Fair value through profit and loss £000	Receivables £000	Financial liabilities £000
			Financial assets			
			Pooled funds			
142,264	0		- managed funds	167,339	0	
152,212	0		- unit linked insurance policies	194,032	0	
33,927	0		Fixed income unit trusts	38,019	0	
46,667	0		Pooled property unit trusts	48,112	0	
0	1,222		Cash	0	2,229	
35	0		Property income due	237	0	
0	1,102		Debtors	0	1,345	
375,105	2,324		Total Financial assets	447,739	3,574	
			Financial liabilities			
		(1,722)	Creditors			(1,414)
		(1,722)	Total Financial liabilities			(1,414)
375,105	2,324	(1,722)	Total Financial Instrume	447,739	3,574	(1,414)

Note 12b - Net gains and losses on financial instruments

31 March 2016 £000		31 March 2017 £000
	Financial assets	
(1,645)	Fair value through profit and loss	(68,734)
(1,645)	Total	(68,734)

Note 12c - Value of financial instruments

31 March 2016			31 March 2017	
Book value £000	Market value £000		Book value £000	Market value £000
		Financial assets		
323,479	375,105	Fair value through profit and loss	327,613	447,739
323,479	375,105	Total	327,613	447,739

Note 13: Nature and Extent of Risks Arising from Financial Instruments

Risk and risk management

The Pension Fund's primary long-term risk is that its assets will fall short of its liabilities (i.e. promised benefits payable to members).

Therefore the aim of investment risk management is to minimise the risk of an overall reduction in the value of the Pension Fund and to maximise the opportunity for gains across the whole Pension Fund portfolio. The Pension Fund achieves this through asset diversification to reduce exposure to market risk (price risk, currency risk and interest rate risk) and credit risk

to an acceptable level. In addition, the Pension Fund manages its liquidity risk to ensure there is sufficient liquidity to meet the Pension Fund's forecast cash flows. The Pension Fund manages these investment risks as part of its overall Pension Fund risk management programme.

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

Market risk

Market risk is the risk of loss from fluctuations in equity, bond and property prices, interest and foreign exchange rates and credit spreads. The Pension Fund is exposed to market risk from its investment activities, particularly through its equity holdings. The level of risk exposure depends on market condition, expectations of future price and yield movements and the asset mix.

The objective of the Pension Fund's risk management strategy is to identify, manage and control market risk exposure within acceptable parameters, whilst optimising the return on risk.

In general, excessive volatility in market risk is managed through the diversification of the portfolio in terms of geographical and industrial sectors and individual securities. To mitigate market risk, the Pension Fund and its investment advisors undertake appropriate monitoring of market conditions and benchmark analysis.

Other price risk

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

The Pension Fund's investment managers mitigate this price risk through diversification and the selection of investments, which is monitored

by the Council, as the administering authority, and the Fund Managers to ensure it is within limits specified in the Pension Fund investment strategy.

Other Pension Fund price risk - sensitivity analysis

In agreement with the Pension Fund's performance analyst and following analysis of historical data and expected investment return during the financial year, the Pension Fund has determined that the following movements in market price risk are deemed reasonably possible for the financial year 2016/17 reporting period:

Asset Type	Potential market movements (+/-)
UK Equities	15.8%
Overseas Equities	18.4%
Property	14.2%
Cash	0.0%
Diversified Growth	12.5%
Alternative Credit	6.1%

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

Had the market price of the Pension Fund investments increased/decreased in line with the above, the change in the net assets available to pay benefits in the market price would have been as shown in the following table (the prior year comparator is shown below):

Asset Type	Value as at 31 March 2017 £000	Percentage Change %	Value on Increase £000	Value on Decrease £000
Cash and cash equivalents	1,218	0.00%	1,218	1,218
Investment portfolio assets:				
UK Equities	81,933	15.8%	94,878	68,988
Global Equities (ex UK)	279,250	18.4%	330,632	227,868
Property	38,206	14.2%	43,631	32,781
Diversified Growth	46,749	12.5%	52,593	40,905
Alternative Credit	1,601	6.1%	1,699	1,503
Total assets	448,957		524,651	373,263

Asset Type	Value as at 31 March 2016 £000	Percentage Change %	Value on Increase £000	Value on Decrease £000
Cash and cash equivalents	44	0.01%	44	44
Investment portfolio assets:				
UK Equities	67,159	10.61%	74,285	60,033
Overseas Equities	227,047	9.43%	248,458	205,636
Total Bonds & Index Linked	34,196	4.77%	35,827	32,565
UK Property	45,048	1.98%	45,940	44,156
Overseas Property	1,655	20.37%	1,992	1,318
Total assets	375,149		406,546	343,752

Interest rate risk

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

The Pension Fund's direct exposure to interest rate movements as at 31 March 2016 and 31 March 2017 are set out below:

31 March 2016 £000	Asset type	31 March 2017 £000
44	Cash and cash equivalents	1,218
1,178	Cash balances	1,011
1,222	Total	2,229

Interest rate risk sensitivity analysis

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

The analysis that follows assumes the total Fund volatility takes into account the expected interactions between the different asset classes shown, based on the underlying volatilities and correlations of the assets, in line with mean variance portfolio theory.

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

Asset Type	Carrying amount as at 31 March 2016 £000	Change in year in the net assets available to pay benefits	
		+100 BPS £000	-100 BPS £000
Cash and cash equivalents	44	0	0
Cash balances	1,178	12	(12)
Total change in assets available	1,222	12	(12)

Currency risk

Currency risk represents the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. The Pension Fund is exposed to currency risk on financial instruments that are denominated in any currency other than the

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

The following table summarises the Pension Fund's currency exposure as at 31 March 2017 and as at the previous period end:

31 March 2016 £000		31 March 2017 £000
	Asset type	
227,047	Pooled Funds - overseas equities	279,250
1,655	Pooled Property Unit Trusts - overseas	1,601
228,702	Total	280,851

Currency risk - sensitivity analysis

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

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

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

Asset Type	Carrying amount as at 31 March 2016 £000	Change to net assets available to pay benefits	
		+6.15% £000	-6.15% £000
Pooled Funds - overseas equities	227,047	241,010	213,084
Pooled Property Unit Trusts - overseas	1,655	1,757	1,553
Total change in assets available	228,702	242,767	214,637

Credit risk

Credit risk represents the risk that the counterparty to a transaction or a financial instrument will fail to discharge an obligation and cause the Pension Fund to incur a financial loss. The market values of investments generally reflect an assessment of credit in their pricing and consequently the risk of loss is implicitly provided for in the carrying value of the Pension Fund's financial assets and liabilities.

In essence, the Pension Fund's entire investment portfolio is exposed to some form of credit risk. However, the selection of high quality counterparties, brokers and financial institutions minimises credit risk that may occur through the failure to settle a transaction in a timely manner.

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

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

The Pension Fund's cash holding under its treasury management arrangements at 31 March 2017 was £2.229m (31 March 2016: £1.222m). This was held with the following institutions:

31 March 2016 £000		31 March 2017 £000
	Fund manager deposits	
42	Schroders cash	1,211
2	BlackRock cash	7
	Bank current accounts	
1,178	Bank of Scotland Plc	1,011
1,222	Total	2,229

Liquidity risk

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

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

The Pension Fund defines liquid assets as assets that can be converted to cash within three months. Illiquid assets are those assets that will take longer than three months to convert into cash. As at 31 March 2017, the value of illiquid assets was £38.2m, which represented 8.5% of the Pension Fund assets (31 March 2016: £46.7m, which represented 12.4% of the Pension Fund assets).

Refinancing risk

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

Note 14: Funding Arrangements

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

The funding policy is set out in the Pension Fund's Funding Strategy Statement (FSS), dated February 2015.

The key elements of the funding policy are:

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

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

Funding position as at the last formal funding valuation

The most recent actuarial valuation carried out under Regulation 32 of the Local Government Pension Scheme (Scotland) (Administration) Regulations 2008 was at 31 March 2014. This valuation revealed that the Pension Fund's assets, which at 31 March 2014 were valued at £333 million, were sufficient to meet 92% (91% at 31 March 2011 valuation) of the liabilities (i.e. the present value of promised retirement benefits) accrued up to that date. The resulting deficit at

the 2014 valuation was £30 million (2011 valuation: £25 million).

The common rate of contribution payable by each employing authority under regulation 32(4)(a) of the Administration Regulations for the period 1 April 2015 to 31 March 2018 is 20.7% of pensionable pay, (i.e. the rate which all employers in the Pension Fund pay).

Individual employers' rates are adjusted under regulation 32(4) (b) from the common contribution rate. The contribution rates payable for the period 1 April 2015 to 31 March 2018 were set in accordance with the Pension Fund's funding policy as set out in its Funding Strategy Statement.

The payment due by the Shetland Islands Council during this period includes an employer's rate of 18.7%, 19.8% and 20.8% per annum for each of the three years.

Copies of the 2014 Valuation Report and Funding Strategy Statement are available on request from Shetland Islands Council, the Administering Authority to the Pension Fund.

Principal actuarial assumptions and method used to value the liabilities

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

Method

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

Assumptions

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

The key financial assumptions adopted for the 2014 valuation were as follows:

Financial assumptions	31 March 2014	
	% p.a. Nominal	% p.a. Real
Discount rate	5.2%	2.5%
Pay increases	4.5%	1.8%
Price inflation/Pension increases	2.7%	0.0%

Mortality assumptions

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

Mortality assumption at age 65	Males	Females
Current Pensioners	22.8 yrs	23.8 yrs
Future Pensioners	24.9 yrs	26.7 yrs

Historic mortality assumptions

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

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

Commutation assumption

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

Note 15: Actuarial Present Value of Promised Retirement Benefits

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

In order to assess the value of the benefits on this basis, the actuary has updated the actuarial assumptions (set out below) from those used for funding purposes (see Note 14). The actuary has also used ill health and death benefits in line with IAS 19.

The actuarial present value of promised retirement benefits at 31 March 2017 was £693 million (31 March 2016: £517 million). The Pension Fund accounts do not take account of liabilities to pay pensions and other benefits in the future.

The liabilities have been projected using a roll forward approximation from the latest formal funding valuation as at 31 March 2014.

Assumptions

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

31 March 2016 % p.a.	Year ended	31 March 2017 % p.a.
2.2	Inflation/pension increase rate	2.4
4.2	Salary increase rate	4.4
3.5	Discount rate	2.6

Note 16: Current Assets

31 March 2016 £000		31 March 2017 £000
	Debtors:	
25	Contributions due - employees	322
1,038	Contributions due - employers	1,020
27	Transfer values receivable	0
2	Sundry debtors	2
0	Prepayments	1
10	Accrued Income	0
1,178	Bank current accounts	1,011
2,280	Total	2,356

Analysis of debtors

31 March 2016 £000		31 March 2017 £000
0	Central government bodies	1
38	Other local authorities	1,162
1	Public corporations & trading funds	0
1,063	Other entities and individuals	182
1,102	Total	1,345

Note 17: Unfunded Pension

31 March 2016 £000		31 March 2017 £000
702	Added years pension	694

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

Note 18: Current Liabilities

31 March 2016 £000		31 March 2017 £000
(1,497)	Sundry creditors	(366)
(225)	Benefits payable	(1,048)
(1,722)	Total	(1,414)

Analysis of creditors

31 March 2016 £000		31 March 2017 £000
(1)	Central government bodies	(1)
(484)	Other local authorities	(286)
(36)	Public corporations and trading funds	(25)
(1,201)	Other entities and individuals	(1,102)
(1,722)	Total	(1,414)

Note 19: Additional Voluntary Contributions

31 March 2016 £000		31 March 2017 £000
4,704	Prudential	5,164
91	Equitable Life	89
4,795	Total	5,253

AVC contributions of £0.672m were paid directly to Prudential during the year (2015/16 £0.582m).

Note 20: Related Party Transactions

Shetland Islands Council

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

The Council incurred costs of £0.338m (2015/16 £0.261m) in relation to the administration of the Pension Fund and was subsequently reimbursed by the Pension Fund for these expenses.

The investments of the Pension Fund are overseen by the Council's Treasury Section; their costs are levied by staff time allocations. Costs

incurred were £0.032m (2015/16 £0.051m) in relation to investment of the Pension Fund and the Council was subsequently reimbursed by the Pension Fund for these expenses.

The Council processed pensioner payments of £9.312m (2015/16 £8.920m). Such payments are reimbursed in full by the Pension Fund.

In addition the Council is the single largest employer of Pension Fund members, and contributed £10.350m to the Pension Fund (2015/16 £11.077m).

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

Governance

There are two members of the Pension Fund Committee who are in receipt of pension benefits from the Shetland Islands Council Pension Fund. In addition, there are other committee members who are active members of the Pension Fund.

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

Key management personnel

Key Management personnel for the Pension Fund include the Shetland Islands Council Councillors, who sit on the Pension Fund Committee and Pension Board. These members are listed below. Another key person is the Section 95 Officer for Shetland Islands Council, Jonathan Belford. All these key personnel are remunerated by Shetland Islands Council.

Pension Fund Committee Membership	
Alistair Cooper	
Stephen Coutts	
Gary Robinson	
Cecil Smith	
George Smith	
Theo Smith	
Michael Stout	
Vaila Wishart	
Pension Board Membership	
Malcolm Bell	
Robert Henderson	
Drew Ratter	

Note 21: Changes in Actuarial Present Value of Promised Retirement Benefits

Actuarial Present Value of Promised Retirement Benefits	Vested Benefits £000	Unvested Benefits £000	Total £000
Balance As at 31 March 2017	693	-	693
Increase/(Decrease) in Value during 2016/17	176	-	176
Balance As at 31 March 2016	517	-	517
Increase/(Decrease) in Value during 2015/16	(34)	-	(34)
Balance As at 31 March 2015	551	-	551

Note 22: Critical Judgements in Applying Accounting Policies

Pension Fund liability

The Pension Fund liability is calculated every three years by the appointed actuary, with annual updates in the intervening years. The methodology used is in line with accepted guidelines and in accordance with IAS 19. Assumptions underpinning the valuations are agreed with the actuary and are summarised in Note 15. This estimate is subject to significant variances based on changes to the underlying assumptions.

Note 23: Events after the Balance Sheet Date

There have been no events since 31 March 2017, and up to the date when these accounts were authorised that require any adjustments to these accounts.

Note 24: Accounting Policies

Pension Fund account - revenue recognition

A Contribution income

Normal contributions, both from the members and from the employers, are accounted for on an accrual basis at the percentage rate

recommended by the Pension Fund actuary in the payroll period to which they relate.

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

B Transfers to and from other schemes

Transfer values represent the amounts received and paid during the year for members who have either joined or left the Pension Fund during the financial year and are calculated in accordance with the Local Government Pension Scheme Regulations (see notes 5 and 7).

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

C Investment income

- **Interest income**
Interest income is recognised in the Pension Fund account as it accrues.
- **Distributions from pooled funds**
Distributions from pooled funds are recognised on the date of issue. Any amount not received by the end of the reporting period is disclosed in the net assets statement as a current financial asset.
- **Movement in the net market value of investments**
Changes in the net market value of investments (including investment properties) are recognised as income and comprise all realised and unrealised profits/losses during the year.

Pension Fund account - expense items

D Benefits payable

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

E Taxation

The Pension Fund is a registered public service scheme under section 1(1) of Schedule 36 of the Finance Act 2004 and as such is exempt from UK

income tax on interest received and from capital gains tax on the proceeds of the investments sold. Income from overseas investments suffers withholding tax in the country of origin, unless exemption is permitted. Irrecoverable tax is accounted for as a Pension Fund expense as it arises.

F Management expenses

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

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

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

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

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

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

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

Net assets statement

G Financial assets

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

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

H Pooled investment vehicles

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

I Foreign currency transactions

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

J Cash and cash equivalents

Cash comprises cash in hand and demand deposits.

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

K Actuarial present value of promised retirement benefits

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

As permitted under IAS 26, the Pension Fund has opted to disclose the actuarial present value of the promised retirement benefits by way of a note to the net assets statement (Note 15).

L Additional voluntary contributions

Shetland Islands Council Pension Fund provides an additional voluntary contributions (AVC) scheme for its members, the assets of which are invested separately from those of the Pension Fund. The Pension Fund has appointed Prudential and Equitable Life (closed to new members) as its AVC providers. AVCs are paid to the AVC provider by employers and are specifically for providing additional benefits for

individual contributors. Each AVC contributor receives an annual statement showing the amount held in their account and the movements in the year.

AVCs are not included in the accounts in accordance with section 4(1) (b) of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 but are disclosed as a note only (Note 19).

Actuarial Statement for 2016/17

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

Description of Funding Policy

The funding policy is set out in the Administering Authority's Funding Strategy Statement (FSS), dated March 2015. In summary, the key funding principles are as follows:

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

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

Funding Position as at the last formal funding valuation

The most recent actuarial valuation carried out under Regulation 32 of the Local Government Pension Scheme (Scotland) (Administration) Regulations 2008 was as at 31 March 2014. This valuation revealed that the Fund's assets, which at 31 March 2014 were valued at £333 million, were sufficient to meet 92% of the liabilities (i.e. the present value of promised retirement benefits) accrued up to that date. The resulting deficit at the 2014 valuation was £30 million.

Individual employers' contributions for the period 1 April 2015 to 31 March 2018 were set in accordance with the Fund's funding policy as set out in its FSS.

Principal Actuarial Assumptions and Method used to value the liabilities

Full details of the methods and assumptions used are described in the valuation report dated 31 March 2015.

Method

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

Assumptions

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

The key financial assumptions adopted for the 2014 valuation were as follows:

Financial Assumptions	31 March 2014	
	% p.a. Nominal	% p.a. Real
Discount rate	5.2%	2.5%
Pay increases	4.5%	1.8%
Price inflation/Pension increases	2.7%	-

The key demographic assumption was the allowance made for longevity. The life expectancy assumptions are based on the Fund's VitaCurves with improvements in line with the CMI 2012 model, assuming the current rate of improvements has reached a peak and will converge to long-term rate of 1.25% p.a. Based on these assumptions, the average future life expectancies at age 65 are as follows:

	Males	Females
Current Pensioners	22.8 years	23.8 years
Future pensioners*	24.9 years	26.7 years

*Future pensioners are assumed to be currently aged 45 as at 31 March 2014.

Copies of the 2014 valuation report and Funding Strategy Statement are available on request from Shetland Islands Council, the Administering Authority to the Fund.

Experience over the period since April 2014

The Fund's experience has been worse than expected since the last formal valuation (excluding the effect of any membership movements). Real bond yields have fallen sharply, which places a significantly higher value on liabilities. The effect of this will have been partially offset by strong asset returns. The overall impact on the funding position at 31 March 2017 is that funding levels have likely worsened and deficits increased since the last formal valuation. This excludes the impact of possible changes to funding assumptions for the 2017 formal valuation, and membership experience, which will be measured as part of that valuation: these items may improve or worsen the funding position.

The next actuarial valuation will be carried out as at 31 March 2017. The Funding Strategy Statement will also be reviewed at that time.



Douglas Green

Fellow of the Institute and Faculty of Actuaries

For and on behalf of Hymans Robertson LLP

3 May 2017

Hymans Robertson LLP
20 Waterloo Street, Glasgow G2 6DB

Independent auditor's report to the members of Shetland Islands Council Pension Fund and the Accounts Commission

This report is made solely to the parties to whom it is addressed in accordance with Part VII of the Local Government (Scotland) Act 1973 and for no other purpose. In accordance with paragraph 120 of the Code of Audit Practice approved by the Accounts Commission, we do not undertake to have responsibilities to members or officers, in their individual capacities, or to third parties.

Report on the audit of the financial statements

Opinion on financial statements

We certify that we have audited the financial statements in the annual accounts of Shetland Islands Council Pension Fund for the year ended 31 March 2017 under Part VII of the Local Government (Scotland) Act 1973. The financial statements comprise the Pension Fund Account and Net Assets Statement and notes to the financial statements, including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union, and as interpreted and adapted by the Code of Practice on Local Authority Accounting in the United Kingdom 2016/17 (the 2016/17 Code).

In our opinion the accompanying financial statements:

- give a true and fair view in accordance with applicable law and the 2016/17 Code of the state of affairs of the Fund as at 31 March 2017 and of its surplus on the provision of services for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union, as interpreted and adapted by the 2016/17 Code; and
- 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.

Basis of opinion

We conducted our audit in accordance with applicable law and International Standards on Auditing in the UK and Ireland (ISAs (UK&I)). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the Fund in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK including the Financial Reporting Council's Ethical Standards for Auditors, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Responsibilities of the Executive Manager – Finance for the financial statements

As explained more fully in the Statement of Responsibilities, the Executive Manager – Finance is responsible for the preparation of financial statements that give a true and fair view in accordance with the financial reporting framework, and for such internal control as the Executive Manager – Finance determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibilities for the audit of the financial statements

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable legal requirements and ISAs (UK&I) as required by the Code of Audit Practice approved by the Accounts Commission. Those standards require us to comply with the Financial Reporting Council's Ethical Standards for Auditors. An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the circumstances of the Fund and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Executive Manager – Finance and the overall presentation of the financial statements.

Our objectives are to achieve reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK&I) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

Other information in the annual accounts

The Executive Manager – Finance is responsible for the other information in the annual accounts. The other information comprises the information other than the financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon except on matters prescribed by the Accounts Commission to the extent explicitly stated later in this report.

In connection with our audit of the financial statements in accordance with ISAs (UK&I), our responsibility is to read all the financial and non-financial information in the annual accounts to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Report on other requirements

Opinions on other prescribed matters

We are required by the Accounts Commission to express an opinion on the following matters. In our opinion, the auditable part of the Remuneration Report has been properly prepared in accordance with The Local Authority Accounts (Scotland) Regulations 2014.

In our opinion, based on the work undertaken in the course of the audit

- the information given in the Management Commentary for the financial year for which the financial statements are prepared is consistent with the financial statements and that report has been prepared in accordance with statutory guidance issued under the Local Government in Scotland Act 2003; and
- the information given in the Annual Governance Statement for the financial year for which the financial statements are prepared is consistent with the financial statements and that report has been prepared in accordance with the Delivering Good Governance in Local Government: Framework (2016).

Matters on which we are required to report by exception

We are required by the Accounts Commission to report to you if, in our opinion:

- adequate accounting records have not been kept; or
- the financial statements and the auditable part of the Remuneration Report are not in agreement with the accounting records; or
- we have not received all the information and explanations we require for our audit; or
- there has been a failure to achieve a prescribed financial objective.

We have nothing to report in respect of these matters.

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Pat Kenny, CPFA (for and on behalf of Deloitte LLP)

110 Queen Street
Glasgow
G1 3BX
United Kingdom

20 September 2017



Meeting(s):	Pension Fund Committee	20 September 2017
Report Title:	Appointment of an Alternative Appointed Person	
Reference Number:	GL-43-F	
Author / Job Title:	Team Leader Legal and Insurance	

1.0 Decisions / Action required:

- 1.1 To appoint Susan Brunton, Team Leader Legal & Insurance as an alternative Appointed Person to resolve disputes in relation to complaints made against the Council as administering body of the Shetland Islands Council Pension Fund where the Appointed Person has a conflict of interest or is otherwise unable to act.

2.0 High Level Summary:

- 2.1 In terms of the Pensions Act 1995 the trustees or managers of an occupational pension scheme, such as the Shetland Islands Pension Fund, is required to have dispute resolution arrangement.
- 2.2 Section 50B(4A) provides that the trustees or managers of a pension fund can nominate one of their number to make decisions on their behalf in respect of disputes. In terms of the Shetland Islands Pension Fund the Executive Manager of Governance and Law has been appointed as that person who can make such decisions under the Dispute Resolution procedures.
- 2.3 A situation has arisen whereby the Executive Manager of Governance and Law has a conflict of interest. Whilst there is no suggestion that the Executive Manager of Governance and Law would act partially, it is necessary for other arrangements to be put in place to allow the aggrieved applicant a demonstrably fair hearing.

3.0 Corporate Priorities and Joint Working:

- 3.1 Shetland Islands Council's Our Plan 2016 -20 recognises the need for the Council to have high standards of governance, that is, the rules on how the Council is governed will mean that the Council is operating effectively. Ensuring that there is an alternative person to carry out this role in the dispute resolution procedure will enhance our ability to make decisions with the minimum of delay.

4.0 Key Issues:

- 4.1 None

5.0 Exempt and/or confidential information:

- 5.1 None

6.0 Implications :		
6.1 Service Users, Patients and Communities:	The proposals in this report will improve the service to be received by members of the Shetland Islands Pension Fund who have a dispute with the Council as administering authority.	
6.2 Human Resources and Organisational Development:	None	
6.3 Equality, Diversity and Human Rights:	None	
6.4 Legal:	In terms of the Pensions Act 1995 and the Regulations made thereunder the Council is required to have a Dispute Resolution procedure for matters relating to their actions as administering authority for the Shetland Islands Pension Scheme. Decisions from this process can be appealed to the Scottish Ministers.	
6.5 Finance:	No direct implications.	
6.6 Assets and Property:	None	
6.7 ICT and new technologies:	None	
6.8 Environmental:	None	
6.9 Risk Management:	Failure to provide an internal dispute resolution within the statutory timescales will lead to cases being escalated to the Scottish Ministers, perhaps unnecessarily.	
6.10 Policy and Delegated Authority:	In terms of Paragraph 2.9.5 Part C of the Constitution, the Council's responsibilities and functions as administering authority for the Shetland Islands Council Pension Fund have been delegated to this Committee.	
6.11 Previously considered by:	None	

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Appendices:

None

END