



Executive Manager: Jan-Robert Riise
Director of Corporate Services: Christine Ferguson

Governance & Law
Corporate Services Department
Montfield
Burgh Road
Lerwick
Shetland, ZE1 0LA

Telephone: 01595 744550
Fax: 01595 744585
committee.services@shetland.gov.uk
www.shetland.gov.uk

If calling please ask for
Louise Adamson
Direct Dial: 01595 744555
Email: louise.adamson@shetland.gov.uk

Date: 14 September 2018

Dear Sir/Madam

You are invited to the following meeting:

Special Pension Fund Committee / Pension Board
Council Chamber, Town Hall, Lerwick
Wednesday 19 September 2018 at 11.30am

Please note that in accordance with the agreed terms of reference, this is a concurrent meeting of both the Pension Fund Committee and the Pension Board - SEE MEMBERSHIP OF BOTH BODIES OVERLEAF

Apologies for absence should be notified to Louise Adamson at the above number.

Yours faithfully

Executive Manager – Governance and Law

Chair: Steven Coutts

AGENDA

- (a) Hold circular calling meeting as read.
- (b) Apologies for absence, if any.

- (c) Declarations of Interest – Members are asked to consider whether they have an interest to declare in relation to any item on the agenda for this meeting. Any Member making a declaration of interest should indicate whether it is a financial or non-financial interest and include some information on the nature of the interest. Advice may be sought from Officers prior to the meeting taking place.

ITEM

1. Annual Audit Report on the 2017/18 Audit – Shetland Islands Council Pension Fund
F-073

Pension Fund Committee	Pension Board	
A Cooper S Coutts S Leask E Macdonald R McGregor I Scott C Smith G Smith T Smith R Thomson	<u>Employers Representatives:</u> M Bell, SIC J Fraser, SIC A Westlake, SIC J Johnston, SRT <u>Joint Secretary</u> J Riise, Executive Manager – Governance and Law	<u>Trade Union Representatives:</u> David Marsh, Unison Alan Goudie, Unite Robert Williamson, GMB Austin Taylor, Unison <u>Substitutes:</u> <i>C Wiseman, Unison</i> <u>Joint Secretary</u> C Wiseman, Unison

	Shetland Islands Council	Agenda Item 1
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Meeting(s):	Audit Committee Pension Fund Board Pension Fund Committee	19 September 2018
Report Title:	Annual Audit Report on the 2017/18 Audit – Shetland Islands Council Pension Fund	
Reference Number:	F-073-F	
Author / Job Title:	Executive Manager - Finance	

1.0 Decisions / Action required:
<p>1.1 That the Audit Committee:</p> <ul style="list-style-type: none"> a) NOTES the findings of the 2017/18 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 2017/18 (Appendix 2) for Shetland Islands Council Pension Fund; <p>1.2 That Pension Fund Committee RESOLVES to:</p> <ul style="list-style-type: none"> a) NOTE the findings of the 2017/18 audit as contained in the external auditor's Annual Report at Appendix 1; and b) APPROVE the audited Annual Accounts for 2017/18 (Appendix 2) for Shetland Islands Council Pension Fund for signature.
2.0 High Level Summary:
<p>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.</p> <p>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.</p> <p>2.3 International Standard on Auditing 260 (ISA 260) requires the external auditors to communicate significant findings from the audit, including:</p> <ul style="list-style-type: none"> • results of work on key audit judgements; • the auditor’s views about significant qualitative aspects of the entity’s accounting practices, including accounting policies, accounting estimates and financial statement disclosures; • the auditor’s internal control observations; 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 ISA260 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 2018.

2.5 The unaudited accounts for the year to 31 March 2018 were approved by Pension Fund Committee on 27 June 2018 and there is no change to the accounting deficit or net assets in the audited annual accounts.

3.0 Corporate Priorities and Joint Working:

3.1 The preparation and presentation of the 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 2018 were submitted to Deloitte LLP by the statutory deadline of 30 June 2018. The external auditor was required to complete the audit by 30 September 2018 and to report on certain matters arising to those charged with governance.

4.2 The Audit Report (Appendix 1) highlights one significant risk and two areas of audit focus areas that were considered, as follows:

- a) Risk - Management override of controls;
- b) Focus area - Accuracy of contributions payable to the Fund;
- c) Focus area - Valuation of investments.

4.3 Pages 7 to 10 of the report at Appendix 1 presents how, in each of these areas, the result of the audit control testing was satisfactory.

4.4 The audit report notes a disclosure deficiency relating to £0.973m that has been disclosed as a cash holding in Note 11a, rather than a Pooled Investment Vehicle. As this is below the materiality threshold, it has not been amended in the audited accounts.

4.5 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:** we are satisfied the Fund has sufficient plans in place to continue to be financially sustainable in the medium and long term.
- **Financial management:** we are satisfied that appropriate financial reports are provided to the Pension Fund Committee to challenge variances and underperformance and that this is performed.

- **Governance and transparency:** From our testing performed we have no issues to note. The Annual Governance Statement and Governance Compliance Statement contains the required information. 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.
- **Value for money:** we are satisfied that 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 arising from this report.
6.2 Human Resources and Organisational Development:	None arising from this report.
6.3 Equality, Diversity and Human Rights:	None arising from this report.
6.4 Legal:	The Local Authority Accounts (Scotland) Regulations 2014 require the Pension Fund to approve the audited Annual Accounts for signature no later than 30 September each year.
6.5 Finance:	None arising from this report.
6.6 Assets and Property:	None arising from this report.
6.7 ICT and new technologies:	None arising from this report.
6.8 Environmental:	None arising from this report.
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:	<p>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.</p> <p>The preparation and presentation of the Annual Accounts is a key element of the Pension Fund's overall governance and reporting arrangements.</p>
6.11 Previously considered by:	N/A

Contact Details:

Christine McCourt, Financial Accountant, 01595 744601

christine.mccourt@shetland.gov.uk

19 September 2018

Appendices:

Appendix 1: Annual Audit Report 2017/18 for Shetland Islands Council Pension Fund

Appendix 2: Audited Annual Accounts 2017/18 for Shetland Islands Council Pension Fund

Background Documents:

The Local Authority Accounts (Scotland) Regulations 2014



Shetland Islands Council Pension Fund

Report to the Members of the Council and the Controller of Audit on the
2017/18 audit

Issued on 13 September 2018 for the meeting on 19 September 2018

Contents

01 Our final report

Introduction	3
Our audit explained	5
<i>Financial statements audit</i>	
Dashboard	7
Significant risk	8
Areas of audit focus	9
Other matters	11
<i>Audit dimensions</i>	
Financial sustainability	13
Financial management	14
Governance and transparency	15
Value for money	15

02 Technical update 16

03 Appendices

Purpose of our report and responsibility statement	23
Audit adjustments	24
Fraud responsibilities and representations	25
Independence and fees	26

Introduction

The key messages in this report

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

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

I have pleasure in presenting our final report to the Members and Audit Controller for the 2018 audit. The scope of our audit was set out within our planning report presented to the Audit Committee in February 2018.

This report summarises our findings and conclusions in relation to:

- The audit of the **financial statements**; and
- Consideration of the **four audit dimensions** that frame the wider scope of public sector audit requirements as illustrated in the following diagram. This includes our consideration of Best Value and the five Strategic Audit Priorities agreed by the Accounts Commission.



Introduction (continued)

The key messages in this report – financial statements audit

I would like to draw your attention to the key messages of this paper in relation to the audit of the financial statements:

Conclusions from our testing

- As communicated in our planning report dated 7 February 2018, we identified management override of controls as our significant audit risk.
- In addition, we identified the following areas of audit focus:
 1. Accuracy of contributions payable to the Pension Fund; and
 2. Valuation of investments
- We have not amended the significant audit risk and areas of focus during our testing and further details of our work performed and findings can be found on pages 7 to 10.
- We have not identified any misstatements from our procedures to date.
- Based on our audit work, we expect to issue an unmodified audit opinion on the financial statements.

Misstatements and disclosure deficiencies

- We have included any disclosure deficiencies found as a result of our testing on page 24.

Status of the audit

- The audit is substantially complete subject to the completion of the following principal matters:
 - Completion of the outstanding testing as advised to you;
 - Independent confirmation of the bank account balance at 31 March 2018;
 - Receipt of the final version of the financial statements;
 - Finalisation of our internal quality control procedures;
 - Receipt of a signed management representation letter; and
 - Satisfactory completion of our post year-end events review.

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:

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

Significant risks

Our risk assessment process is a continuous cycle throughout the year. Page 7 provides a summary of our risk assessment of your significant risk (and areas of audit focus).

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.

Final audit report

In this report we have concluded on the audit risks identified in our planning report and any other key findings from the audit.

Key developments in your business

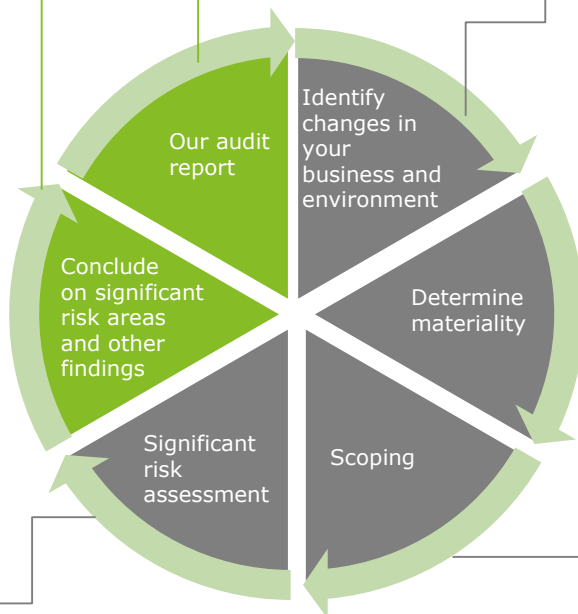
As noted in our planning report, there have not been any significant changes to the Fund during the year, other than the increase in employer contribution rates. The Code of Practice on Local Authority Accounting in the UK is still applicable in the current year.

Materiality

We have determined materiality based on 1% of the Fund's net assets at 31 March 2018 to be £4,602,000 (2017: £4,490,000). We have determined performance materiality as £4,141,800 (2017: £4,041,000) based on total anticipated uncorrected misstatements amounting to 10% of our materiality. Our reporting threshold of misstatements in the financial statements is £230,000 (2017: £224,500) based on 5% of materiality.

Scope of the audit

We have audited the financial statements of the Shetland Islands Council Pension Fund for the year ended 31 March 2018. The scope of our audit remains consistent with that in our planning report.



Timeline 2017/18

November 2017 – February 2018

Meetings with management and other staff to update understanding of the processes and controls.

7 February 2018

Presented planning paper to the Audit Committee

July – August 2018

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

March 2018

Year end

19 September 2018

Audit Committee and full Council meeting

19 September 2018










Accounts sign off








Financial statements audit



Significant risk and areas of audit focus

Dashboard

Risk	Risk level	Fraud risk	Level of judgement	Planned approach to controls testing	Comments	Page no.
Significant audit risk						
Management override of controls				D&I	Satisfactory	8
Areas of audit focus						
Accuracy of contributions payable to the Fund				D&I	Satisfactory	9
Valuation of investments				D&I	Satisfactory	10

	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 risk

Management override of controls



Risk identified

In accordance with ISA 240 (UK) management override is a significant risk.

This risk area includes the potential for management to use their judgement to influence the financial statements as well as the potential to override the Pension Fund's controls for specific transactions.

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 not identified any significant bias in the key judgements made by management.

Areas of audit focus

Focus area 1 – Accuracy and timeliness of contributions payable to the Fund

Risk identified

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 and employee normal contributions received in the year, basing our expectation on the prior year audited balance, adjusted for the movement in active member numbers, contribution rate changes and any average pay rise awarded in the year;
- For a sample of monthly contributions, checked that they were paid within the time limits stipulated in the Local Government Pension Scheme (Scotland) Regulations 2014 ("LGPS Regulations")
- 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 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

In our sample across the different employers, we noted 3 instances of late payment:

- July 2017 and October 2017 contributions paid by SADA were paid 2 days and 1 day late respectively.
- January 2018 contributions paid by SAT were underpaid by £2,544. This amount was paid in the subsequent month.

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

Areas of audit focus

Focus area 2 – Valuation of investments



Risk identified

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;
- Performed a unit reconciliation of all the investments held to ensure completeness;
- Agreed the valuations as at 31 March 2018 to the reports received directly from the investment managers and the Fund's custodian; and

Performed valuation testing on the valuation of the investments at 31 March 2018 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 compared the price per the statement to the audited accounts.

Deloitte view

The Schroder Liquidity Fund is currently disclosed under Cash income due in note 11a of the financial statements. As this is a Pooled Investment Vehicle, it should really be disclosed under that heading. The result of the current classification is that £973,000 of sales are not presented in note 11a. While not considered material, this is a disclosure deficiency.

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

Our audit report

Other matters relating to the form and content of our report

Here we discuss how the results of the audit impact on other significant sections of our audit report. The revisions to ISA (UK) 700 have changed the form and content of audit report, including how different sections are presented.



Our opinion on the financial statements

Our opinion on the financial statements is unmodified.



Material uncertainty related to going concern

We expect to report by exception regarding the appropriateness of the use of the going concern basis of accounting.



Emphasis of matter and other matter paragraphs

There are no matters we judge to be of fundamental importance in the financial statements that we consider it necessary to draw attention to in an emphasis of matter paragraph.

There are no matters relevant to users' understanding of the audit that we consider necessary to communicate in an other matter paragraph.



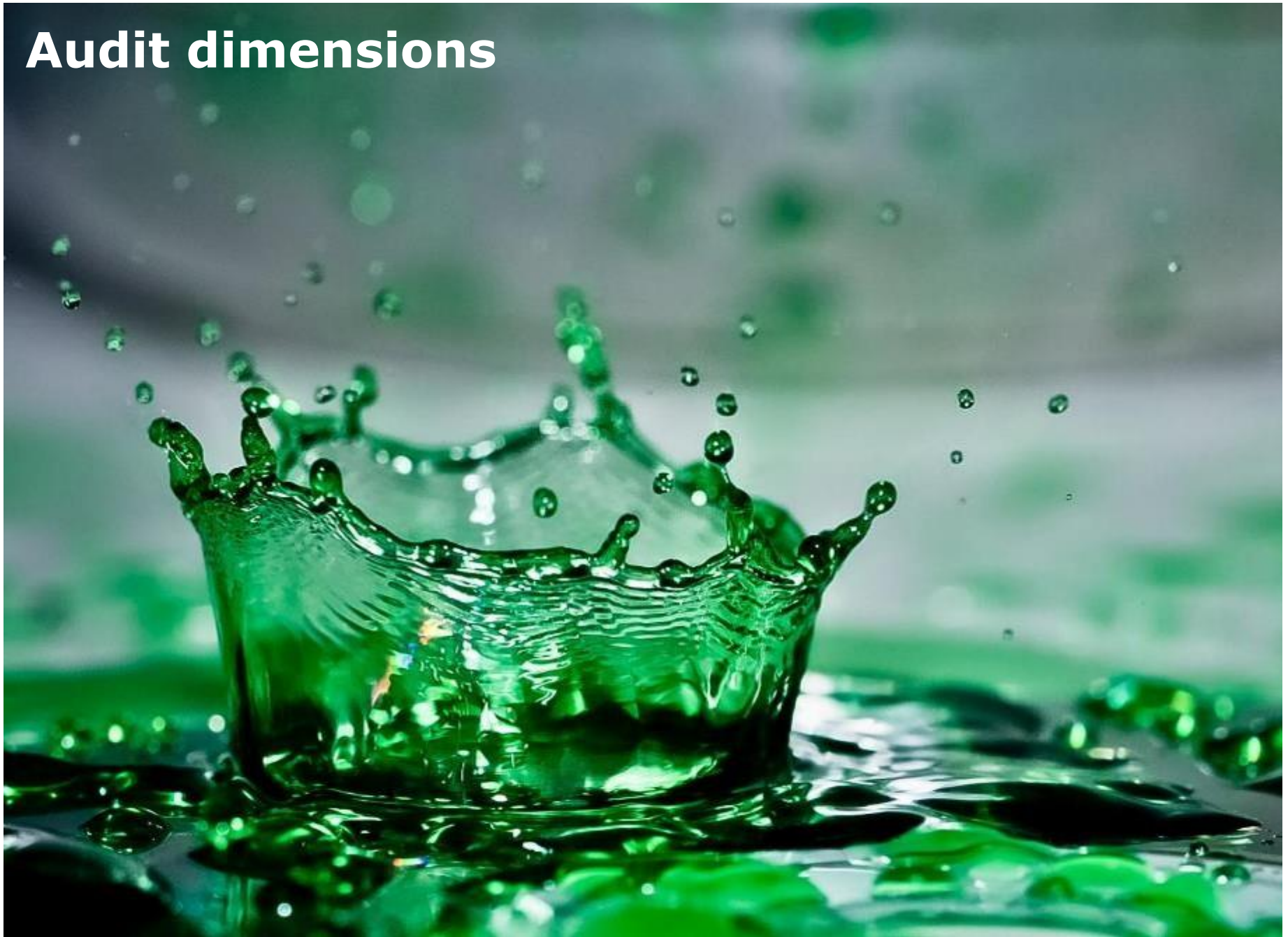
Other reporting responsibilities

The Annual Report is reviewed in its entirety for material consistency with the financial statements and the audit work performance and to ensure that they are fair, balanced and reasonable.

Our opinion on matters prescribed by the Controller of Audit are discussed further on page 25.



Audit dimensions



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 looks forward to the medium and longer term to consider whether the Pension Fund is planning effectively to continue to deliver its services or the way in which they should be delivered.</p>	<ul style="list-style-type: none"> • We reviewed the financial planning systems in place by the Pension Fund to ensure that its services can continue to be delivered. • We also reviewed the arrangements in place to address any funding gaps. • We looked at the affordability and effectiveness of funding and investment decisions made. <p>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.</p> <p>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 within 20 years.</p>

Wider Scope Requirements (continued)

Audit Dimensions (continued)

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 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; • We ensured that there is a proper officer 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; and • We reviewed the design and implementation of the Pension Fund and third party advisers controls in place to ensure they were operating effectively. 	<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.</p> <p>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> <p>Although for our audit purposes, we did not perform operating effectiveness testing, our implementation walkthroughs of controls in place did not show evidence of failing controls. In addition, our review of the investment managers’ published controls reports did not raise any matters.</p>

Wider Scope Requirements (continued)

Audit Dimensions (continued)

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>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 the main reason for the increase in management expenses was due to an increase of £32k in oversight and governance expenses compared to 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 within 20 years.</p>

Technical update



Topical matters

tPR governance programme

21st Century trusteeship

The Regulator has launched a long-term programme to improve governance of both DB and DC schemes.

The Regulator is not seeking to implement new governance or administration standards but is focussed on ensuring all trustees satisfy the current standards.

They have confirmed they are intending to be **clearer, quicker** and **tougher** in their approach and that they will set out their expectations more clearly and enforce further regulatory action more readily. The Regulator has set out the key areas they believe support good decision making:

- Clear roles and responsibilities and clear strategic objectives.
- A skilled, engaged and diverse board led by an effective chair.
- Close relationships with employers, advisers and others involved in running the scheme.
- Sound structures and processes focussed on outcomes.
- A robust risk management framework focussed on key risks.

tPR support and guidance

In September 2017 the Regulator launched clear guidance setting out their expectations (link below).



<http://www.thepensionsregulator.gov.uk/21st-century-trusteeship.aspx>

Deloitte view

We welcome the Regulator's focus on driving up governance and administration standards.

We recommend trustees take this as an opportunity to review their current governance arrangements and assess their compliance with the Regulator's standards. The Regulator's published guidance is a useful resource for trustees considering their annual training requirements.

The guidance focusses on:

- Good governance.
- Clear roles and responsibilities.
- Clear purpose and strategy.
- Trustee training and improving trustee knowledge.
- Skills and experience.
- Advisers and service providers.
- Managing risk.

Recent examples of the Regulator putting **clearer, quicker** and **tougher into action** are:

- Being **clear** that when employers pay high dividends, this should be reflected in the amounts paid into pension schemes.
- **Quickly** making it **clear** to GKN and Melrose Trustees what is expected of them in the event of a takeover.
- **Tougher:**
 - C.£1bn recovery into pensions schemes through exercising anti-avoidance powers.
 - Restitution of assets in the event of a potential scam.
 - Appointing of skills persons.
 - Criminal prosecutions – non-compliance with auto enrolment, misleading the Regulator and failing to answer Regulator requirements for information in the event of an investigation.



Topical matters

Regulator enforcement action

Effective governing of pension schemes

The Pensions Regulator has recently taken a more robust approach to ensure that pension plans are governed in line with existing legislation.

Action taken by the Pensions Regulator against schemes in contravention of laws and regulations include:

- Recovering late or missing payments.
- Barring trustees that are not considered fit and proper for the role.
- Issuing fines for any contraventions to the Pensions Acts.
- Adding names of all employers ordered to pay TPR fines to a compliance and enforcement quarterly bulletin.
- The government could impose civil fines of up to £1m, as well as criminal sanctions on bosses and employers who are deemed to be failing their pension scheme.



For more information:

www.thepensionsregulator.gov.uk/docs/monetary-penalties-policy.pdf

Deloitte view

The Regulator has stated that they will be taking a stronger stance towards enforcement and so we can expect to see an increase in enforcement action in the year ahead. Trustees may want to consider obtaining extra assurance over their compliance with key legislation.



Recently in the news

Pension Trustee fined

TPR fined a trustee for not reporting to the regulator nor members of £900,000 worth of unpaid contributions.

Master Trust Trustee

A Master Trust Trustee fined £70,000 for continued administrative issues.

TPR fined the trustee £50,000 in November 2017 for failing to ensure that all employee and employer contributions were collected and invested and a further £20,000 in January 2018 for failing to keep some members properly informed.

Local Authority Pension Scheme

TPR issued the fine of £1,000 against the LGPS scheme manager for failing to submit its 2016 scheme return.

There is a discretionary penalty for failing to provide a scheme return, and TPR can impose a maximum fine of £5,000 for each individual trustee and up to £50,000 in other cases (e.g. corporate trustees).

Construction Company

The Pensions Regulator is considering enforcing its anti-avoidance powers against the company directors, forcing them to pay into the firm's collapsed pension schemes.

Topical matters

Pension transfers

FCA policy statement on advising on pension transfers

On 26 March 2018 the Financial Conduct Authority(FCA) published a new policy statement (PS18/6: Advising on Pension Transfers) which provides feedback on the FCA's consultation paper (CP17/6) and contains new rules and guidance on how advice should be provided to consumers on pension transfers where consumers are considering giving up safeguarded benefits, primarily for transfers from defined benefit to defined contribution pension schemes. The resulting policy will come into force over the period April 2018 to April 2019.

The policy statement sets a requirement for advice on a transfer and/or conversion of safeguard benefits to include a personal recommendation based on individual needs. Some of the new rules considered are as follows:



The new rules **outline the FCA's expectations of advisers and pension transfer specialists** to ensure that **consumers receive advice which considers all relevant factors**. This is emphasised by considering the advice as a personal recommendation from the advisor.



The **changes replace the current transfer value analysis (TVAS)** with a requirement to analyse a client's options.



There is a handbook with guidance on the **role of a Pension Transfer Specialist (PTS)** when they review pension transfers, opt outs or conversion of safeguarded benefits, among other matters. The **guidance seeks to make clear the FCA's expectation that this is not just restricted to numerical analysis** and it can be accessed at <https://www.handbook.fca.org.uk/handbook>.



The new rules on advice will apply to advice on pension opt outs. However, the FCA **will not require the appropriate pension transfer analysis (APTA) and transfer value comparator (TVC) in the case of opt-outs, and excludes opt-outs that do not involve safeguarded benefits** from these provisions altogether.

Topical matters

Pension transfers (continued)

Consultation paper on improving the quality of pension transfer advice

Alongside the policy statement, **the FCA also published a consultation paper (CP18/7) on improving the quality of pension transfer advice.** The proposals in the new consultation paper follow from a number of questions posed in the FCA's previous paper, some of which have been addressed in the new pension statement.

The recommendations in order to improve the pension advice given include:



Requiring a Pension Transfer Specialist (PTS) to have the investment advice qualification. The new rules require that a firm must ensure all advice on pension transfers is given or checked by a PTS.



The **role of the PTS in relation to the destination of a client's transfer funds is clarified**, including the relationship a PTS has with another adviser firm that provides the investment advice. The paper also sets out expectations for how pension transfer advisers should interact with a "self investor".



A requirement for **firms to provide a suitability report** regardless of the outcome of advice.



Guidance is set to illustrate **how firms can carry out an appropriate 'triage' service** (an initial conversation with potential customers), without stepping across the advice boundary, by providing generic, balanced information on the merits of pension transfers, among other rules.

Next steps:

The consultation closed 25 May 2018 and the FCA are due to publish a policy statement in autumn 2018.

Deloitte view

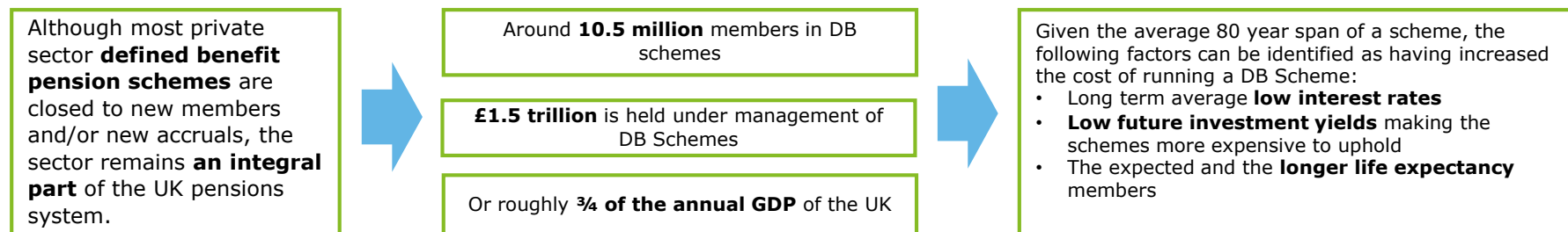
In light of the changes to guidance and rules, trustees should work towards ensuring controls and safeguards are put in place or updated to match up to the new policy so as to ensure compliance with the new requirements.



Topical Matters

DWP White Paper - March 2018: Protecting Defined Benefit Schemes

This follows from the DWP Green paper - Security and Sustainability in DB Pension Schemes – issued in February 2017.



The review has not identified systematic issues, however it has highlighted that there are **irresponsible employers who eventually cost other schemes** when their schemes enter the Pension Protection Fund. The best defence is considered to be a solid and in the money employer that practices good governance. The key areas addressed are:

1. A Stronger Regulator:

The government policy has made a guarantee to take action against the trustees and employers whose activities put pension schemes at risk:

- The government will give the regulator the authority to **discipline and penalise trustees** who intentionally put the schemes at risk.
- Legislation will be passed to present a **criminal offence** to punish those found to have practices involving irresponsible conduct and to disqualify company directors.
- The regulatory framework will reinforce the current notifiable events framework and voluntary clearance regime so that employers have respect for pension considerations in any business transactions e.g. buy outs.
- The Regulator will have the power to obtain information required to examine compliance. **Penalties will be introduced** to ensure co-operation.

2. Scheme Funding:

To reinforce the regulator's ability to enforce standards a code will be in place to focus on :

- How **prudence** is shown when measuring the scheme liabilities.
- What factors are suitable when making an allowance for a recovery plan.
- Ensuring a **long-term view** is considered when setting the statutory funding principles.

The code will also require the trustees of a **DB Scheme to elect a Chair** who will be accountable to the Regulator for a **Chair's statement** submitted with the triennial valuation (not in the annual accounts as with DC schemes).

3. Scheme Consolidation:

Benefits of consolidation

- Economies of scale (**cheaper administration cost** per member);
- **more effective and efficient investment strategies;** and
- **improved governance.**

To simplify and enable consolidation the Department of Works and Pensions will:

- Work on a channel within which new methods of consolidation will operate.
- Form a new accreditation regime to build assurance on existing forms of consolidation.
- Consider some changes to GMP conversion legislation to reduce intricacies in the benefit structure.

Next step:

Changes will be made via a phased approach.

The Regulator has already started implementing their two programmes -TPR Future and 21st Century Trusteeship in order to be more efficient, effective and flexible.

Deloitte response: For more information please refer to the full White Paper:

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/693655/protecting-defined-benefit-pension-schemes.pdf

We recommend trustees monitor the result of the White Paper and ensure any necessary changes are made.

Appendices



Purpose of our report and responsibility statement

Our report is designed to help you meet your governance duties

What we report

Our report is designed to help the Audit Committee and the Pension Fund Committee discharge their governance duties. It also represents one way in which we fulfil our obligations under ISA 260 (UK) 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 business 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.

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.



for and on behalf of Deloitte LLP
Glasgow

13 September 2018

Audit adjustments

Unadjusted misstatements and disclosure deficiencies

We have identified the following misstatements and disclosure deficiencies from our audit work, most of which have been corrected by management but we nonetheless bring to your attention.

	Debit/ (credit) in Fund Account £'000	Debit/ (credit) in net assets £'000	If applicable, control deficiency identified
Uncorrected misstatements			
None			
Corrected misstatements			
None			
Total			

Disclosure deficiencies

[1] The Schroder Liquidity Fund is currently disclosed under Cash income due in note 11a of the financial statements. As this is a Pooled Investment Vehicle, it should really be disclosed under that heading. The result of the current classification is that £973,000 of sales are not presented in note 11a.

Fraud responsibilities and representations

Responsibilities explained



Responsibilities:

The primary responsibility for the prevention and detection of fraud rests with management and those charged with governance, including establishing and maintaining internal controls over the reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations. As auditors, 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.



Required representations:

We have asked the Pension Fund to confirm in writing that it has disclosed to us the results of its own assessment of the risk that the financial statements may be materially misstated as a result of fraud and that it is not aware of any fraud or suspected fraud that affects the entity.

We have also asked the Pension Fund to confirm in writing its responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud and error.



Audit work performed:

In our planning we identified the risk of fraud in complying with recognition of grant income and management override of controls as a key audit risk for your organisation.

During course of our audit, we have had discussions with internal audit, management and those charged with governance.

In addition, we have reviewed management's own documented procedures regarding fraud and error in the financial statements

We have reviewed the paper prepared by management for the Audit Committee on the process for identifying, evaluating and managing the system of internal financial control.

Concerns:

No concerns have been identified regarding fraud.



Independence and fees

As part of our obligations under International Standards on Auditing (UK), 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	<p>The audit fee for 2017/18 is £29,486 as detailed in our Audit Plan.</p> <p>No fees for non-audit services have been charged by Deloitte in the period.</p>
Non-audit services	In our opinion there are no inconsistencies between FRC's Ethical Standard 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	<p>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.</p> <p>We are not aware of any relationships which are required to be disclosed.</p>





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



Shetland Islands Council

Table of Contents

Management Structure	1
Management Commentary	2
Annual Governance Statement.....	9
Statement of Responsibilities for the Statement of Accounts	15
Independent Auditor's Report	16
Pension Fund Account 2017/18.....	19
Net Assets Statement as at 31 March 2018.....	17
Note 1: Description of Pension Fund	18
Note 2: Basis of Preparation	19
Note 4: Assumptions and Major Sources of Estimation Uncertainty.....	19
Note 5: Contributions Receivable	20
Note 6: Transfers in from Other Pension Funds.....	20
Note 7: Benefits Payable	20
Note 8: Payments to and on Account of Leavers	20
Note 9: Management Expenses.....	21
Note 10: Investment Income	21
Note 11: Investments.....	21
Note 12: Fair Value Hierarchy.....	23
Note 13: Financial Instruments	24
Note 14: Nature and Extent of Risks Arising from Financial Instruments	25
Note 15: Funding Arrangements.....	28
Note 16: Actuarial Present Value of Promised Retirement Benefits	30
Note 17: Current Assets	31
Note 18: Unfunded Pension.....	31
Note 19: Current Liabilities	31
Note 20: Additional Voluntary Contributions.....	31
Note 21: Related Party Transactions	31
Note 22: Changes in Actuarial Present Value of Promised Retirement Benefits	32
Note 23: Critical Judgements in Applying Accounting Policies	33
Note 24: Events after the Balance Sheet Date.....	33
Note 25: Accounting Policies	33
Actuarial Statement for 2017/18	35
Funding Strategy Statement.....	37

Management Structure

Administering Authority

Shetland Islands Council
Town Hall
Lerwick
Shetland
ZE1 0HB

Fund Custodian

The Northern Trust Company

Investment Advisor

KPMG

Investment Managers

Blackrock
Schroders
M & G Investments
KBI Global Investors Limited
Newton

Fund Actuary

Hymans Robertson LLP

Banker

Bank of Scotland

AVC Providers

Prudential
Equitable Life (closed to new members)

Independent Auditor

Deloitte LLP

Management Commentary

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

Background

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

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

Employers with active members at 31 March 2018

Scheduled Bodies:

- Shetland Islands Council
- Orkney & Shetland Valuation Joint Board

Admitted Bodies:

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

Employers with no active members at 31 March 2018

Admitted Bodies:

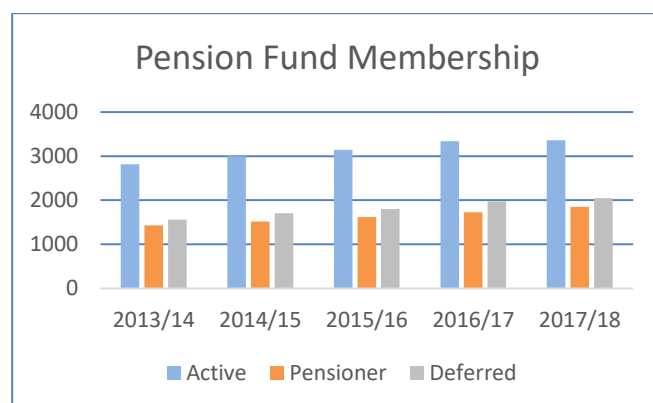
- Shetland Enterprise Co Ltd (Highlands & Island Enterprise)

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

Membership

The Pension Fund is made up of:

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



Valuation

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

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

The fall in funding level is due to a fall in real gilt yields, which has the impact of increasing the value of the Pension Fund liabilities (i.e. pensions payable in the future). This was offset by better than expected asset returns and lower costs.

Investment Policy

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

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

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

The focus of the Pension Fund's investment strategy is on achieving a 100% funding level, where the Pension Fund's assets equal its liabilities, within a maximum time horizon of 20 years. 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 this strategy will improve the level of return and be protected against the full negative impact of volatile and falling markets due to its increased diversity.

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

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

The Pension Fund has five Fund Managers, as follows:

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

On 3 January 2018, the Markets in Financial Instrument Directive 2014/65 (MiFID II) was implemented. Local authorities were automatically categorised as retail investors; this meant that they had access to increased protections, but it restricted access to financial markets and investment managers, asset classes and products.

During the year an exercise was carried out to 'opt up' to being a professional client and to lose the protections offered by MiFID II. This ensured that the Pension Fund had access to the investment products it needs to deliver the investment returns required to fund pensions.

Investment Performance

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

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

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

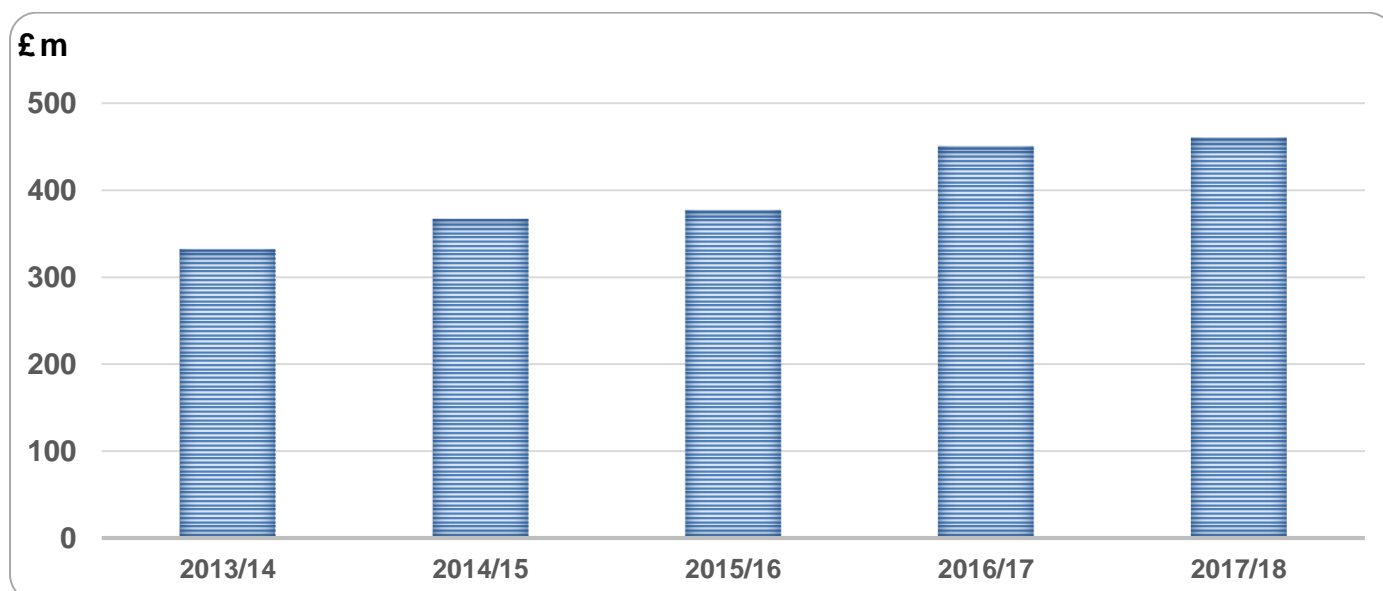
- Blackrock's passive equity fund returned 2.0%, which was above the benchmark return of 1.8%;
- Schroder's property fund returned 10.6% which was ahead of the benchmark return of 10.0%
- Newton's diversified growth fund returned - 1.4% which was below the benchmark return of 4.4%;
- M & G's alternative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

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

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

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

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



Risk

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

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

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

Funding Strategy

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

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

Funding Strategy Statement

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

of the Funding Strategy Statement are found in Note 15: Funding Arrangements, on page 28.

The purpose of the Funding Strategy Statement is:

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

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

Statement of Investment Principles

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

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

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

Performance Management

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

Primary Financial Statements

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

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

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

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

Financial Performance 2017/18

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

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

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

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

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

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

Administration Strategy

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

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

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

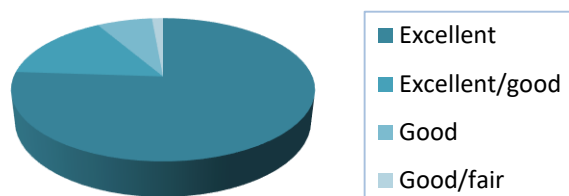
During 2017/18, a Pensions Employer Forum was held, bringing together all employers who contribute to the Fund. This gave employers a chance to ask questions and engage with the Pension Fund and the Fund Actuary, both on the subject of the triennial valuation and on a more general basis. This was welcomed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

Administration Performance

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

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

Member Satisfaction Survey (71 responses)



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

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

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

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

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

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

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

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

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

Monitoring Arrangements

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

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

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

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

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

Remuneration Report

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

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

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

Pension Fund Outlook

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

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

The Pension Fund records are subject to General Data Protection Regulations that came into force on 25 May 2018. Work has been undertaken to ensure that the Pension Fund is fully compliant.

Executive Manager – Finance

The unaudited annual accounts were signed by the then Executive Manager – Finance and section 95 officer, Jonathan Belford, who took up a new post at Aberdeen City Council on 1 September 2018. Jamie Manson has been appointed as the new Executive Manager – Finance and will start on 24 September 2018. In the interim Hazel Tait, Acting s95 Officer, has been given delegated authority to sign the annual accounts.

.....
Steven Coutts
Leader of the Council
Chair of the Pension Fund Committee
19 September 2018

.....
Hazel Tait, CPFA
Acting Section 95 Officer
19 September 2018

.....
Maggie Sandison
Chief Executive
19 September 2018

Annual Governance Statement

Introduction

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

Administering Authority

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

Regulatory Framework

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

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

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

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

Scope of Responsibility

The Council is responsible for ensuring that the Pension Fund:

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

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

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

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

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

Governance Framework

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

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

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

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

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

The effective arrangements include:

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

- a demonstrable best value service, including good use of benchmarking data on the cost and quality of service provided; and
- effective internal control arrangements, including appropriate segregation of duties for the Pension Fund staff.

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

Review of Effectiveness

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

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

Management Assurance

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

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

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

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

Assurance from Internal Audit

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

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

External Audit and Other External Scrutiny

Each year, the Council's external auditors undertake an assessment of the internal controls in operation within the Council, and relied upon by the Pension Fund, to determine whether they can place reliance on them in the preparation of the final accounts.

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

Investments

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

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

Self-Evaluation of Compliance

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

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 therefore 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, meetings and training and are given opportunities to contribute to the decision making process, with or without voting rights.	Yes, Pension Board members have the same access to information, papers and training.
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 2017/18, following the Scottish Local Government elections.
That at the start of any meeting, committee members are invited to declare any financial or pecuniary interest related to specific matters on the agenda.	Yes, 'Declarations of Interest' is a standing item on all agendas.
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, an updated Member Development Programme was put in place, following the elections in May 2017.
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 are wholly focused on Pension Fund business.
That an administering authority's secondary committee or panel meet at least twice a year and is synchronised with the dates when the main committee sits.	Yes, the Pension Board sits concurrently with the Pension Fund Committee.
That an administering authority that does not include lay members in their formal governance arrangements, must provide a forum outside of those arrangements by which the interests of key stakeholders can be represented.	Yes, lay members are included in formal governance arrangements.
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 and all agenda items and subsequent minutes are available on the Shetland Islands Council Committee Information Pages (COINS) and can be accessed by all Pension Fund Committee and Pension Board members.
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. Governance and constitutional documents are available on the Council website.

Significant Governance Issues

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

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

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.

Steven Coutts
Leader of the Council
Chair of the Pension Fund Committee
19 September 2018

Maggie Sandison
Chief Executive
Shetland Islands Council
19 September 2018

Statement of Responsibilities for the Statement of Accounts

The administering authority's responsibilities

The Authority is required to:

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

I can confirm that these Annual Accounts were approved for signature by the Council on 19 September 2018.

Signed on behalf of Shetland Islands Council.

.....
Steven Coutts
Leader of the Council
Chair of the Pension Fund Committee
19 September 2018

The Executive Manager – Finance's responsibilities

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

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

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

The Executive Manager - Finance has also:

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

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

.....
Hazel Tait, CPFA
Acting Section 95 Officer
Shetland Islands Council
19 September 2018

Independent Auditor's Report to the members of Shetland Islands Council as administering authority for Shetland Islands Council Pension Fund and the Accounts Commission

Report on the audit of the financial statements

Opinion on financial statements

We certify that we have audited the financial statements in the annual report of Shetland Islands Council Pension Fund (the fund) for the year ended 31 March 2018 under Part VII of the Local Government (Scotland) Act 1973. The financial statements comprise the Pension Fund Account, the 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 2017/18 (the 2017/18 Code).

In our opinion the accompanying financial statements:

- give a true and fair view in accordance with applicable law and the 2017/18 Code of the financial transactions of the fund during the year ended 31 March 2018 and of the amount and disposition at that date of its assets and liabilities;
- have been properly prepared in accordance with IFRSs as adopted by the European Union, as interpreted and adapted by the 2017/18 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 for opinion

We conducted our audit in accordance with applicable law and International Standards on Auditing (UK) (ISAs (UK)). 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 Standard, 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.

Conclusions relating to going concern basis of accounting

We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

- the use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the Executive Manager – Finance has not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the fund's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

Responsibilities of the Executive Manager – Finance and Shetland Islands Council Pension Fund 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.

In preparing the financial statements, the Executive Manager – Finance is responsible for assessing the fund's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless deemed inappropriate.

Shetland Islands Council is responsible for overseeing the financial reporting process.

Auditor's responsibilities for the audit 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) 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.

A further description of the auditor's responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Other information in the annual report

The Executive Manager – Finance is responsible for the other information in the annual report. 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, our responsibility is to read all the other information in the annual report and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Report on other requirements

Opinions on matters prescribed by the Accounts Commission

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;
- 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); and
- the information given in the Governance Compliance 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 Local Government Pension Scheme (Scotland) Regulations 2014.

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 are not in agreement with the accounting records; or
- we have not received all the information and explanations we require for our audit.

We have nothing to report in respect of these matters.

Use of our report

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.

.....
Pat Kenny, CPFA (for and on behalf of Deloitte LLP)
110 Queen Street
Glasgow
G1 3BX

19 September 2018

Pension Fund Account 2017/18

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

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

Net Assets Statement as at 31 March 2018

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

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

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

.....
Hazel Tait, CPFA
Acting Section 95 Officer
Shetland Islands Council
19 September 2018

Notes to the Accounts

Note 1: Description of Pension Fund

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

General

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

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

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

Shetland Islands Council, Orkney and Shetland Valuation Joint Board and admitted bodies within Shetland. Teachers are not included as they are members of the Scottish Teachers' Pension Scheme.

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

Membership

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

Organisations participating in the Shetland Islands Council Pension Fund include:

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

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

31 March 2017	Shetland Islands Council Pension Fund	31 March 2018
11	Number of employers with active members	11
	Number of employees in scheme:	
2,957	Shetland Islands Council	2,976
385	Other employers	382
3,342	Total	3,358
	Number of pensioners/dependants	
1,583	Shetland Islands Council	1,702
145	Other employers	149
1,728	Total	1,851
	Deferred pensioners	
1,611	Shetland Islands Council	1,710
362	Other employers	334
1,973	Total	2,044
7,043	Scheme Total	7,253

Funding

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

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

Benefits

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

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

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

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

Note 2: Basis of Preparation

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

The accounts summarise the transactions of the Pension Fund and report on the net assets available to pay pension benefits. The accounts do not take account of obligations to pay pensions and benefits that fall due after the end of the financial year. The actuarial present value of promised retirement benefits, valued on an International Accounting Standard (IAS) 19 basis, is disclosed at Note 16.

Note 3: Accounting Standards Issued not Adopted

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

Note 4: Assumptions and Major Sources of Estimation Uncertainty

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

The items in the net assets statement at 31 March 2018 for which there is a significant risk of material adjustment in the forthcoming financial year are as follows:

Item	Uncertainties	Effect if actual results differ from assumptions
Actuarial present value of promised retirement benefits	Estimation of the net liability to pay pensions depends on a number of complex judgements relating to the discount rate used, the rate at which salaries are projected to increase, changes in retirement ages, mortality rates and expected returns on pension fund assets. An actuary to the Fund is appointed to provide the fund with expert advice about the assumptions to be applied.	The effects on the net pension liability of changes in individual assumptions can be measured. For instance, a 0.5% decrease in the real discount rate assumption would result in an increase in the pension liability of £69m. A 0.5% increase in salary increase rate assumption would increase the value of liabilities by approximately £10m, and a 0.5% increase in pension increase rate assumption would increase the liability by approximately £56m.

Note 5: Contributions Receivable

By category:

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

By authority:

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

Note 6: Transfers in from Other Pension Funds

The total transfers received during the year are as follows:

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

The Pension Fund received 48 transfers in during 2017/18 with an average value of £29,616, compared to 41 transfers in during 2016/17 with an average value of £30,683.

Note 7: Benefits Payable

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

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

Note 8: Payments to and on Account of Leavers

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

Note 9: Management Expenses

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

Note 10: Investment Income

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

Note 11: Investments

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

Note 11a - Reconciliation of movements in investments

	Market Value at 1 April 2017 £000	Purchases during the year £000	Sales during the year £000	Change in market value during the year £000	Market Value at 31 March 2018 £000
Investment Assets:					
Pooled funds - managed funds	172,375	78,941	(77,744)	(2,282)	171,290
- unit linked insurance policies	194,032	0	(37)	3,994	197,989
Fixed income unit trusts	38,019	701	0	437	39,157
Pooled property unit trusts	42,889	4,646	(1,350)	2,083	48,267
Total Pooled Investment Vehicles	447,315	84,288	(79,131)	4,232	456,703
Other investment balances:					
Fixed income due	187				290
Property income due	237				108
Cash income due	1,218				2,319
Net investment assets	448,957	84,288	(79,131)	4,232	459,420

The following table has been restated for presentational reasons.

Comparative movements in 2016/17	Market Value at 1 April 2016 £000	Purchases during the year £000	Sales during the year £000	Change in market value during the year £000	Market Value at 31 March 2017 £000
Investment Assets:					
Pooled funds - managed funds	147,050	0	(35)	25,360	172,375
- unit linked insurance policies	152,212	0	(35)	41,855	194,032
Fixed income unit trusts	33,926	2,571	0	1,522	38,019
Pooled property unit trusts	41,612	3,402	(2,122)	(3)	42,889
Total Pooled Investment Vehicles	374,800	5,973	(2,192)	68,734	447,315
Other investment balances					
Fixed income due	270				187
Property income due	35				237
Cash income due	44				1,218
Net investment assets	375,149	5,973	(2,192)	68,734	448,957

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

Note 11b - Analysis of Pooled Investment Vehicles

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

Note 11c - Analysis by Fund Manager

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

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

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

Note 12: Fair Value Hierarchy

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

Level 1

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

Level 2

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

where valuation techniques are used to determine fair value.

Level 3

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

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

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

Basis of Valuation

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

Description of Asset	Valuation hierarchy	Basis of valuation	Observable / unobservable inputs	Key sensitivities affecting valuations
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 13: Financial Instruments

Note 13a - Classification of financial instruments

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

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

As at 31 March 2017 (restated)				As at 31 March 2018		
Fair value through profit and loss £000	Receivables £000	Financial liabilities £000		Fair value through profit and loss £000	Receivables £000	Financial liabilities £000
			Financial assets			
			Pooled funds			
172,562	0	0	- managed funds	171,580	0	0
194,032	0	0	- unit linked insurance policies	197,989	0	0
38,019	0	0	Fixed income unit trusts	39,157	0	0
42,889	0	0	Pooled property unit trusts	48,267	0	0
0	2,229	0	Cash	0	3,054	0
237	0	0	Property income due	108	0	0
0	1,345	0	Debtors	0	1,647	0
447,739	3,574	0	Total Financial assets	457,101	4,701	0
			Financial liabilities			
0	0	(1,414)	Creditors	0	0	(1,583)
0	0	(1,414)	Total Financial liabilities	0	0	(1,583)
447,739	3,574	(1,414)	Total	457,101	4,701	(1,583)

Note 13b - Net gains and losses on financial instruments

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

Note 13c - Value of financial instruments

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

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

Risk and risk management

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

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

Market risk

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

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

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

advisors undertake appropriate monitoring of market conditions and benchmark analysis.

Other price risk

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

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

Other Pension Fund price risk - sensitivity analysis

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

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

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

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

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

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	15.80%	94,878	68,988
Overseas Equities	279,250	18.40%	330,632	227,868
Total Bonds & Index Linked	38,206	14.20%	43,631	32,781
UK Property	46,749	12.50%	52,593	40,905
Overseas Property	1,601	6.10%	1,699	1,503
Total assets	448,957		524,651	373,263

Interest rate risk

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

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

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

The Pension Fund's investment strategy aims to manage interest rate risk by having various investment portfolios managed by external Fund Managers.

Interest rate risk sensitivity analysis

The Pension Fund recognises that interest rates can vary and can affect both income to the Pension Fund and the value of the net assets available to pay benefits. A 110 basis point (BPS) movement in interest rates is viewed as a reasonable level of risk sensitivity for the Pension Fund under current interest rate circumstances.

The Pension Fund's performance analyst has also agreed that the long-term average rates are expected to move less than 110 basis points (hence 100 basis points used in the examples below) from one year to the next and experience suggests that such movements are possible.

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

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

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)

Currency risk

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

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

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

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

Exposure to risk of loss in adverse movements in exchange rates is greatly reduced through the use of currency hedging strategies to specifically negate any currency movement impact.

Currency risk - sensitivity analysis

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

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

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

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

Credit risk

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

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

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

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

The Pension Fund's cash holding under its treasury management arrangements at 31 March 2018 was £3.054m (31 March 2017: £2.229m).

This was held with the following institutions:

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

Liquidity risk

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

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

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

Refinancing risk

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

Note 15: Funding Arrangements

In line with the Local Government Pension Scheme (Scotland) Regulations 2014 (as amended), the Pension Fund's actuary undertakes a funding valuation every three years for the purpose of setting employer contribution rates for the forthcoming triennial period. The valuation for the current accounting period took place as at 31 March 2017.

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

The key elements of the funding policy are:

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

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

Funding position as at the last formal funding valuation

The most recent actuarial valuation carried out under Regulation 32 of the Local Government Pension Scheme (Scotland) (Administration) Regulations 2008 was at 31 March 2017. This valuation revealed that the Pension Fund's assets, which at 31 March 2017 were valued at £450m, were sufficient to meet 90% (£333m and 92% at 31 March 2014 valuation) of the liabilities (i.e. the present value of promised retirement benefits) accrued up to that date. The resulting deficit at the 2017 valuation was £51m (2014 valuation: £30m).

The common rate of contribution payable by each employing authority under regulation 32(4)(a) of the Administration Regulations for the period 1 April 2018 to 31 March 2021 is 22.1% of pensionable pay, (i.e. the rate which all employers in the Pension Fund pay).

Individual employers' rates are adjusted under regulation 32(4) (b) from the common contribution rate. The contribution rates payable for the period 1 April 2018 to 31 March 2021 were set in accordance with the Pension Fund's funding policy as set out in its Funding Strategy Statement.

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

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

Principal actuarial assumptions and method used in the valuation

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

Method

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

Assumptions

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

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

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

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

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

Mortality assumptions

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

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

Historic mortality assumptions

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

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

Commutation assumption

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

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

50:50 Option

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

Note 16: Actuarial Present Value of Promised Retirement Benefits

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

In order to assess the value of the benefits on this basis, the actuary has updated the actuarial assumptions (set out below) from those used for funding purposes (see Note 15). The actuary has also used ill health and death benefits in line with IAS 19.

The actuarial present value of promised retirement benefits at 31 March 2018 was £622m (31 March 2017: £693m). The Pension Fund accounts do not take account of liabilities to pay pensions and other benefits in the future.

The liabilities have been projected using a roll forward approximation from the latest formal funding valuation as at 31 March 2017.

Assumptions

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

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

Note 17: Current Assets

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

Analysis of debtors

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

Note 18: Unfunded Pension

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

Local Government (Discretionary Payments and Injury Benefits) (Scotland) Regulations 1998 [Section 31] allows local authorities and admitted bodies to pay additional pension on a voluntary basis. Additional pension in respect of added years' enhancement is awarded from the body or service where the employee retired and costs are paid directly by the employer and not the Pension Fund.

Note 19: Current Liabilities

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

Analysis of creditors

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

Note 20: Additional Voluntary Contributions

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

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

Note 21: Related Party Transactions

Shetland Islands Council

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

The Council incurred costs of £0.363m (2016/17 £0.338m) in relation to the administration of the Pension Fund and was subsequently reimbursed by the Pension Fund for these expenses.

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

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

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

Governance

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

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

Key management personnel

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

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

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

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

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

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

Note 23: Critical Judgements in Applying Accounting Policies

Pension Fund liability

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

Note 24: Events after the Balance Sheet Date

The annual accounts were authorised for issue on 19 September 2018. Events taking place after this date are not reflected in the financial statements or notes. Where events taking place before this date provided information about conditions existing at 31 March 2018, the figures in the financial statements and notes have been adjusted in all material respects to reflect the impact of this information.

Note 25: Accounting Policies

Pension Fund account - revenue recognition

A Contribution income

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

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

B Transfers to and from other schemes

Transfer values represent the amounts received and paid during the year for members who have

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

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

C Investment income

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

Pension Fund account - expense items

D Benefits payable

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

E Taxation

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

F Management expenses

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

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

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

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

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

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

Net assets statement

G Financial assets

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

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

H Pooled investment vehicles

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

I Foreign currency transactions

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

overseas investments and purchase and sales outstanding at the end of the reporting period.

J Cash and cash equivalents

Cash comprises cash in hand and demand deposits.

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

K Actuarial present value of promised retirement benefits

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

As permitted under IAS 26, the Pension Fund has opted to disclose the actuarial present value of the promised retirement benefits by way of a note to the net assets statement (Note 16).

L Additional voluntary contributions

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

AVCs are paid to the AVC provider by employers and are specifically for providing additional benefits for individual contributors. Each AVC contributor receives an annual statement showing the amount held in their account and the movements in the year.

AVCs are not included in the accounts in accordance with section 4(1) (b) of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 but are disclosed as a note only (Note 20).

Actuarial Statement for 2017/18

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

Description of Funding Policy

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

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

The FSS sets out how the Administering Authority seeks to balance the conflicting aims of securing the solvency of the Fund and keeping employer contributions stable. Asset-liability modelling has been carried out which demonstrates that if these contribution rates are paid and future contribution changes are constrained as set out in the FSS, there is at least a 66% chance that the Fund will return to full funding over 14 years.

Funding Position as at the last formal funding valuation

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

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

Principal Actuarial Assumptions and Method used to value the liabilities

Full details of the methods and assumptions used are described in the 2017 valuation report.

Method

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

Assumptions

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

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

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

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

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

*Currently aged 45

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

Experience over the period since 31 March 2017

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

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



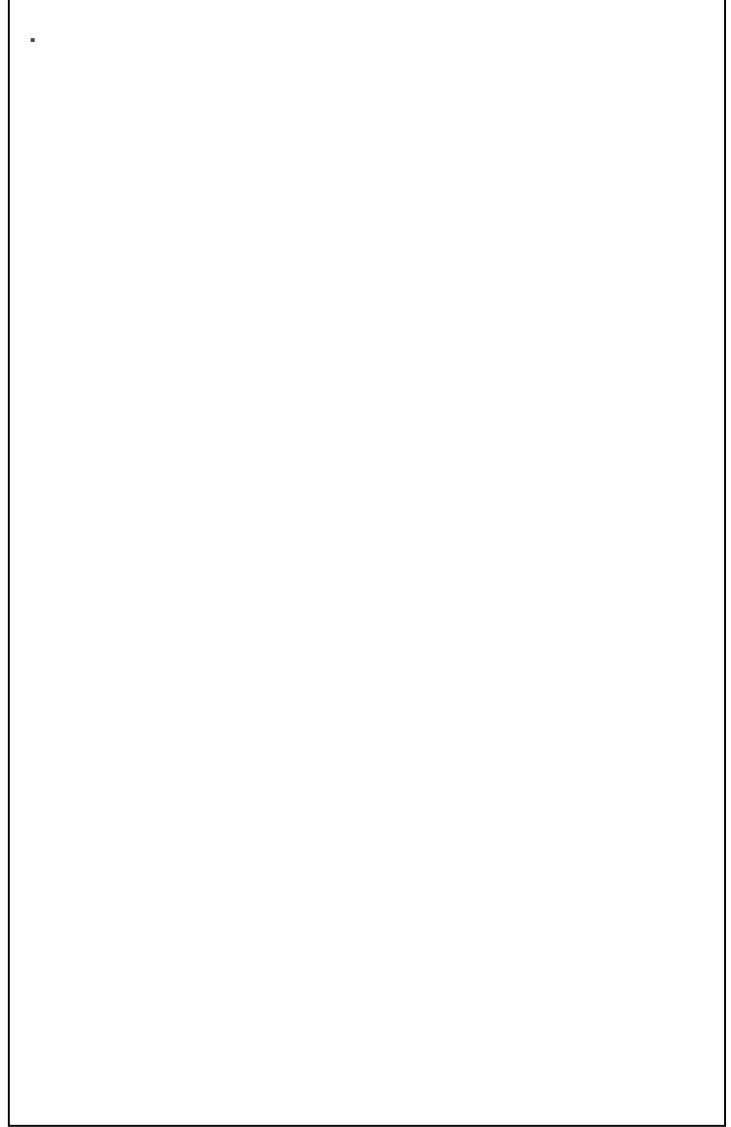
Douglas Green FFA
For and on behalf of Hymans Robertson LLP
4 May 2018

Hymans Robertson LLP
20 Waterloo Street, Glasgow, G2 6DB

Shetland Islands Council Pension Fund

FINAL Funding Strategy Statement

FEBRUARY 2018



Contents

DRAFT Funding Strategy Statement		PAGE
1	Introduction	39
2	Basic Funding issues	42
3	Calculating contributions for individual Employers	46
4	Funding strategy and links to investment strategy	56
5	Statutory reporting and comparison to other LGPS Funds	57
Appendices		
Appendix A – Regulatory framework		57
Appendix B – Responsibilities of key parties		61
Appendix C – Key risks and controls		63
Appendix D – The calculation of Employer contributions		67
Appendix E – Actuarial assumptions		70
Appendix F – Glossary		73

1 Introduction

1.1 What is this document?

This is the Funding Strategy Statement (FSS) of the Shetland Islands Council Pension Fund (“the Fund”), which is administered by Shetland Islands Council, (“the Administering Authority”).

It has been prepared by the Administering Authority in collaboration with the Fund’s actuary, Hymans Robertson LLP, and after consultation with the Fund’s employers and investment adviser. It is effective from 14 February 2018.

1.2 What is the Shetland Islands Council Pension Fund?

The Fund is part of the Scottish Local Government Pension Scheme (LGPS). The LGPS was set up by the UK Government to provide retirement and death benefits for local government employees, and those employed in similar or related bodies, across the whole country. The Administering Authority runs the Shetlands Islands Council Pension Fund, in effect the LGPS for the Shetland Islands area, to make sure it:

- receives the proper amount of contributions from employees and employers, and any transfer payments;
- invests the contributions appropriately, with the aim that the Fund’s assets grow over time with investment income and capital growth; and
- uses the assets to pay Fund benefits to the members (as and when they retire, for the rest of their lives), and to their dependants (as and when members die), as defined in the various LGPS Regulations applicable to Scotland. Assets are also used to pay transfer values and administration costs.

The roles and responsibilities of the key parties involved in the management of the Fund are summarised in [Appendix B](#).

1.3 Why does the Fund need a Funding Strategy Statement?

Employees’ benefits are guaranteed by the LGPS Regulations and do not change with market values or employer contributions. Investment returns will help pay for some of the benefits, but probably not all, and certainly with no guarantee. Employees’ contributions are fixed in those Regulations also, at a level which covers only part of the cost of the benefits.

Therefore, employers need to pay the balance of the cost of delivering the benefits to members and their dependants.

The FSS focuses on how employer liabilities are measured, the pace at which these liabilities are funded, and how employers or pools of employers pay for their own liabilities. This statement sets out how the Administering Authority has balanced the conflicting aims of:

- affordability of employer contributions,
- transparency of processes,
- stability of employers’ contributions, and
- prudence in the funding basis.

There are also regulatory requirements for an FSS, as given in [Appendix A](#).

The FSS is a summary of the Fund's approach to funding its liabilities, and this includes reference to the Fund's other policies; it is not an exhaustive statement of policy on all issues. The FSS forms part of a framework which includes:

- the LGPS Regulations applicable in Scotland;
- the Rates and Adjustments Certificate (confirming employer contribution rates for the next three years) which can be found in an appendix to the formal valuation report;
- actuarial factors for valuing individual transfers, early retirement costs and the costs of buying added service; and
- the Fund's Statement of Investment Principles (see [Section 4](#))

1.4 How does the Fund and this FSS affect me?

This depends on who you are:

- a member of the Fund, i.e. a current or former employee, or a dependant: the Fund needs to be sure it is collecting and holding enough money so that your benefits are always paid in full;
- an employer in the Fund (or which is considering joining the Fund): you will want to know how your contributions are calculated from time to time, that these are fair by comparison to other employers in the Fund, and in what circumstances you might need to pay more. Note that the FSS applies to all employers participating in the Fund;
- an Elected Member whose council participates in the Fund: you will want to be sure that the council balances the need to hold prudent reserves for members' retirement and death benefits, with the other competing demands for council money;
- a Council Tax payer: you will want to know how your council seeks to strike the balance above, and also to minimise cross-subsidies between different generations of taxpayers.

1.5 What does the FSS aim to do?

The FSS sets out the objectives of the Fund's funding strategy, such as:

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

1.6 How do I find my way around this document?

In [Section 2](#) there is a brief introduction to some of the main principles behind funding, i.e. deciding how much an employer should contribute to the Fund from time to time.

In [Section 3](#) we outline how the Fund calculates the contributions payable by different employers in different situations.

In [Section 4](#) we show how the funding strategy is linked with the Fund's investment strategy.

In the [Appendices](#) we cover various issues in more detail if you are interested:

- A. the regulatory background, including how and when the FSS is reviewed,
- B. who is responsible for what,
- C. what issues the Fund needs to monitor, and how it manages its risks,
- D. some more details about the actuarial calculations required,
- E. the assumptions which the Fund actuary currently makes about the future,
- F. a [glossary](#) explaining the technical terms occasionally used here.

If you have any other queries please contact Mary Smith in the first instance at e-mail address **mary.smith@shetland.gov.uk** or on telephone number 01595 744669.

2 Basic Funding issues

(More detailed and extensive descriptions are given in [Appendix D](#)).

2.1 How does the actuary measure the required contribution rate?

In essence this is a three-step process:

1. Calculate the ultimate funding target for that employer, i.e. the ideal amount of assets it should hold in order to be able to pay all its members' benefits. See [Appendix E](#) for more details of what assumptions we make to determine that funding target;
2. Determine the time horizon over which the employer should aim to achieve that funding target. See the table in [3.3](#) and [Note \(b\)](#) for more details;
3. Calculate the employer contribution rate such that it has at least a given probability of achieving that funding target over that time horizon, allowing for different likelihoods of various possible economic outcomes over that time horizon. See [2.4](#) below, and [Section 3](#) for more details.

2.2 What is each employer's contribution rate?

This is described in more detail in [Appendix D](#). Employer contributions are normally made up of two elements:

- a) the estimated cost of benefits being built up each year, after deducting the members' own contributions and including administration expenses. This is referred to as the "*Primary rate*", and is expressed as a percentage of members' pensionable pay; plus
- b) an adjustment for the difference between the Primary rate above, and the actual contribution the employer needs to pay, referred to as the "*Secondary rate*". In broad terms, payment of the Secondary rate will aim to return the employer to full funding over an appropriate period (the "time horizon"). The Secondary rate may be expressed as a percentage of pay and/or a monetary amount in each year.

The rates for all employers are shown in the Fund's Rates and Adjustments Certificate, which forms part of the formal Actuarial Valuation Report. Employers' contributions are expressed as minima, with employers able to pay contributions at a higher rate. Account of any higher rate will be taken by the Fund actuary at subsequent valuations, i.e. will be reflected as a credit when next calculating the employer's contributions.

2.3 What different types of employer participate in the Fund?

Historically the LGPS was intended for local authority employees only. However over the years, with the diversification and changes to delivery of local services, many more types and numbers of employers now participate.

In essence, participation in the LGPS is open to public sector employers providing some form of service to the local community. Whilst the majority of members will be local authority employees (and ex-employees), the majority of participating employers are those providing services in place of (or alongside) local authority services: colleges, contractors, housing associations, charities, etc.

The LGPS Regulations define various types of employer as follows:

Scheduled bodies - councils, and other specified employers such as further education establishments. These must provide access to the LGPS in respect of their employees who are not eligible to join another public sector scheme (such as the Teachers Scheme). These employers are so-called because they are specified in a schedule to the LGPS Regulations.

Other employers are able to participate in the Fund via an admission agreement, and are referred to as 'admission bodies'. These employers are generally those with a "community of interest" with another scheme employer – **community admission bodies** ("CAB") or those providing a service on behalf of a scheme employer – **transferee admission bodies** ("TAB"). CABs will include housing associations and charities, TABs will generally be contractors. The Fund is able to set its criteria for participation by these employers and can refuse entry if the requirements as set out in the Fund's admissions policy are not met. (NB The terminology CAB and TAB has been dropped from recent LGPS Regulations, which instead combine both under the single term 'admission bodies'; however, we have retained the old terminology here as we consider it to be helpful in setting funding strategies for these different employers).

2.4 How does the measured contribution rate vary for different employers?

All three steps above are considered when setting contributions (more details are given in [Section 3](#) and [Appendix D](#)).

1. The **funding target** is based on a set of assumptions about the future, (e.g. investment returns, inflation, pensioners' life expectancies). However, if an employer is approaching the end of its participation in the Fund then its funding target may be set on a more prudent basis, so that its liabilities are less likely to be spread among other employers after its cessation;
2. The **time horizon** required is, in broad terms, the period over which any deficit is to be recovered. A shorter period will lead to higher contributions, and vice versa (all other things being equal). Employers may be given a lower time horizon if they have a less permanent anticipated membership, or do not have tax-raising powers to increase contributions if investment returns under-perform; and
3. The **probability of achieving** the funding target over that time horizon will be dependent on the Fund's view of the strength of employer covenant and its funding profile. Where an employer is considered to be weaker, or potentially ceasing from the Fund, then the required probability will be set higher, which in turn will increase the required contributions (and vice versa).

For some employers it may be agreed to pool contributions, see [3.4](#).

Any costs of non ill-health early retirements must be paid by the employer, see [3.6](#).

Costs of ill-health early retirements are covered in [3.7](#).

2.5 How is a deficit (or surplus) calculated?

An employer's "funding level" is defined as the ratio of:

- the market value of the employer's share of assets (see [Appendix D](#), section [D5](#), for further details of how this is calculated), to
- the value placed by the actuary on the benefits built up to date for the employer's employees and ex-employees (the "liabilities"). The Fund actuary agrees with the Administering Authority the assumptions to be used in calculating this value.

If this is less than 100% then it means the employer has a shortfall, which is the employer's deficit; if it is more than 100% then the employer is said to be in surplus. The amount of deficit or shortfall is the difference between the asset value and the liabilities value.

It is important to note that the deficit/surplus and funding level are only measurements at a particular point in time, on a particular set of assumptions about the future. Whilst we recognise that various parties will take an interest in these measures, for most employers the key issue is how likely it is that their contributions will be sufficient to pay for their members' benefits (when added to their existing asset share and anticipated investment returns).

In short, deficits and funding levels are short term measures, whereas contribution-setting is a longer term issue.

2.6 How does the Fund recognise that contribution levels can affect council and employer service provision, and council tax?

The Administering Authority and the Fund actuary are acutely aware that, all other things being equal, a higher contribution required to be paid to the Fund will mean less cash available for the employer to spend on the provision of services. For instance:

- Higher pension fund contributions may result in reduced council spending, which in turn could affect the resources available for council services, and/or greater pressure on council tax levels;
- Contributions which colleges and universities pay to the Fund will therefore not be available to pay for providing education; and
- Other employers will provide various services to the local community, perhaps through housing, charitable work, or contracting council services. If they are required to pay more in pension contributions to the LGPS then this may affect their ability to provide the local services at a reasonable cost.

Whilst all this is true, it should also be borne in mind that:

- The Fund provides invaluable financial security to local families, whether to those who formerly worked in the service of the local community who have now retired, or to their families after their death;
- The Fund must have the assets available to meet these retirement and death benefits, which in turn means that the various employers must each pay their own way. Lower contributions today will mean higher contributions tomorrow: deferring payments does not alter the employer's ultimate obligation to the Fund in respect of its current and former employees;
- Each employer will generally only pay for its own employees and ex-employees (and their dependants), not for those of other employers in the Fund;

- The Fund strives to maintain reasonably stable employer contribution rates where appropriate and possible. However, a recent shift in regulatory focus means that solvency within each generation is considered by the Government to be a higher priority than stability of contribution rates;
- The Fund wishes to avoid the situation where an employer falls so far behind in managing its funding shortfall that its deficit becomes unmanageable in practice: such a situation may lead to employer insolvency and the resulting deficit falling on the other Fund employers. In that situation, those employers' services would in turn suffer as a result; and
- Council contributions to the Fund should be at a suitable level, to protect the interests of different generations of council tax payers. For instance, underpayment of contributions for some years will need to be balanced by overpayment in other years; the council will wish to minimise the extent to which council tax payers in one period are in effect benefitting at the expense of those paying in a different period.

Overall, therefore, there is clearly a balance to be struck between the Fund's need for maintaining prudent funding levels, and the employers' need to allocate their resources appropriately. The Fund achieves this through various techniques which affect contribution increases to various degrees (see [3.1](#)). In deciding which of these techniques to apply to any given employer, the Administering Authority takes a view on the financial standing of the employer, i.e. its ability to meet its funding commitments over the relevant time horizon.

The Administering Authority will consider a risk assessment of that employer using a knowledge base which is regularly monitored and kept up-to-date. This database will include such information as the type of employer, its membership profile and funding position, any guarantors or security provision, material changes anticipated, etc.

For instance, where the Administering Authority has reasonable confidence that an employer will be able to meet its funding commitments, then the Fund will permit options such as a longer time horizon relative to other employers, and/or a lower probability of achieving their funding target. Such options will temporarily produce lower contribution levels than would otherwise have applied. This is permitted in the expectation that the employer will still be able to meet its obligations for many years to come.

On the other hand, where there is doubt that an employer will be able to meet its funding commitments or withstand a significant change in its commitments, then a higher funding target, and/or a shorter deficit recovery period relative to other employers, and/or a higher probability of achieving the target may be required.

The Fund actively seeks employer input, including to its funding arrangements, through various means: see [Appendix A](#).

3 Calculating contributions for individual Employers

3.1 General comments

A key challenge for the Administering Authority is to balance the need for stable, affordable employer contributions with the requirement to take a prudent, longer-term view of funding and ensure the solvency of the Fund. With this in mind, the Fund's three-step process identifies the key issues:

1. What is a suitably (but not overly) prudent funding target?
2. How long should the employer be permitted to reach that target? This should be realistic but not so long that the funding target is in danger of never actually being achieved.
3. What probability is required to reach that funding target? This will always be less than 100% as we cannot be certain of future market movements. Higher probability "bars" can be used for employers where the Fund wishes to reduce the risk that the employer ceases leaving a deficit to be picked up by other employers.

These and associated issues are covered in this Section.

The Administering Authority recognises that there may occasionally be particular circumstances affecting individual employers that are not easily managed within the rules and policies set out in the Funding Strategy Statement. Therefore the Administering Authority may, at its sole discretion, direct the actuary to adopt alternative funding approaches on a case by case basis for specific employers.

3.2 The effect of paying lower contributions

In limited circumstances the Administering Authority may permit employers to pay contributions at a lower level than is assessed for the employer using the three step process above. At their absolute discretion the Administering Authority may:

- extend the time horizon for targeting full funding;
- adjust the required probability of meeting the funding target;
- permit extended phasing in of contribution rises or reductions;
- pool contributions amongst employers with similar characteristics; and/or
- accept some form of security or guarantee in lieu of a higher contribution rate than would otherwise be the case.

Employers which are permitted to use one or more of the above methods will often be paying, for a time, contributions less than required to meet their funding target, over the appropriate time horizon with the required likelihood of success. Such employers should appreciate that:

- their true long term liability (i.e. the actual eventual cost of benefits payable to their employees and ex-employees) is not affected by the pace of paying contributions;
- lower contributions in the short term will be assumed to incur a greater loss of investment returns on the deficit. Thus, deferring a certain amount of contribution may lead to higher contributions in the long-term; and
- it may take longer to reach their funding target, all other things being equal.

Overleaf ([3.3](#)) is a summary of how the main funding policies differ for different types of employer, followed by more detailed notes where necessary.

[Section 3.4](#) onwards deals with various other funding issues which apply to all employers.

3.3 The different approaches used for different employers

Type of employer	Scheduled Bodies		Community Admission Bodies		Transferee Admission Bodies
Sub-type	Local Authorities	Colleges	Open to new entrants	Closed to new entrants	(all)
Funding Target Basis used	Ongoing, assumes long-term Fund participation (see Appendix E)		Ongoing, but may move to “gilts basis” - see Note (a)		Ongoing, assumes fixed contract term in the Fund (see Appendix E)
Primary rate approach	(see Appendix D – D.2)				
Maximum time horizon – Note (b)	20 years	20 years	20 years	Period equivalent to the expected future working lifetime of the remaining scheme members allowing for expected leavers, subject to no less than nine years	Outstanding contract term
Secondary rate – Note (c)	% of payroll	% of payroll	% of payroll	Monetary amount	% of payroll
Treatment of surplus	Preferred approach: contributions kept at Primary rate. However, reductions may be permitted by the Admin. Authority				Reduce contributions by spreading the surplus over the remaining contract term
Probability of achieving target – Note (d)	65-70%	70-75%	75-80%	75-80%	50-70%
Phasing of contribution changes – Note (e)	2 – 4 years				None
Review of rates – Note (f)	Administering Authority reserves the right to review contribution rates and amounts, and the level of security provided, at regular intervals between valuations				Particularly reviewed in last 3 years of contract
New employer	n/a	n/a	Note (g)		Notes (g) & (h)
Cessation of participation: cessation debt payable	Cessation is assumed not to be generally possible, as Scheduled Bodies are legally obliged to participate in the LGPS. In the rare event of cessation occurring (machinery of Government changes for example), the cessation debt principles applied would be as per Note (i) .		Can be ceased subject to terms of admission agreement. Cessation debt will be calculated on a basis appropriate to the circumstances of cessation – see Note (i) .		Participation is assumed to expire at the end of the contract. Cessation debt (if any) calculated on ongoing basis. Awarding Authority will be liable for future deficits and contributions arising.

Note (a) (Basis for CABs closed to new entrants)

In the circumstances where:

- the employer is an Admission Body but not a Transferee Admission Body, and
- the employer has no guarantor, and
- the admission agreement is likely to terminate, or the employer is likely to lose its last active member, within a timeframe considered appropriate by the Administering Authority to prompt a change in funding,

the Administering Authority may set a higher funding target (e.g. using a discount rate set equal to gilt yields) by the time the agreement terminates or the last active member leaves, in order to protect other employers in the Fund. This policy will increase regular contributions and reduce, but not entirely eliminate, the possibility of a final deficit payment being required from the employer when a cessation valuation is carried out.

The Administering Authority also reserves the right to adopt the above approach in respect of those Admission Bodies with no guarantor, where the strength of covenant is considered to be weak but there is no immediate expectation that the admission agreement will cease.

Note (b) (Maximum time horizon)

The maximum time horizon starts at the commencement of the revised contribution rate (1 April 2018 for the 2017 valuation). The Administering Authority would normally expect the same period to be used at successive triennial valuations, but would reserve the right to propose alternative time horizons, for example where an employer closed to new entrants over the inter-valuation period.

Note (c) (Secondary rate)

The Secondary contribution rate for each employer covering the three year period until the next valuation will often be set as a percentage of salaries. However, the Administering Authority reserves the right to amend these rates between valuations and/or to require these payments in monetary terms instead, for instance where:

- the employer is relatively mature, i.e. has a large Secondary contribution rate (e.g. above 15% of payroll), or
- there has been a significant reduction in payroll due to outsourcing or redundancy exercises, or
- the employer has closed to new entrants.

Note (d) (Probability of achieving funding target)

Each employer has its funding target calculated, and a relevant time horizon over which to reach that target. Contributions are set such that, combined with the employer's current asset share and anticipated market movements over the time horizon, the funding target is achieved with a given minimum probability. A higher required probability bar will give rise to higher required contributions, and vice versa.

The way in which contributions are set using these three steps, and relevant economic projections, is described in further detail in [Appendix D](#).

Different probabilities are set for different employers depending on their nature and circumstances: in broad terms, a higher probability will apply due to one or more of the following:

- the Fund believes the employer poses a greater funding risk than other employers;
- the employer does not have tax-raising powers;

- the employer does not have a guarantor or other sufficient security backing its funding position; and/or
- the employer is likely to cease participation in the Fund in the short or medium term.

Note (e) (Phasing of contribution changes)

The Administering Authority may agree with employers that any increases in employer contribution be phased in over an agreed period.

Transferee Admission Bodies are not eligible for phasing in of contributions rises. Other employers may opt to phase in contribution rises as follows:

- For employers contributing at or above its future service rate in 2016/17, phasing in the rise in employer contributions over a period of four years;
- For employers contributing at less than its future service rate in 2016/17, phasing in the rise in contribution rises over a period of two years.

In exceptional circumstances the Administering Authority, following discussion with the Fund actuary, may agree to extend the phasing period for an employer beyond those stated above.

Note (f) (Regular Reviews)

Such reviews may be triggered by significant events including but not limited to: significant reductions in payroll, altered employer circumstances, Government restructuring affecting the employer's business, or failure to pay contributions or arrange appropriate security as required by the Administering Authority.

The result of a review may be to require increased contributions (by strengthening the actuarial assumptions adopted which will increase the funding target and/or moving to monetary levels of deficit recovery contributions), and/or an increased level of security or guarantee.

Note (g) (New Admission Bodies)

All new Admission Bodies will be required to provide some form of security, such as a guarantee from the letting employer, an indemnity or a bond, as set out in the LGPS Regulations. The security is required to cover some or all of the following:

- the strain cost of any redundancy early retirements resulting from the premature termination of the contract;
- allowance for the risk of asset underperformance;
- allowance for the risk of a fall in gilt yields;
- allowance for the possible non-payment of employer and member contributions to the Fund; and/or
- the current deficit.

Transferee Admission Bodies: For all TABs, the security must be to the satisfaction of the Administering Authority as well as the letting employer, and will be reassessed on an annual basis. See also [Note \(h\)](#) below.

Community Admission Bodies: The Administering Authority will only consider requests from CABs (or other similar bodies) to join the Fund if they are sponsored by a Scheduled Body with tax raising powers, or the Scottish or UK Government, guaranteeing their liabilities and also providing a form of security as above.

The above approaches reduce the risk, to other employers in the Fund, of potentially having to pick up any shortfall in respect of Admission Bodies ceasing with an unpaid deficit.

Note (h) (New Transferee Admission Bodies)

A new TAB usually joins the Fund as a result of the letting/outsourcing of some services from an existing employer (normally a Scheduled Body such as a council) to another organisation (a “contractor”). This involves the TUPE transfer of some staff from the letting employer to the contractor. Consequently, for the duration of the contract, the contractor is a new participating employer in the Fund so that the transferring employees maintain their eligibility for LGPS membership. At the end of the contract the employees revert to the letting employer or to a replacement contractor.

Ordinarily, the TAB would be set up in the Fund as a new employer with responsibility for all the accrued benefits of the transferring employees; in this case, the contractor would usually be assigned an initial asset allocation equal to the past service liability value of the employees’ Fund benefits. The quid pro quo is that the contractor is then expected to ensure that its share of the Fund is also fully funded at the end of the contract: see [Note \(i\)](#).

Employers which “outsource” have flexibility in the way that they can deal with the pension risk potentially taken on by the contractor. In particular there are three different routes that such employers may wish to adopt. Clearly as the risk ultimately resides with the employer letting the contract, it is for them to agree the appropriate route with the contractor:

i) Pooling

Under this option, the contractor is pooled with the letting employer. In this case, the contractor pays the same rate as the letting employer.

ii) Letting employer retains pre-contract risks

Under this option the letting employer would retain responsibility for assets and liabilities in respect of service accrued prior to the contract commencement date. The contractor would be responsible for the future liabilities that accrue in respect of transferred staff. The contractor’s contribution rate could vary from one valuation to the next. It would be liable for any deficit at the end of the contract term in respect of assets and liabilities attributable to service accrued during the contract term.

iii) Fixed contribution rate agreed

Under this option the contractor pays a fixed contribution rate and does not pay any cessation deficit.

The Administering Authority is willing to administer any of the above options as long as the approach is documented in the Admission Agreement as well as the transfer agreement. The Admission Agreement should ensure that some element of risk transfers to the contractor where it relates to its own decisions and it is unfair to burden the letting employer with that risk. For example the contractor should typically be responsible for pension costs that arise from:

- above average pay increases, including the effect in respect of service prior to contract commencement even if the letting employer takes on responsibility for the latter under (ii) above; and
- redundancy and early retirement decisions.

Note (i) (Admission Bodies Ceasing)

Admission Agreements for Transferee Admission Bodies are assumed to expire at the end of the contract.

Admission Agreements for other employers are generally assumed to be open-ended until all benefits have been paid out in full. Admission Agreements can be terminated at any point subject to the terms of the Agreement. Notwithstanding the provisions of the Admission Agreement, the Administering Authority may consider any of the following as triggers for the cessation of an admission agreement with any type of body:

- Last active member ceasing participation in the Fund (NB recent LGPS Regulation changes mean that the Administering Authority has the discretion to defer taking action for up to three years, so that if the employer acquires one or more active Fund members during that period then cessation is not triggered. The current Fund approach is that this is left as a discretion and may or may not be applied in any given case;
- The insolvency, winding up or liquidation of the Admission Body;
- Any breach by the Admission Body of any of its obligations under the Agreement that they have failed to remedy to the satisfaction of the Fund;
- A failure by the Admission Body to pay any sums due to the Fund within the period required by the Fund; or
- The failure by the Admission Body to renew or adjust the level of the bond or indemnity, or to confirm an appropriate alternative guarantor, as required by the Fund.

In addition either party can voluntarily terminate the Admission Agreement by giving the appropriate period of notice as set out in the admission agreement to the other party (or parties in the case of a TAB).

On cessation, the Administering Authority will instruct the Fund actuary to carry out a cessation valuation to determine whether there is any deficit or surplus. Where there is a deficit, payment of this amount in full would normally be sought from the Admission Body; where there is a surplus it should be noted that current legislation does not permit a refund payment to the Admission Body.

For non-Transferee Admission Bodies whose participation is voluntarily ended either by themselves or the Fund, or where a cessation event has been triggered, the Administering Authority must look to protect the interests of other ongoing employers. The actuary will therefore adopt an approach which, to the extent reasonably practicable, protects the other employers from the likelihood of any material loss emerging in future:

- (a) Where a guarantor does not exist then, in order to protect other employers in the Fund, the cessation liabilities and final deficit will normally be calculated using a “gilts cessation basis”, which is more prudent than the ongoing basis. This has no allowance for potential future investment outperformance above gilt yields, and has added allowance for future improvements in life expectancy. This could give rise to significant cessation debts being required;
- (b) Where there is a guarantor for future deficits and contributions, the details of the guarantee will be considered prior to the cessation valuation being carried out. In some cases the guarantor is simply guarantor of last resort and therefore the cessation valuation will be carried out consistently with the approach taken had there been no guarantor in place. Alternatively, where the guarantor is not simply guarantor of last resort, the cessation may be calculated using the ongoing basis as described in [Appendix E](#); or
- (c) Again, depending on the nature of the guarantee, it may be possible to simply pool the former Admission Body’s liabilities and assets with the guarantor, without needing to crystallise any deficit. This approach may be adopted where the employer cannot pay the contributions due, and this is within the terms of the guarantee.

Under (a) and (b), any shortfall would usually be levied on the departing Admission Body as a single lump sum payment. If this is not possible, then the Fund would spread the payment subject to there being some security in place for the employer such as a bond indemnity or guarantee.

In the event that the Fund is not able to recover the required payment in full, then:

- (a) In the case of TABs the Awarding Authority will be liable. At its absolute discretion the Awarding Authority may agree to recover any outstanding amounts via an increase in the Awarding Authority's contribution rate over an agreed period.
- (b) In the case of Admission Bodies that are not TABs and have no guarantor, the unpaid amounts fall to be shared amongst all of the other employers in the Fund. This may require an immediate revision to the Rates and Adjustments Certificate affecting other employers in the Fund, or instead be reflected in the contribution rates set at the next formal valuation following the cessation date.

As an alternative, where the ceasing Admission Body is continuing in business, the Fund at its absolute discretion reserves the right to enter into an agreement with the ceasing Admission Body. Under this agreement the Fund would accept an appropriate alternative security to be held against any deficit, and would carry out the cessation valuation on an ongoing basis: deficit recovery payments would be derived from this cessation debt. This approach would be monitored as part of each triennial valuation: the Fund reserves the right to revert to a "gilts cessation basis" and seek immediate payment of any funding shortfall identified. The Administering Authority may need to seek legal advice in such cases.

3.4 Pooled contributions

From time to time, with the advice of the Actuary, the Administering Authority may set up pools for employers with similar or complementary characteristics. This will always be in line with its broader funding strategy. Currently the pools in place within the Fund are as follows:

- Some Admission Bodies are with guarantors are pooled with the Council
- Some bodies are pooled with the Shetlands Charitable Trust

Those employers which have been pooled are identified in the Rates and Adjustments Certificate.

Employers who are permitted to enter (or remain in) a pool at the 2017 valuation will not normally be advised of their individual contribution rate unless agreed by the Administering Authority.

Community Admission Bodies that are deemed by the Administering Authority to have closed to new entrants and Transferee Admission Bodies are not usually permitted to participate in a pool.

3.5 Additional flexibility in return for added security

The Administering Authority may permit greater flexibility to the employer's contributions if the employer provides added security to the satisfaction of the Administering Authority.

Such flexibility includes a reduced rate of contribution, an extended time horizon, or permission to join a pool with another body (e.g. the Local Authority).

Such security may include, but is not limited to, a suitable bond, a legally-binding guarantee from an appropriate third party, or security over an employer asset of sufficient value.

The degree of flexibility given may take into account factors such as:

- the extent of the employer's deficit;
- the amount and quality of the security offered;
- the employer's financial security and business plan; and
- whether the admission agreement is likely to be open or closed to new entrants.

3.6 Non ill health early retirement costs

It is assumed that members' benefits are payable from the earliest age that the employee could retire without incurring a reduction to their benefit (and without requiring their employer's consent to retire). (**NB** the relevant age may be different for different periods of service, following the benefit changes from April 2009 and April 2015). Employers are required to pay additional contributions ('strain') wherever an employee retires before attaining this age. The actuary's funding basis makes no allowance for premature retirement except on grounds of ill-health.

Employers must make these additional contributions as a one off payment to the Fund immediately on awarding the early retirement. The exception to this is statutory bodies with tax raising powers who are able to spread the payment over a period not exceeding 5 years. In any event the spread period cannot exceed the period to the member's normal retirement date if this is shorter than 5 years.

3.7 Ill health early retirement costs

In the event of a member's early retirement on the grounds of ill-health, a funding strain will usually arise, which can be very large. Such strains are currently met by each employer. The Fund monitors each employer's, or pool of employers, ill health experience on an ongoing basis. If the cumulative number of ill health retirement in any financial year exceeds the allowance at the previous valuation, the employer will be charged additional contributions on the same basis as apply for non-ill health cases.

Alternatively where an employer has entered into an agreement to take out insurance on ill health costs, the Fund, together with the Fund actuary, will liaise with the insurer to ensure appropriate premiums are set for the employers in the Fund. Employers will be charged additional contributions for each ill health retirement (as for non-ill health cases) and it will be expected that the employer will make a claim for an amount equal to the strain amount identified, which will then be reimbursed to the Fund.

3.8 Employers with no remaining active members

In general an employer ceasing in the Fund, due to the departure of the last active member, will pay a cessation debt on an appropriate basis (see [3.3](#), [Note \(i\)](#)) and consequently have no further obligation to the Fund. Thereafter it is expected that one of two situations will eventually arise:

- a) The employer's asset share runs out before all its ex-employees' benefits have been paid. In this situation the other Fund employers will be required to contribute to pay all remaining benefits: this will be done by the Fund actuary apportioning the remaining liabilities on a pro-rata basis at successive formal valuations;
- b) The last ex-employee or dependant dies before the employer's asset share has been fully utilised. In this situation the remaining assets would be apportioned pro-rata by the Fund's actuary to the other Fund employers.

In exceptional circumstances the Fund may permit an employer with no remaining active members to continue contributing to the Fund. This would require the provision of a suitable security or guarantee, as well as a written ongoing commitment to fund the remainder of the employer's obligations over an appropriate period. The Fund would reserve the right to invoke the cessation requirements in the future, however. The Administering Authority may need to seek legal advice in such cases.

3.9 Policies on bulk transfers

Each case will be treated on its own merits, but in general:

- Where only active members transfer out, the Fund will not pay bulk transfers greater than the value of the members' liabilities had they opted to transfer on an individual basis (i.e. Cash Equivalent Transfer Values);
- Where the entire membership of the employer (i.e. active, deferred and pensioner members) transfers out, the Fund will not pay a bulk transfer greater than the asset share of the transferring employer;
- The Fund will not grant added benefits to members bringing in entitlements from another Fund unless the asset transfer is sufficient to meet the added liabilities; and
- The Fund may permit shortfalls to arise on bulk transfers if the Fund employer has suitable strength of covenant and commits to meeting that shortfall in an appropriate period. This may require the employer's Fund contributions to increase between valuations.

4 Funding strategy and links to investment strategy

4.1 What is the Fund's investment strategy?

The Fund has built up assets over the years, and continues to receive contribution and other income. All of this must be invested in a suitable manner, which is the investment strategy.

Investment strategy is set by the administering authority, after consultation with the employers and after taking investment advice. The precise mix, manager make up and target returns are set out in the Statement of Investment Principles, which is available to members and employers.

The investment strategy is set for the long-term, but is reviewed from time to time. Normally a full review is carried out as part of each actuarial valuation, and is kept under review annually between actuarial valuations to ensure that it remains appropriate to the Fund's liability profile.

The same investment strategy is currently followed for all employers.

4.2 What is the link between funding strategy and investment strategy?

The Fund must be able to meet all benefit payments as and when they fall due. These payments will be met by contributions (resulting from the funding strategy) or asset returns and income (resulting from the investment strategy). To the extent that investment returns or income fall short, then higher cash contributions are required from employers, and vice versa

Therefore, the funding and investment strategies are inextricably linked.

4.3 How does the funding strategy reflect the Fund's investment strategy?

In the opinion of the Fund actuary, the current funding policy is consistent with the current investment strategy of the Fund. The asset outperformance assumption contained in the discount rate (see Appendix [E3](#)) is within a range that would be considered acceptable for funding purposes; it is also considered to be consistent with the requirement to take a "prudent longer-term view" of the funding of liabilities as required by the Government (see Appendix [A1](#)).

However, in the short term – such as the three yearly assessments at formal valuations – there is the scope for considerable volatility and there is a material chance that in the short-term and even medium term, asset returns will fall short of this target. The stability measures described in [Section 3](#) will damp down, but not remove, the effect on employers' contributions.

The Fund does not hold a contingency reserve to protect it against the volatility of equity investments.

4.4 Does the Fund monitor its overall funding position?

The Administering Authority monitors the relative funding position, i.e. changes in the relationship between asset values and the liabilities value by means of a Triennial Valuation report. It reports the result of this report back to the Pensions Committee and employers.

5 Statutory reporting and comparison to other LGPS Funds

5.1 Purpose

Under Section 13(4)(c) of the Public Service Pensions Act 2013 ("Section 13"), the Government Actuary's Department must, following each triennial actuarial valuation, report to the Scottish Public Pensions Agency (SPPA) acting on behalf of Scottish Ministers, on each of the LGPS Funds in Scotland. This report will cover whether, for each Fund, the rate of employer contributions are set at an appropriate level to ensure both the solvency and the long term cost efficiency of the Fund.

This additional SPPA oversight may have an impact on the strategy for setting contribution rates at future valuations.

5.2 Solvency

For the purposes of Section 13, the rate of employer contributions shall be deemed to have been set at an appropriate level to ensure solvency if:

- (a) the rate of employer contributions is set to target a funding level for the Fund of 100%, over an appropriate time period and using appropriate actuarial assumptions (where appropriateness is considered in both absolute and relative terms in comparison with other funds); and either
- (b) employers collectively have the financial capacity to increase employer contributions, and/or the Fund is able to realise contingent assets should future circumstances require, in order to continue to target a funding level of 100%; or
- (c) there is an appropriate plan in place should there be, or if there is expected in future to be, a material reduction in the capacity of fund employers to increase contributions as might be needed.

5.3 Long Term Cost Efficiency

The rate of employer contributions shall be deemed to have been set at an appropriate level to ensure long term cost efficiency if:

- i. the rate of employer contributions is sufficient to make provision for the cost of current benefit accrual,
- ii. with an appropriate adjustment to that rate for any surplus or deficit in the Fund.

In assessing whether the above condition is met, SPPA may have regard to various absolute and relative considerations. A relative consideration is primarily concerned with comparing LGPS pension funds with other LGPS pension funds. An absolute consideration is primarily concerned with comparing Funds with a given objective benchmark.

Relative considerations include:

- 1. the implied deficit recovery period; and
- 2. the investment return required to achieve full funding after 20 years.

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Absolute considerations include:

1. the extent to which the contributions payable are sufficient to cover the cost of current benefit accrual and the interest cost on any deficit;
2. how the required investment return under “relative considerations” above compares to the estimated future return being targeted by the Fund’s current investment strategy; and
3. the extent to which any new deficit recovery plan can be directly reconciled with, and can be demonstrated to be a continuation of, any previous deficit recovery plan, after allowing for actual Fund experience.

SPPA may assess and compare these and other metrics on a suitable standardised market-related basis, for example where the local funds’ actuarial bases do not make comparisons straightforward.

Appendix A – Regulatory framework

A1 Why does the Fund need an FSS?

The purpose of the FSS is:

*“to establish a **clear and transparent fund-specific strategy** which will identify how employers’ pension liabilities are best met going forward;*

*to support the regulatory framework to maintain **as nearly constant employer contribution rates as possible**;*
and

*to take a **prudent longer-term view** of funding those liabilities.”*

These objectives are desirable individually, but may be mutually conflicting.

The requirement to maintain and publish an FSS is contained in LGPS Regulations which are updated from time to time. In publishing the FSS the Administering Authority has to have regard to any guidance published by Chartered Institute of Public Finance and Accountancy (CIPFA) (most recently in 2016) and to its Statement of Investment Principles.

This is the framework within which the Fund’s actuary carries out triennial valuations to set employers’ contributions and provides recommendations to the Administering Authority when other funding decisions are required, such as when employers join or leave the Fund. The FSS applies to all employers participating in the Fund.

A2 Does the Administering Authority consult anyone on the FSS?

Yes. This is required by LGPS Regulations. It is covered in more detail by the most recent CIPFA guidance, which states that the FSS must first be subject to “consultation with such persons as the authority considers appropriate”, and should include “a meaningful dialogue at officer and elected member level with council tax raising authorities and with corresponding representatives of other participating employers”.

The consultation process for the FSS was as follows:

- a) **A draft version of the FSS was issued to all participating employers for comment on 12 January 2018.**
- b) **An Employers Forum was held on 23 January 2018 at which questions regarding the FSS was raised and answered;**
- b) **Comments on the draft version of the FSS was requested to be returned by 13 February 2018;**
- c) **Following the end of the consultation period the FSS was updated where required and will be published, in March 2018.**

A3 How is the FSS published?

The FSS is made available through the following routes:

Published on the Shetland Islands Council website at [CLIENT URL](#)

A copy sent by email to each participating employer in the Fund;

A full copy included in the annual report and accounts of the Fund;

Copies sent to investment managers and independent advisers;

Copies made available on request.

A4 How often is the FSS reviewed?

The FSS is reviewed in detail at least every three years as part of the triennial valuation. This version is expected to remain unaltered until it is consulted upon as part of the formal process for the next valuation in 2020.

It is possible that (usually slight) amendments may be needed within the three year period. These would be needed to reflect any regulatory changes, or alterations to the way the Fund operates (e.g. to accommodate a new class of employer). Any such amendments would be consulted upon as appropriate:

- trivial amendments would be simply notified at the next round of employer communications,
- amendments affecting only one class of employer would be consulted with those employers,
- other more significant amendments would be subject to full consultation.

In any event, changes to the FSS would need agreement by the Pensions Committee and would be included in the relevant Committee Meeting minutes.

A5 How does the FSS fit into other Fund documents?

The FSS is a summary of the Fund's approach to funding liabilities. It is not an exhaustive statement of policy on all issues, for example there are a number of separate statements published by the Fund including the Statement of Investment Principles, Administration Strategy and Communications Strategy. In addition, the Fund publishes an Annual Report and Accounts with up to date information on the Fund.

These documents can be found on the Shetland Islands Council website at [CLIENT URL](#)

Appendix B – Responsibilities of key parties

The efficient and effective operation of the Fund needs various parties to each play their part.

B1 The Administering Authority should:-

1. operate the Fund as per the LGPS Regulations;
2. effectively manage any potential conflicts of interest arising from its dual role as Administering Authority and a Fund employer;
3. collect employer and employee contributions, and investment income and other amounts due to the Fund;
4. ensure that cash is available to meet benefit payments as and when they fall due;
5. pay from the Fund the relevant benefits and entitlements that are due;
6. invest surplus monies (i.e. contributions and other income which are not immediately needed to pay benefits) in accordance with the Fund's Statement of Investment Principles (SIP) and LGPS Regulations;
7. communicate appropriately with employers so that they fully understand their obligations to the Fund;
8. take appropriate measures to safeguard the Fund against the consequences of employer default;
9. manage the valuation process in consultation with the Fund's actuary;
10. provide data and information as required by the Government Actuary's Department to carry out their statutory obligations (see [Section 5](#));
11. prepare and maintain a FSS and a SIP, after consultation;
12. notify the Fund's actuary of material changes which could affect funding (this is covered in a separate agreement with the actuary); and
13. monitor all aspects of the Fund's performance and funding and amend the FSS and SIP as necessary and appropriate.

B2 The Individual Employer should:-

1. deduct contributions from employees' pay correctly;
2. pay all contributions, including their own as determined by the actuary, promptly by the due date;
3. have a policy and exercise discretions within the regulatory framework;
4. make additional contributions in accordance with agreed arrangements in respect of, for example, augmentation of scheme benefits, early retirement strain; and
5. notify the Administering Authority promptly of all changes to its circumstances, prospects or membership, which could affect future funding.

B3 The Fund Actuary should:-

1. prepare valuations, including the setting of employers' contribution rates. This will involve agreeing assumptions with the Administering Authority, having regard to the FSS and LGPS Regulations, and targeting each employer's solvency appropriately;
2. provide data and information as required by the Government Actuary's Department to carry out their statutory obligations (see [Section 5](#));
3. provide advice relating to new employers in the Fund, including the level and type of bonds or other forms of security (and the monitoring of these);

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4. prepare advice and calculations in connection with bulk transfers and individual benefit-related matters;
5. assist the Administering Authority in considering possible changes to employer contributions between formal valuations, where circumstances suggest this may be necessary;
6. advise on the termination of employers' participation in the Fund; and
7. fully reflect actuarial professional guidance and requirements in the advice given to the Administering Authority.

B4 Other parties:-

1. investment advisers (either internal or external) should ensure the Fund's SIP remains appropriate, and consistent with this FSS;
2. investment managers, custodians and bankers should all play their part in the effective investment (and dis-investment) of Fund assets, in line with the SIP;
3. auditors should comply with their auditing standards, ensure Fund compliance with all requirements, monitor and advise on fraud detection, and sign off annual reports and financial statements as required;
4. governance advisers may be appointed to advise the Administering Authority on efficient processes and working methods in managing the Fund;
5. legal advisers (either internal or external) should ensure the Fund's operation and management remains fully compliant with all regulations and broader local government requirements, including the Administering Authority's own procedures; and
6. the SPPA/Scottish Ministers (assisted by the Government Actuary's Department) and the Scottish LGPS Scheme Advisory Board, should work with LGPS Funds to meet Section 13 requirements.

Appendix C – Key risks and controls

C1 Types of risk

The Administering Authority has an active risk management programme in place. The measures that it has in place to control key risks are summarised below under the following headings:

- financial;
- demographic;
- regulatory; and
- governance.

C2 Financial risks

Risk	Summary of Control Mechanisms
Fund assets fail to deliver returns in line with the anticipated returns underpinning the valuation of liabilities over the long-term.	<p>Only anticipate long-term returns on a relatively prudent basis to reduce risk of under-performing.</p> <p>Assets invested on the basis of specialist advice, in a suitably diversified manner across asset classes, geographies, managers, etc.</p> <p>Analyse progress at three yearly valuations for all employers.</p> <p>Inter-valuation monitoring of liabilities between valuations at whole Fund level, can be instructed at any time.</p>
Inappropriate long-term investment strategy.	<p>Overall investment strategy options considered as an integral part of the funding strategy. Used asset liability modelling to measure 4 key outcomes.</p> <p>Chosen option considered to provide the best balance; reviewed at least every three years.</p>
Fall in risk-free returns on Government bonds, leading to rise in value placed on liabilities.	<p>Inter-valuation monitoring, as above.</p> <p>Some investment in bonds helps to mitigate this risk.</p>
Active investment manager under-performance relative to benchmark.	<p>Quarterly investment monitoring analyses market performance and active managers relative to their index benchmark.</p>
Pay and price inflation significantly more than anticipated.	<p>The focus of the actuarial valuation process is on real returns on assets, net of price and pay increases.</p> <p>Inter-valuation monitoring, as above, gives early warning.</p>

Risk	Summary of Control Mechanisms
	<p>Some investment in bonds also helps to mitigate this risk.</p> <p>Employers pay for their own salary awards and should be mindful of the geared effect on pension liabilities of any bias in pensionable pay rises towards longer-serving employees.</p>
Effect of possible increase in employer's contribution rate on service delivery and admission/scheduled bodies	The funding strategy includes various measures to limit sudden increases in contributions: see 3.2.
Orphaned employers give rise to added costs for the Fund	<p>The Fund seeks a cessation debt (or security/guarantor) to minimise the risk of this happening in the future.</p> <p>If it occurs, the Actuary calculates the added cost spread pro-rata among all employers – (see 3.8).</p>

C3 Demographic risks

Risk	Summary of Control Mechanisms
Pensioners living longer, thus increasing cost to Fund.	<p>Set mortality assumptions with some allowance for future increases in life expectancy.</p> <p>The Fund Actuary has direct access to the experience of over 50 LGPS funds which allows early identification of changes in life expectancy that might in turn affect the assumptions underpinning the valuation.</p>
Maturing Fund – i.e. proportion of actively contributing employees declines relative to retired employees.	Continue to monitor at each valuation, consider seeking monetary amounts rather than % of pay and consider alternative investment strategies.
Deteriorating patterns of early retirements	<p>Employers are charged the extra cost of non ill-health retirements following each individual decision.</p> <p>Employer ill health retirement experience is monitored, and insurance is an option.</p>
Reductions in payroll causing insufficient deficit recovery payments	<p>In many cases this may not be sufficient cause for concern, and will in effect be caught at the next formal valuation. However, there are protections where there is concern, as follows:</p> <p>Review of contributions is permitted in general between valuations (see Note (f) to 3.3) and may</p>

Risk	Summary of Control Mechanisms
	require a move in deficit contributions from a percentage of payroll to fixed monetary amounts.

C4 Regulatory risks

Risk	Summary of Control Mechanisms
Changes to national pension requirements and/or HMRC rules e.g. changes arising from public sector pensions reform.	<p>The Administering Authority considers all consultation papers issued by the Government and comments where appropriate.</p> <p>The results of the most recent reforms were built into the 2017 valuation. Any changes to member contribution rates or benefit levels will be carefully communicated with members to minimise possible opt-outs or adverse actions.</p>
Time, cost and/or reputational risks associated with any SPPA/Scottish Ministers intervention triggered by the Section 13 analysis (see Section 5).	Take advice from Fund Actuary on proposed valuation approach relative to anticipated Section 13 analysis.
Changes by Government to particular employer participation in LGPS Funds, leading to impacts on funding and/or investment strategies.	<p>The Administering Authority considers all consultation papers issued by the Government and comments where appropriate.</p> <p>Take advice from Fund Actuary on impact of changes on the Fund and amend strategy as appropriate.</p>

C5 Governance risks

Risk	Summary of Control Mechanisms
Administering Authority unaware of structural changes in an employer's membership (e.g. large fall in employee members, large number of retirements) or not advised of an employer closing to new entrants.	<p>The Administering Authority has a close relationship with employing bodies and communicates required standards e.g. for submission of data.</p> <p>The Actuary may revise the Rates and Adjustments Certificate to increase an employer's contributions between triennial valuations</p> <p>Deficit contributions may be expressed as monetary amounts.</p>
Actuarial or investment advice is not sought, or is not heeded, or proves to be insufficient in some way	The Administering Authority maintains close contact with its specialist advisers.

Risk	Summary of Control Mechanisms
	<p>Advice is delivered via formal meetings involving Elected Members, and recorded appropriately.</p> <p>Actuarial advice is subject to professional requirements such as peer review.</p>
<p>Administering Authority failing to commission the Fund Actuary to carry out a termination valuation for a departing Admission Body.</p>	<p>The Administering Authority requires employers with Best Value contractors to inform it of forthcoming changes.</p> <p>Community Admission Bodies' memberships are monitored and, if active membership decreases, steps will be taken.</p>
<p>An employer ceasing to exist with insufficient funding or adequacy of a bond.</p>	<p>The Administering Authority believes that it would normally be too late to address the position if it was left to the time of departure.</p> <p>The risk is mitigated by:</p> <p>Seeking a funding guarantee from another scheme employer, or external body, where-ever possible (see Notes (g) and (i) to 3.3).</p> <p>Alerting the prospective employer to its obligations and encouraging it to take independent actuarial advice.</p> <p>Vetting prospective employers before admission.</p> <p>Where permitted under the regulations requiring a bond to protect the Fund from various risks.</p> <p>Requiring new Community Admission Bodies to have a guarantor.</p> <p>Reviewing bond or guarantor arrangements at regular intervals (see Note (f) to 3.3).</p> <p>Reviewing contributions well ahead of cessation if thought appropriate (see Note (a) to 3.3).</p>

Appendix D – The calculation of Employer contributions

In [Section 2](#) there was a broad description of the way in which contribution rates are calculated. This Appendix considers these calculations in much more detail.

All three steps above are considered when setting contributions (more details are given in [Section 3](#) and [Appendix D](#):

1. The **funding target** is based on a set of assumptions about the future, e.g. investment returns, inflation, pensioners' life expectancies. However, if an employer is approaching the end of its participation in the Fund then its funding target may be set on a more prudent basis, so that its liabilities are less likely to be spread among other employers after its cessation of participation;
2. The **time horizon** required is, in broad terms, the period over which any deficit is to be recovered. A shorter period will lead to higher contributions, and vice versa (all other things being equal). Employers may be given a lower time horizon if they have a less permanent anticipated membership, or do not have tax-raising powers to increase contributions if investment returns under-perform; and
3. The required **probability of achieving** the funding target over that time horizon will be dependent on the Fund's view of the strength of employer covenant and its funding profile. Where an employer is considered to be weaker, or potentially ceasing from the Fund, then the required probability will be set higher, which in turn will increase the required contributions (and vice versa).

The calculations involve actuarial assumptions about future experience, and these are described in detail in [Appendix E](#).

D1 What is the difference between calculations across the whole Fund and calculations for an individual employer?

Employer contributions are normally made up of two elements:

- a) the estimated cost of ongoing benefits being accrued, referred to as the "Primary contribution rate" (see [D2](#) below); plus
- b) an adjustment for the difference between the Primary rate above, and the actual contribution the employer needs to pay, referred to as the "Secondary contribution rate" (see [D3](#) below).

The contribution rate for each employer is measured as above, appropriate for each employer's funding position and membership. The whole Fund position, including that used in reporting to SPPA (see [section 5](#)), is calculated in effect as the sum of all the individual employer rates. SPPA currently only regulates at whole Fund level, without monitoring individual employer positions.

D2 How is the Primary contribution rate calculated?

The Primary element of the employer contribution rate is calculated with the aim that these contributions will meet benefit payments in respect of members' **future** service in the Fund. This is based upon the cost (in excess of members' contributions) of the benefits which employee members earn from their service each year.

The Primary rate is calculated separately for all the employers, although employers within a pool will pay the Primary rate applicable to the pool as a whole. The Primary rate is calculated such that it is projected to:

1. meet the required funding target for all future years' accrual of benefits*, excluding any accrued assets,
2. within the determined time horizon (see [note 3.3 Note \(c\)](#) for further details), and

3. with a sufficiently high probability, as set by the Fund's strategy for the category of employer (see [3.3 Note \(e\)](#) for further details).

* The projection is for the current active membership where the employer no longer admits new entrants, or additionally allows for new entrants where this is appropriate.

The projections are carried out using an economic modeller developed by the Fund's actuary Hymans Robertson: this allows for a wide range of outcomes as regards key factors such as asset returns (based on the Fund's investment strategy), inflation, and bond yields. The measured contributions are calculated such that the proportion of outcomes meeting the employer's funding target (by the end of the time horizon) is equal to the required probability.

The approach includes expenses of administration to the extent that they are borne by the Fund, and includes allowances for benefits payable on death in service and on ill health retirement.

D3 How is the Secondary contribution rate calculated?

The combined Primary and Secondary rates aim to achieve the employer's funding target, within the appropriate time horizon, with the relevant degree of probability.

For the funding target, the Fund actuary agrees the assumptions to be used with the Administering Authority – see [Appendix E](#). These assumptions are used to calculate the present value of all benefit payments expected in the future, relating to that employer's current and former employees, based on pensionable service to the valuation date only (i.e. ignoring further benefits to be built up in the future).

The Fund operates the same target funding level for all employers of 100% of its accrued liabilities valued on the ongoing basis, unless otherwise determined (see [Section 3](#)).

The Secondary rate is calculated as the balance over and above the Primary rate, such that the total is projected to:

1. meet the required funding target relating to combined past and future service benefit accrual, including accrued asset share (see [D5](#) below);
2. within the determined time horizon (see [3.3 Note \(c\)](#) for further details); and
3. with a sufficiently high probability, as set by the Fund's strategy for the category of employer (see [3.3 Note \(e\)](#) for further details).

The projections are carried out using an economic modeller developed by the Fund Actuary Hymans Robertson: this allows for a wide range of outcomes as regards key factors such as asset returns (based on the Fund's investment strategy), inflation, and bond yields. The measured contributions are calculated such that the proportion of outcomes with at least 100% solvency (by the end of the time horizon) is equal to the required probability.

D4 What affects a given employer's valuation results?

The results of these calculations for a given individual employer will be affected by:

1. past contributions relative to the cost of accruals of benefits;
2. different liability profiles of employers (e.g. mix of members by age, gender, service vs. salary);
3. the effect of any differences in the funding target, i.e. the valuation basis used to value the employer's liabilities;
4. any different time horizons;

5. the difference between actual and assumed rises in pensionable pay;
6. the difference between actual and assumed increases to pensions in payment and deferred pensions;
7. the difference between actual and assumed retirements on grounds of ill-health from active status;
8. the difference between actual and assumed amounts of pension ceasing on death;
9. the additional costs of any non ill-health retirements relative to any extra payments made; and/or
10. differences in the required probability of achieving the funding target.

D5 How is each employer's asset share calculated?

The Administering Authority does not account for each employer's assets separately. Instead, the Fund's actuary is required to apportion the assets of the whole Fund between the employers, at each triennial valuation.

This apportionment uses the income and expenditure figures provided for certain cash flows for each employer. This process adjusts for transfers of liabilities between employers participating in the Fund, but does make a number of simplifying assumptions. The split is calculated using an actuarial technique known as "analysis of surplus".

Actual investment returns achieved on the Fund between each valuation are applied proportionately across all employers, to the extent that employers in effect share the same investment strategy. Transfers of liabilities between employers within the Fund occur automatically within this process, with a sum broadly equivalent to the reserve required on the ongoing basis being exchanged between the two employers.

The Fund actuary does not allow for certain relatively minor events, including but not limited to:

1. the actual timing of regular employer contributions within any financial year;
2. the actual timing of transfers in or out of the Fund; and
3. the actual timing of changes in the benefit payments made due to retirements and deaths.

These effects are swept up within a miscellaneous item in the analysis of surplus, which is split between employers in proportion to their liabilities.

The methodology adopted means that there will inevitably be some difference between the asset shares calculated for individual employers and those that would have resulted had they participated in their own ring-fenced section of the Fund.

The asset apportionment is capable of verification but not to audit standard. The Administering Authority recognises the limitations in the process, but it considers that the Fund actuary's approach addresses the risks of employer cross-subsidisation to an acceptable degree.

Appendix E – Actuarial assumptions

E1 What are the actuarial assumptions?

These are expectations of future experience used to place a value on future benefit payments (“the liabilities”). Assumptions are made about the amount of benefit payable to members (the financial assumptions) and the likelihood or timing of payments (the demographic assumptions). For example, financial assumptions include investment returns, salary growth and pension increases; demographic assumptions include life expectancy, probabilities of ill-health early retirement, and proportions of member deaths giving rise to dependants’ benefits.

Changes in assumptions will affect the measured funding target. However, different assumptions will not of course affect the actual benefits payable by the Fund in future.

The combination of all assumptions is described as the “basis”. A more optimistic basis might involve higher assumed investment returns (discount rate), or lower assumed salary growth, pension increases or life expectancy; a more optimistic basis will give lower funding targets and lower employer costs. A more prudent basis will give higher funding targets and higher employer costs.

E2 What basis is used by the Fund?

The Fund’s standard funding basis is described as the “ongoing basis”, which applies to most employers in most circumstances. This is described in more detail below. It anticipates employers remaining in the Fund in the long term.

However, in certain circumstances, typically where the employer is not expected to remain in the Fund long term or poses an elevated risk to the Fund, a more prudent basis applies: see [Note \(a\)](#) to [3.3](#).

E3 What assumptions are made in the ongoing basis?

a) Investment return / discount rate

The key financial assumption is the anticipated return on the Fund’s investments. This “discount rate” assumption makes allowance for an anticipated out-performance of Fund returns relative to long term yields on UK Government bonds (“gilts”). There is, however, no guarantee that Fund returns will out-perform gilts. The risk is greater when measured over short periods such as the three years between formal actuarial valuations, when the actual returns and assumed returns can deviate sharply.

Given the very long-term nature of the liabilities, a long term view of prospective asset returns is taken. The long term in this context would be 20 to 30 years or more.

For the purpose of the triennial funding valuation at 31 March 2017 and setting contribution rates effective from 1 April 2018, the Fund actuary has assumed that future investment returns earned by the Fund over the long term will be 1.8% per annum greater than gilt yields at the time of the valuation (this is higher than that used at the 2014 valuation, which therefore gives a lower funding target, all other things being equal). In the opinion of the Fund actuary, based on the current investment strategy of the Fund, this asset out-performance assumption is within a range that would be considered acceptable for the purposes of the funding valuation.

b) Salary growth

Pay for many public sector employees is currently subject to restriction. Although this “pay freeze” does not officially apply to local government and associated employers, it has been suggested that they are likely to show similar restraint in respect of pay awards. Based on long term historical analysis of the membership in LGPS funds, and continued austerity measures, the salary increase assumption at the 2017 valuation has been set to be a blended rate combined of:

1. 1.3% p.a. until 31 March 2020, followed by
2. The retail prices index (RPI) p.a. thereafter.

This gives a single “blended” assumption of RPI less 0.4%. This is a change from the previous valuation, which assumed a flat assumption of RPI plus 1.0% per annum. The change has led to a reduction in the funding target (all other things being equal).

c) Pension increases

Since 2011 the consumer prices index (CPI), rather than RPI, has been the basis for increases to public sector pensions in deferment and in payment. Note that the basis of such increases is set by the Government, and is not under the control of the Fund or any employers.

As at the previous valuation, we derive our assumption for RPI from market data as the difference between the yield on long-dated fixed interest and index-linked government bonds. This is then reduced to arrive at the CPI assumption, to allow for the “formula effect” of the difference between RPI and CPI. At this valuation, we have used a reduction of 1.0% per annum. This is a larger reduction than at 2014 (which was 0.8%), which will serve to reduce the funding target (all other things being equal). (Note that the reduction is applied in a geometric, not arithmetic, basis).

d) Life expectancy

The demographic assumptions are intended to be best estimates of future experience in the Fund based on past experience of LGPS funds which participate in Club Vita, the longevity analytics service used by the Fund, and endorsed by the actuary.

The longevity assumptions that have been adopted at this valuation are a bespoke set of “VitaCurves”, produced by the Club Vita’s detailed analysis, which are specifically tailored to fit the membership profile of the Fund. These curves are based on the data provided by the Fund for the purposes of this valuation.

It is acknowledged that future life expectancy and, in particular, the allowance for future improvements in life expectancy, is uncertain. There is a consensus amongst actuaries, demographers and medical experts that life expectancy is likely to improve in the future. Allowance has been made in the ongoing valuation basis for future improvements in line with the 2016 version of the Continuous Mortality Investigation model published by the Actuarial Profession and a 1.25% per annum minimum underpin to future reductions in mortality rates. This is a similar allowance for future improvements than was made in 2014.

The combined effect of the above changes from the 2014 valuation approach, is to reduce life expectancy by around 0.5 – 1.0 years on average, which reduces the funding target all other things being equal. The approach taken is considered reasonable in light of the long term nature of the Fund and the assumed level of security underpinning members’ benefits.

e) General

The same financial assumptions are adopted for most employers, in deriving the funding target underpinning the Primary and Secondary rates: as described in (3.3), these calculated figures are translated in different ways into employer contributions, depending on the employer's circumstances.

The demographic assumptions, in particular the life expectancy assumption, in effect vary by type of member and so reflect the different membership profiles of employers.

Appendix F – Glossary

Actuarial assumptions/basis	The combined set of assumptions made by the actuary, regarding the future, to calculate the value of the funding target . The main assumptions will relate to the discount rate , salary growth, pension increases and longevity. More prudent assumptions will give a higher target value, whereas more optimistic assumptions will give a lower value.
Administering Authority	The council with statutory responsibility for running the Fund, in effect the Fund's "trustees".
Admission Bodies	Employers where there is an Admission Agreement setting out the employer's obligations. These can be Community Admission Bodies or Transferee Admission Bodies. For more details (see 2.3).
Covenant	The assessed financial strength of the employer. A strong covenant indicates a greater ability (and willingness) to pay for pension obligations in the long run. A weaker covenant means that it appears that the employer may have difficulties meeting its pension obligations in full over the longer term.
Discount rate	The annual rate at which future assumed cashflows (in and out of the Fund) are discounted to the present day. This is necessary to provide a funding target which is consistent with the present day value of the assets. A lower discount rate gives a higher target value, and vice versa. It is used in the calculation of the Primary and Secondary rates .
Employer	An individual participating body in the Fund, which employs (or used to employ) members of the Fund. Normally the assets and funding target values for each employer are individually tracked, together with its Primary rate at each valuation .
Funding target	The actuarially calculated present value of all pension entitlements of all members of the Fund, built up to date. This is compared with the present market value of Fund assets to derive the deficit . It is calculated on a chosen set of actuarial assumptions .
Gilt	A UK Government bond, ie a promise by the Government to pay interest and capital as per the terms of that particular gilt, in return for an initial payment of capital by the purchaser. Gilts can be "fixed interest", where the interest payments are level throughout the gilt's term, or "index-linked" where the interest payments vary each year in line with a specified index (usually RPI). Gilts can be bought as assets by the Fund, but their main use in funding is as an objective measure of solvency.
Guarantee / guarantor	A formal promise by a third party (the guarantor) that it will meet any pension obligations not met by a specified employer. The presence of a guarantor will mean, for instance, that the Fund can consider the employer's covenant to be as strong as its guarantor's.

Letting employer	An employer which outsources or transfers a part of its services and workforce to another employer (usually a contractor). The contractor will pay towards the LGPS benefits accrued by the transferring members, but ultimately the obligation to pay for these benefits will revert to the letting employer. A letting employer will usually be a local authority.
LGPS	The Local Government Pension Scheme, a public sector pension arrangement put in place via Government Regulations, for workers in local government. These Regulations also dictate eligibility (particularly for Scheduled Bodies), members' contribution rates, benefit calculations and certain governance requirements. The LGPS is divided into 100 Funds which map the UK. Each LGPS Fund is autonomous to the extent not dictated by Regulations, e.g. regarding investment strategy, employer contributions and choice of advisers.
Maturity	A general term to describe a Fund (or an employer's position within a Fund) where the members are closer to retirement (or more of them already retired) and the investment time horizon is shorter. This has implications for investment strategy and, consequently, funding strategy.
Members	The individuals who have built up (and may still be building up) entitlement in the Fund. They are divided into actives (current employee members), deferreds (ex-employees who have not yet retired) and pensioners (ex-employees who have now retired, and dependants of deceased ex-employees).
Primary contribution rate	The employer contribution rate required to pay for ongoing accrual of active members' benefits (including an allowance for administrative expenses). See Appendix D for further details.
Profile	The profile of an employer's membership or liability reflects various measurements of that employer's members , i.e. current and former employees. This includes: the proportions which are active, deferred or pensioner; the average ages of each category; the varying salary or pension levels; the lengths of service of active members vs their salary levels, etc. A membership (or liability) profile might be measured for its maturity also.
Rates and Adjustments Certificate	A formal document required by the LGPS Regulations, which must be updated at least every three years at the conclusion of the formal valuation . This is completed by the actuary and confirms the contributions to be paid by each employer (or pool of employers) in the Fund for the three year period until the next valuation is completed.
Scheduled Bodies	Types of employer explicitly defined in the LGPS Regulations, whose employers must be offered membership of their local LGPS Fund. These include Councils, colleges, some universities, police and fire authorities etc, other than employees who have entitlement to a different public sector pension scheme (e.g. teachers, police and fire officers).
Secondary contribution rate	The difference between the employer's actual and Primary contribution rates . In broad terms, this relates to the shortfall of its asset share to its funding target . See Appendix D for further details.

Valuation

An actuarial investigation to calculate the liabilities, and usually individual employer Primary and Secondary contribution rates. This is normally carried out in full every three years (last done as at 31 March 2017), but can be approximately updated at other times. The assets value is based on market values at the valuation date, and the liabilities value and contribution rates are based on long term bond market yields at that date also.