

10.00am, Thursday, 26 October 2017

Audited Annual Report 2017 of the Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund, including Annual Report by External Auditor – referral from the Pensions Committee

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|----------------------------|-----|
| Item number | 8.4 |
| Report number | |
| Executive/routine | |
| Wards | All |
| Council Commitments | |

Executive summary

On 27 September 2017 the Pensions Committee considered the Audited Annual Report for the year ended 31 March 2017 for the Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund. The unaudited Annual Report had been considered by the external auditor Scott-Moncrieff and their annual report to Members and the Controller of Audit was presented to the Committee. The audited financial statement for the wholly-owned companies LPFE Limited and LPFI Limited were also provided.

The report was referred to the Council for information, as the administering authority of the Pension Funds

Terms of Referral

Audited Annual Report 2017 of the Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund, including Annual Report by External Auditor

Terms of referral

- 1.1 On 27 September 2017, the Pensions Committee considered a report by the Executive Director of Resources regarding the Annual Report 2017 of Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund including the Annual Report by the External Auditor.
- 1.2 The Pensions Committee agreed:
 - 1.2.1 To note the report by Scott-Moncrieff “Lothian Pension Funds 2016/17 Annual Audit Report to Members and the Controller of Audit” as detailed in Appendix 1 to the report by the Executive Director of Resources.
 - 1.2.2 To approve the audited Annual Report for the year ended 31 March 2017 for the Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund as detailed in Appendix 2 to the report by the Executive Director of Resources.
 - 1.2.3 To note that the audited financial statements, for the year ended 31 March 2017, of both the wholly-owned companies, LPFE Limited and LPFI Limited, were approved by the respective Board of Directors in June 2017 as detailed in Appendix 3 and Appendix 4 to the report by the Executive Director of Resources.
 - 1.2.4 To note that Scott-Moncrieff had made no comment in respect of the Chartered Institute of Public Finance and Accountancy (CIPFA) guidance “Accounting for Local Government Pension Scheme Management Costs”, as revised in June 2016, and its failure to reflect full transparency of investment management fees, specifically through “fund of fund arrangements”.
 - 1.2.5 To note that the Pension Funds meet CIPFA guidance providing a level of transparency beyond what was required.
 - 1.2.6 To refer the report by the Executive Director of Resources, to the City of Edinburgh Council, in its role as administering authority of the Pension Funds.

For Decision/Action

2.1 The City of Edinburgh Council is asked to consider the attached report.

Background reading / external references

Pensions Committee 27 September 2017.

Laurence Rockey

Head of Strategy and Insight

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Appendices

Appendix 1 – report by the Executive Director of Resources

Pensions Committee

11.00am, Wednesday, 27 September 2017

Audited Annual Report 2017 of the Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund, including Annual Report by External Auditor

| | |
|---------------------|---|
| Item number | 5.10 |
| Report number | |
| Executive/routine | |
| Wards | All |
| Council Commitments | Delivering a Council that works for all |

Executive Summary

The unaudited Annual Report for the year ended 31 March 2017 for the Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund has now been considered by the external auditor, Scott-Moncrieff.

International Standard on Auditing (ISA) 260 requires the external auditor to communicate their findings to those charged with governance of the Funds. Accordingly, the Scott-Moncrieff “Lothian Pension Funds 2016/17 Annual Audit Report to Members and the Controller of Audit” is included at Appendix 1.

The review of the unaudited financial statements concluded that no numerical adjustments were required. Some presentational changes have been reflected in the full revised report at Appendix 2 – “Audited Annual Report 2017 for the Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund”.

Scott-Moncrieff has provided “an unqualified opinion on the financial statements and other prescribed matters for Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund within our independent auditor’s report” and has also stated “that there were no matters which we were required to report by exception”.

Audited Annual Report 2017 of the Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund, including Annual Report by External Auditor

1. Recommendations

Committee is requested to:

- 1.1 Invite the Pension Board to raise any relevant matters or concerns which the Committee should consider;
- 1.2 Note the points raised by the Pensions Audit Sub-Committee following its consideration of this report at its meeting on 26 September 2017;
- 1.3 Note the report by Scott-Moncrieff “Lothian Pension Funds 2016/17 Annual Audit Report to Members and the Controller of Audit” (at Appendix 1);
- 1.4 Approve the audited Annual Report for the year ended 31 March 2017 for the Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund (at Appendix 2);
- 1.5 Note that the audited financial statements, for the year ended 31 March 2017, of both the wholly-owned companies, LPFE Limited and LPFI Limited, were approved by the respective Board of Directors in June 2017. These statements are shown in full at Appendices 3 and 4.
- 1.6 Note that Scott-Moncrieff has made no comment in respect of the Chartered Institute of Public Finance and Accountancy (CIPFA) guidance “Accounting for Local Government Pension Scheme Management Costs”, as revised in June 2016, and its failure to reflect full transparency of investment management fees, specifically through “fund of fund arrangements”; and
- 1.7 Refer this report, for information, to the City of Edinburgh Council, in its role as administering authority of the Pension Funds.

2. Background

ISA 260 annual report by External Auditor

- 2.1 Under statutory accounting guidance issued by the Scottish Government, Administering Authorities are required to issue a separate Annual Report covering the Local Government Pension Scheme (LGPS) funds that they are responsible for. These Annual Reports are subject to a separate external audit.

- 2.2 International Standard on Auditing (UK and Ireland) 260 (ISA 260) requires the External Auditor to communicate his findings to those charged with governance of the Funds. This summarises any matters arising from the audit of the financial statements prior to the formal signing of the independent auditor's report.
- 2.3 As part of the standard, the External Auditor is required to provide its view of the following:
- Any significant qualitative aspects within the Funds' accounting practice;
 - Any significant difficulties encountered during the audit;
 - Any material weakness in the design, implementation or operating effectiveness of the system of internal control;
 - Any significant matters arising from the audit discussed with management;
 - Any representations that have been requested from management; and
 - Any other matter that is significant.
- 2.4 City of Edinburgh Council noted the Unaudited Annual Report 2017 for the Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund at its meeting on 29 June 2017.

3. Main report

Scott-Moncrieff - Lothian Pension Funds 2016/17 Annual Audit report to Members and the Controller of Audit

- 3.1 The report by the external auditor on the financial statements is included at Appendix 1 – “Scott-Moncrieff - Lothian Pension Funds 2016/17 Annual Audit Report to Members and the Controller of Audit.
- 3.2 Scott-Moncrieff has stated that its “work has been performed in accordance with the Audit Scotland Code of Audit Practice, International Standards on Auditing (UK and Ireland) and Ethical Standards”.
- 3.3 This report will be presented to Committee by Nick Bennett, Partner, and Kirstie MacDonald, Public Sector Audit Senior, Scott-Moncrieff.
- 3.4 Scott-Moncrieff has provided “an unqualified opinion on the financial statements and other prescribed matters for Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund within our independent auditor's report” and has also stated “that there were no matters which we were required to report by exception”.
- 3.5 Scott-Moncrieff has made no comment in respect of the Chartered Institute of Public Finance and Accountancy (CIPFA) guidance “Accounting for Local Government Pension Scheme Management Costs”, as revised in June 2016, and its failure to reflect full transparency of investment management fees, specifically through “fund of fund arrangements”. Committee is reminded that the financial statements of Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund continue, however, to include full transparency of all investment management fees.

- 3.6 Appendix 1 (“Appendix 1: Management action plan”, Pages 28 to 30 of that report) “details the control weaknesses and opportunities for improvement that we (Scott-Moncrieff) have identified during our audit”. Planned management actions by Lothian Pension Fund staff in relation to the points raised by the external auditor are also stated.
- 3.7 In addition to members of the Pensions Committee and Pensions Audit Sub-Committee, Scott-Moncrieff has also sent the report to the Controller of Audit and has advised that it will be published on the Audit Scotland web-site in due course.

Audited Annual Report 2017 for Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund

- 3.8 With the completion of the work by Scott-Moncrieff, the Audited Annual Report 2017 for the Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund has been finalised and is included at Appendix 2.
- 3.9 No numerical adjustments were required to be made on the unaudited financial statements following the Fund’s audit. Some minor presentational changes have also been incorporated.
- 3.10 As part of the completion of the audit, the auditor seeks written assurances from the Chief Finance Officer, Lothian Pension Fund, on aspects of the financial statements and judgements and estimates made. A draft letter of representation under ISA580 is attached at Appendix 5.

Audited Financial Statements for the year ended 31 March 2017; LPFE Limited and LPFI Limited

- 3.11 The consolidated financial statements (within the Annual Report 2017) combine those of the Fund (the parent entity) and its controlled entities (the investment staffing company, LPFE Limited, and now also the investment services company, LPFI Limited, which commenced trading during the year) as defined in International Accounting Standard (IAS) 27. The financial statements of both companies have been audited by Scott-Moncrieff and approved by the respective Board of Directors in June 2017, LPFE Limited on 12 June 2017 and LPFI Limited on 15 June 2017. These statements are shown in full at Appendices 3 and 4.
- 3.12 As previously reported to Committee, LPFE Limited is the employment vehicle for the Fund’s investment and senior staff. It provides staffing services to the City of Edinburgh Council, LPFI Limited and to Falkirk Council. The company’s financial objective is “to make a modest trading surplus before adjustments required under International Financial Reporting Standards (IFRS)”. Such adjustments primarily relate to pension costs, as required by International Accounting Standard (IAS) 19, and the related deferred tax. For the year ended 31 March 2017, the underlying trading profit of the company was £30,730 (2016: £28,243).
- 3.13 A separate report on the Phase 2 transfer of staff to the company is provided elsewhere on the agenda for this Committee.
- 3.14 LPFI Limited provides Financial Conduct Authority (FCA) regulated investment services, both to Lothian Pension Fund and other pension funds, but does not

employ any staff directly. Its financial objective is “to make a modest trading surplus”. LPFI commenced trading in December 2016 and completed its first collaborative “club-deal” in the infrastructure sector in January 2017. A second project was in progress at the year-end. Profit for the financial year after taxation was £432.

- 3.15 Committee was previously advised of the appointment of Leslie Robb as non-executive director of LPFI Limited, subject to the receipt of requisite approvals from the FCA. These were received and his appointment commenced from 1 February 2017. Leslie is expected to attend the meeting of the Pensions Committee on 27 September.
- 3.16 A full report will be provided to Committee in December 2017 on the progress and further development of collaborative initiatives with other LGPS funds.

4. Measures of success

- 4.1 The prime objective of the Council, as administering authority of the Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund, is to ensure an unqualified audit opinion of the Annual Report 2017. This has been achieved.
- 4.2 Planned management actions in relation to the points raised by the external auditor, Scott-Moncrieff, are stated at Appendix 1 (“Appendix 1: Management action plan”, Pages 28 to 30 of that report).

5. Financial impact

- 5.1 There are no direct financial implications arising from this report.

6. Risk, policy, compliance and governance impact

- 6.1 The financial statements have been prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2016/17 and also in compliance with the requirements of the Local Government Scotland Act 1973.
- 6.2 The annual report summarises the opinions and conclusions of Scott-Moncrieff, in accordance with International Standards on Auditing (UK and Ireland) and the principles contained in the Code of Practice issued by Audit Scotland in May 2011. The Scott-Moncrieff report sets out the significant audit risks identified at the planning stage and how the auditor addressed each risk in arriving at his opinion on the financial statements. Appendix I (of that report) is the “Management action plan” “detailing the control weaknesses and opportunities for improvement” which were identified by the External Auditor during the audit. Officers have considered the issues and responded in the column headed “Management Comments”.

7. Equalities impact

7.1 There are no adverse equalities impacts arising from this report

8. Sustainability impact

8.1 There are no adverse sustainability impacts arising from this report.

9. Consultation and engagement

9.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the Funds.

10. Background reading/external references

10.1 None

Stephen S. Moir

Executive Director of Resources

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11. Appendices

Appendix 1 – Scott-Moncrieff - Lothian Pension Funds 2016/17 Annual Audit Report to Members and the Controller of Audit, in accordance with International Standard on Auditing (UK and Ireland) 260 (ISA 260)

Appendix 2 - Audited Annual Report 2017 for the Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund

Appendix 3 - LPFE Limited – Financial Statements (Audited) for the year ended 31 March 2017

Appendix 4 – LPFI Limited – Financial Statements (Audited) for the year ended 31 March 2017

Appendix 5 – Letter of Representation (ISA 580) by Chief Finance Officer, Lothian Pension Fund



Scott-Moncrieff
business advisers and accountants

Appendix 1

Lothian Pension Funds

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

August 2017

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Key messages

Annual accounts

Lothian Pension Funds are scheduled to approve the annual accounts for 2016/17 on 27 September 2017 and the accounts will be submitted, together with this report, to the Controller of Audit by the deadline of 30 September 2017. We intend to report unqualified opinions on the financial statements and other prescribed matters for Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund within our independent auditor's report. We also intend to report that there were no matters which we were required to report by exception.

Wider Scope

Financial management

- The Funds have adequate and effective arrangements in place for managing their financial position and use of resources.
- We have evaluated the Funds' key financial systems and internal financial controls and determined these are adequate to prevent material misstatements in the annual accounts.

Financial sustainability

- We have concluded that the Funds have effective arrangements in place to ensure the ongoing sustainability of the pension funds.

Governance & transparency

- Our work on corporate governance focussed on reviewing the Funds' arrangements to ensure effective systems are in place regarding internal control, prevention and detection of fraud and irregularity and standards of conduct.
- Governance arrangements at the Funds were found to be satisfactory and appropriate.

Value for money

- The Funds have appropriate arrangements in place to monitor performance of investments and the administration of the Funds.

Key facts

- Net assets increased by 21% in 2016/17 to £6,595 million (2015/16: £5,433 million).
- Contributions received in year (£201.8 million) fell below the benefits paid out by the fund (£211.1 million) leaving a net withdrawal on the fund of £9.2 million.
- Return on investments in 2016/17 was 21.7% slightly behind the benchmark of 24.8%; however, the performance over the five year period to 31 March 2017 is exceeding the target of 11.4% by 1.5%.

Conclusion

This report concludes our audit for 2016/17. Our work has been performed in accordance with the Audit Scotland Code of Audit Practice, International Standards on Auditing (UK and Ireland) and Ethical Standards.

Scott-Moncrieff August 2017

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Introduction

Introduction

1. This report summarises our findings from the 2016/17 audit of the Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund (collectively referred to as the “Funds”).
2. We outlined the scope of our audit in our external audit plan, which we presented to the Pensions Committee on 20 March 2017. The core elements of our audit work in 2016/17 have been:
 - an interim audit of the Funds’ key financial systems and governance arrangements;
 - an audit of the Funds’ 2016/17 annual report and accounts, including a review of the Annual Governance Statement;
 - a review of arrangements as they relate to the four dimensions of wider-scope public audit: financial management, financial sustainability, governance and transparency, and value for money; and
 - consideration of the local impact of the national performance report [The Role of Boards](#).
3. The Funds are responsible for preparing annual accounts that show a true and fair view and for implementing appropriate internal control systems. The weaknesses and risks identified in this report are only those that have come to our attention during our normal audit work, and may not be all that exist. Communication in this report of matters arising from the audit of the financial statements or of risks or weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.
4. We discussed and agreed the content of this report with the Chief Finance Officer and Chief Executive. We would like to thank all management and staff for their co-operation and assistance during our audit.

5. This report contains an action plan with specific recommendations, responsible officers and dates for implementation. Senior management should assess these recommendations and consider their wider implications before deciding appropriate actions. We give each recommendation a grading to help the Funds assess their significance and prioritise the actions required.

Adding value through the audit

6. All of our clients quite rightly demand of us a positive contribution to meeting their ever-changing business needs. Our aim is to add value to the Funds through our external audit work by being constructive and forward looking, by identifying areas of improvement and by recommending and encouraging good practice. In this way, we aim to help the Funds promote improved standards of governance, better management and decision making and more effective use of resources.
7. We welcome any comments you may have on the quality of our work and this report via: www.surveymonkey.co.uk/r/S2SPZBX
8. This report is addressed to both Lothian Pension Funds and the Controller of Audit and will be published on Audit Scotland’s website. www.audit-scotland.gov.uk.

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Annual accounts

Annual accounts

Introduction

9. The Funds' annual financial statements are the principal means of accounting for the stewardship of its resources and its performance in the use of those resources. The respective responsibilities of the Funds and the auditor in relation to the financial statements are outlined in appendix 2.

Overall conclusion

Unqualified audit opinions

10. The annual accounts for the year ended 31 March 2017 are due to be approved by the Pensions Committee on 27 September 2017. We plan to report within our independent auditor's report:
- an unqualified opinion on the financial statements; and
 - an unqualified opinion on other prescribed matters.

11. We are also satisfied that there are no matters which we are required to report to you by exception.

Good administrative processes were in place

12. We received draft financial statements and supporting papers of a good standard, in line with our agreed audit timetable. Our thanks go to management and staff for their assistance.

Our assessment of risks of material misstatement

13. The assessed risks of material misstatement described below are those that had the greatest effect on our audit strategy, the allocation of resources in the audit and directing the efforts of the audit team. We designed our audit procedures relating to these matters in the context of our audit of the annual report and accounts as a whole, and not to express an opinion on individual accounts or disclosures. We outline the significant risks below.

Audit Risk 1: Revenue Recognition

Under ISA 240 - The auditor's responsibilities relating to fraud in an audit of financial statements there is a presumed risk of fraud in relation to revenue recognition. The presumption is that the Funds could adopt accounting policies or recognise income and expenditure transactions in such a way as to lead to a material misstatement in the reported financial position.

14. While we did not suspect incidences of material fraud and error, we evaluated each type of revenue transaction and documented our conclusions. We have reviewed the controls in place over revenue accounting and found them to be sufficient. We have evaluated key revenue transactions and streams and carried out testing to confirm that the Funds' revenue recognition policies are appropriate and have been applied consistently.

Audit Risk 2: Management override of controls


In any organisation, there exists a risk that management have the ability to process transactions or make adjustments to the financial records outside the normal financial control processes. Such issues could lead to a material misstatement in the annual accounts. This is treated as a presumed risk area in accordance with ISA 240 - *The auditor's responsibilities relating to fraud in an audit of financial statements*.

15. While we did not suspect any incidences of management override leading to financial reporting issues, we reviewed the accounting records for significant transactions outside the normal course of business and obtained evidence to ensure that these were valid and accounted for

correctly. Based on our audit work to detect potential material misstatement we have not identified any indications of such management override during the year.


Audit Risk 3: Valuation of Investments

The Lothian Pension Fund held investments of £5.399 billion as at 31 March 2016, of which 30% (£1.663 billion) were classified as level 2 or level 3 financial instruments, meaning the valuation was not based on unadjusted quoted prices in active markets. Investments of this nature are complex, difficult to value and include a significant degree of judgement from the investment manager. The material nature of this balance means that any error in judgement could result in a material valuation error.

- 
16. In 2016/17 the value of level 2 and level 3 investments rose in year to £2.069 billion increasing as a proportion of overall investments to 31%. Fair values of investments of this nature are provided by the fund managers and custodian using different bases as deemed appropriate, including reference to similar companies and bid prices. The valuation basis for each class of investment is disclosed within the accounting policies of the Funds.
 17. We have considered the competence, capability and objectivity and control environment of the key fund managers and the custodian. Our testing did not raise any issues regarding the qualifications of or work provided by management's experts.
 18. The disclosures in the financial statements are consistent with the information provided by the custodian.

Audit Risk 4: Pension liability assumptions

An actuarial estimate of the pension fund liability is calculated on an annual basis under IAS 19 and on a triennial funding basis by independent firm of actuaries with specialist knowledge and experience. The estimates are based on the most up to date membership data held by the pension fund and have regard to local factors such as mortality rates and expected pay rises with other assumptions around inflation when calculating the liabilities. There is a risk that the assumptions used are not appropriate.

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19. Our review of the control environment around membership data did not identify any weaknesses in its design which would be likely to lead to a material misstatement.
 20. The assumptions used by the actuary were compared to benchmarks across the sector and deemed to be reasonable.

Our application of materiality

21. Materiality is an expression of the relative significance of a matter in the context of the financial statements as a whole. A matter is material if its omission or misstatement would reasonably influence the decisions of an addressee of the auditor's report. The assessment of what is material is a matter of professional judgement over both the amount and the nature of the misstatement.

22. On receipt of the draft 2016/17 accounts, we reassessed materiality which resulted in a change to the level of materiality applied. Our revised assessment of materiality along with our planning materiality for each Fund is set out in the table below. The Funds hold significant investment assets, which form the largest part of the net asset statements for each pension fund. We consider that the net asset statements are of primary interest to the reader of the annual accounts and therefore consider that these should be used in the calculation of overall materiality.

23. ISA 320 states that in certain circumstances it is appropriate to set a materiality amount for particular classes of transactions for which the lesser amounts than the overall materiality could influence the decision of the users of the accounts. We considered the transactions in

the Fund Accounts to be of key interest to the users as it contains information around the day to day performance of the Funds. We have therefore set a materiality for this class of transactions based on return on investments and the expenditure incurred for providing payments to pensioners.

| | Overall Planning materiality £million | Fund account planning materiality £million | Overall Final materiality £million | Fund account final materiality £million |
|---|---------------------------------------|--|------------------------------------|---|
| Lothian Pension Fund (group) ¹ | 81.5 | 8.8 | 98.9 | 19.9 |
| Lothian Pension Fund (single entity) | 81.5 | 8.8 | 98.9 | 19.9 |
| Lothian Buses Pension Fund | 5.9 | 0.4 | 7.3 | 1.5 |
| Scottish Homes Pension Fund | 2.3 | 0.2 | 2.5 | 0.5 |

24. We set a performance materiality for each area of work which is based on a risk assessment for that area. We have performed audit procedures on all transactions, or groups of transactions, and balances that exceed our performance materiality. This means that we performed a greater level of testing on the areas deemed to be of significant risk of material misstatement

| | | | |
|-----------------------------|-----|-----|-----|
| Scottish Homes Pension Fund | 1.7 | 1.4 | 1.1 |
|-----------------------------|-----|-----|-----|

| | Area risk assessment £million | | |
|---|-------------------------------|--------------|-----------|
| | High (45%) | Medium (55%) | Low (70%) |
| Lothian Pension Fund (group and parent) | 44.5 | 54.4 | 69.2 |
| Lothian Buses Pension Fund | 13.9 | 10.9 | 8.9 |

25. We agreed to report any misstatements identified through our audit that fall into one of the following categories:

- All material corrected misstatements;
- Uncorrected misstatements over £250,000, less than 1% of the overall materiality figure;
- Misstatements below the £250,000 threshold we believe warrant reporting on qualitative grounds.

Other matters

26. We identified one medium risk matter relating to the authorisation of journal entries. We have reported on this fully within appendix 1 to this report.

¹ Lothian Pension Fund group comprises Lothian Pension Fund, LPFE Ltd and LPFI Ltd

Audit adjustments identified

27. We identified some disclosure and presentational adjustments during our audit, which have been reflected in the final set of annual accounts.

Board representations

28. We have requested that the Pensions Committee present a signed representation letter, covering a number of issues, to us at the date of signing the financial statements.
29. In June 2017 a voluntary disclosure of under-declared Output Tax was made to HMRC by the City of Edinburgh Council on behalf of the Funds. The under declaration arose from two properties managed by Standard Life which did not have VAT applied correctly. A review of all properties has been undertaken and the total under declaration was £0.51 million. The total under declaration covers a number of tax periods and does not breach the penalty threshold in any financial year. The proposed adjustment is outlined at appendix 2.
30. We do not consider the difference to be material to the financial statements, either individually or in aggregate. Through discussion with the Chief Finance Officer, the decision was taken not to adjust the financial statements. The difference is reported through the representation letter.

An overview of the scope of our audit

31. We detailed the scope of our audit in our external audit plan. We presented the plan to the Pensions Committee on 20 March 2017.
32. Our plan explained that we follow a risk-based approach to audit planning that reflects our overall assessment of the relevant risks that apply to the Pensions Committee. This ensures that our audit focuses on the areas of highest risk. Planning is a continuous process and our audit plan is subject to review during the course of the audit to take account of developments that arise.

33. At the planning stage we identified the significant risks that had the greatest effect on our audit. We then designed audit procedures to mitigate these risks. We base our standard audit approach on performing a review of the key accounting systems in place, substantive tests and detailed analytical review.

34. Tailored audit procedures, including those designed to address significant risks, were completed by the audit fieldwork team and the results were reviewed by the audit manager and audit partner. In performing our work, we have applied the concept of materiality, which is explained earlier in this report.

Accounting and Internal Control systems

35. The Funds have adequate systems in place to record, process, summarise and report financial and other relevant data. We have not identified any material weaknesses or governance issues in the Funds' accounting and internal control systems during our final audit.

Other matters identified during our audit

36. During the course of our audit we noted the following:

The Local Authority Accounts (Scotland) Regulations 2014

37. As part of our audit we reviewed the Council's compliance with the Local Authority Accounts (Scotland) Regulations 2014, in particular with respect to regulations 8 to 10² as they relate to the annual accounts. Overall we concluded that appropriate arrangements are in place to comply with these Regulations.

Management commentary

38. The Local Authority Accounts (Scotland) Regulations 2014 require pension funds to include a management commentary within the annual accounts. The management commentary is intended to assist readers in understanding the annual accounts and the organisation that has prepared them. As auditors we are required to read the

² Regulations 8 to 10 relates to the preparation and publication of unaudited accounts, notice of public right to

inspect and object to the accounts and consideration and signing of the audited accounts.

management commentary and express an opinion as to whether it is consistent with the annual accounts. We have concluded that the management commentary is consistent with the annual accounts.

39. As part of our audit we also reviewed the Council's management commentary against the non-statutory guidance issued by the Scottish Government (Local Government Finance Circular 5/2015). We considered the extent to which the Funds' management commentary included relevant information in respect of:

- The context of the annual accounts;
- Insight into the priorities of the Funds' and strategies adopted to achieve these priorities and objectives;
- Information on future plans;
- KPIs which measure the investment performance of the Funds'; and
- Information on the principal risks and uncertainties facing the authority.

Annual governance statement and Governance Compliance Statement

40. The Chief Executive and Acting Executive Director of Resources of the City of Edinburgh Council along with the Chief Executive Officer of Lothian Pension Fund have confirmed that in their opinion, reasonable assurance can be placed upon the adequacy and effectiveness of Lothian Pension Funds' systems of governance. The Annual Governance Statement identifies a range of actions that have been, or will be, taken by the Council to continue to progress improvements in the Council's governance arrangements.

41. We have reviewed the Funds' Annual Governance Statement and have found that it complies with the relevant guidance: *Delivering Good Governance in Local Government*. However, it is a requirement that the Annual Governance Statement outlines an action plan outlining the actions that the Funds' will take to continue to progress improvements in the Funds' governance processes. This was not present in the draft accounts.

Action Plan point 2

42. We found that the processes used to prepare the statements are reasonable and appropriate.

43. The Local Government Pension Scheme (Scotland) Regulations 2014 require all pension

funds to prepare a Governance Compliance Statement. The purpose of this statement is to compare the Funds' governance arrangements with those standards set out in guidance from the Scottish Ministers.

44. We have reviewed the Governance Compliance Statement and we are satisfied the disclosures comply with guidance issued by Scottish Ministers and are not inconsistent with our knowledge of the arrangements in place at the Funds.

Group accounts

45. The Pensions Committee for the Funds approved the creation of two special purpose vehicles, LPFE Ltd and LPFI Ltd in October 2014. The companies are wholly owned and controlled by the City of Edinburgh Council. Group accounts were prepared for the Funds for the first time in 2015/16 incorporating LPFE Ltd. LPFI Ltd became operational in 2016/17 after the funds received Financial Conduct Authority authorisation.

46. We reviewed the consolidation process in 2016/17 and concluded the subsidiary companies had been correctly included in the group accounts of Lothian Pension Fund.

Legality

47. We have planned and performed our audit recognising that non-compliance with statute or regulations may materially impact on the annual accounts. Our audit procedures included the following:

- Reviewing minutes of relevant meetings;
- Enquiring of senior management and the Funds' solicitors the position in relation to litigation, claims and assessments; and
- Performing detailed testing of transactions and balances.

48. We are pleased to report that we did not identify any instances of concern with regard to the legality of transactions or events.

Qualitative aspects of accounting practices and financial reporting

49. We have considered the qualitative aspects of the financial reporting process, including items that have a significant impact on the relevance, reliability, comparability, understandability and materiality of the information provided by the financial statements. Our findings are summarised below:

| Qualitative aspect considered | Audit conclusion |
|---|---|
| The appropriateness of the accounting policies used. | <p>We have reviewed the significant accounting policies which are disclosed in the annual accounts of the Funds. We consider the policies to be appropriate to the Funds, however, we have noted that the Funds have departed from CIPFA Guidance in relation to investment management expenses.</p> <p>During 2015/16 CIPFA issued guidance stating that pension funds should only report the direct costs of using investment managers. The impact of this is that investment management costs associated with fund of funds transactions would not be reported. The Funds feel this would detract from the transparency of the accounts and have reported indirect costs of £4.16 million for Lothian Pension Fund and £0.33 million for Lothian Buses (there were no indirect costs for Scottish Homes).</p> <p>The impact of this accounting treatment is to increase the investment management expense which is offset by an increase in the change in market value of investments. The net impact on the fund account is therefore zero.</p> |
| The timing of the transactions and the period in which they are recorded. | We did not identify any concerns over the timing of transactions or the period in which they were recognised. |
| The appropriateness of the accounting estimates and judgements used. | <p>The Funds have significant levels of accounting estimates and judgements used by management in preparing the financial statements. The principal areas of estimation concern the valuation of unquoted private equity and infrastructure investments and the actuarial valuation of promised retirement benefits.</p> <p>We are satisfied with the appropriateness of the accounting estimates and judgements used in the preparation of the annual accounts. We have considered the disclosures around the estimates, including sensitivity analysis and concluded that they are appropriate.</p> |
| The potential effect on the financial statements of any uncertainties, including significant risks and related disclosures that are required. | We have not identified any uncertainties, including any significant risk or required disclosures, which should be included in the financial statements (beyond the existing disclosures made). |

| | |
|--|--|
| The extent to which the financial statements have been affected by unusual transactions during the period and the extent that these transactions are separately disclosed. | From the testing performed, we identified no significant unusual transactions in the period. |
| Apparent misstatements in the Management Commentary or material inconsistencies with the financial statements. | The annual report and accounts contain no material misstatements or inconsistencies with the annual accounts in the Management Commentary. |
| Any significant financial statements disclosures to bring to your attention. | There are no significant financial statements disclosures that we consider should be brought to your attention. All the disclosures required by relevant legislation and applicable accounting standards have been made appropriately. |
| Disagreement over any accounting treatment or financial statements disclosure. | While some disclosure and presentational adjustments were made through the audit process, there was no material disagreement during the course of the audit over any significant accounting treatment or disclosure. |
| Difficulties encountered in the audit. | There were no significant difficulties encountered during the audit. |

3

Financial management

Financial management

Overall conclusion

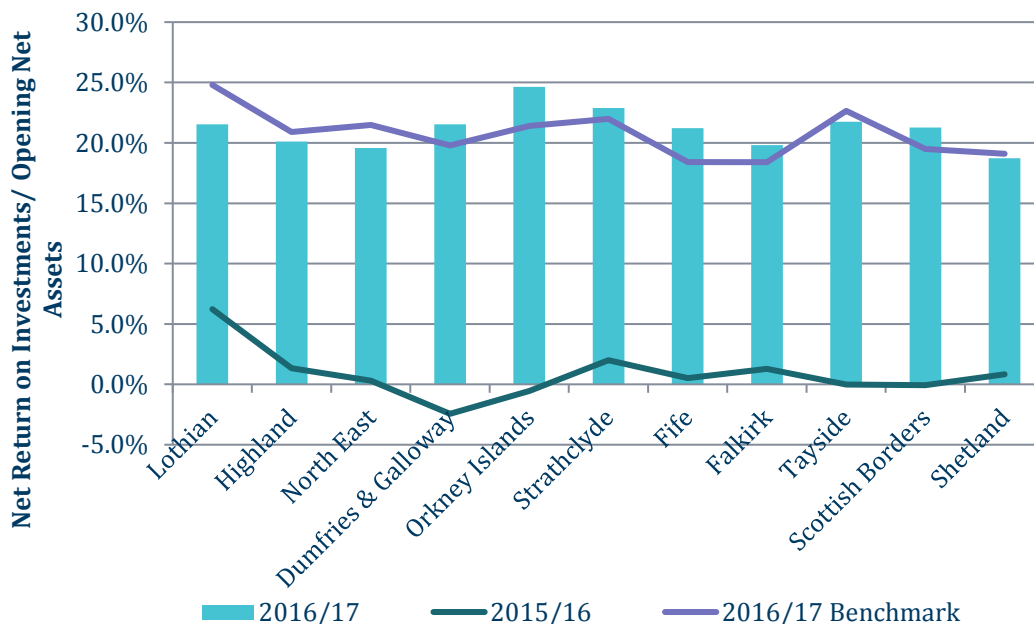
The Funds have effective arrangements in place for financial management and the use of resources

50. Overall, the Funds have effective arrangements in place for financial management and the use of resources. Our conclusion is based on a review of the Funds' financial performance against their investment strategy and our review of the system of internal control

The Funds' financial performance in 2016/17

The Funds were slightly behind the 1 year benchmark but achieved their longer term targets

51. The key financial indicator for the across pension funds in Scotland is the return on investments. Following a relatively poor performance across all investment funds in 2015/16 the investment performance has improved across all Scottish Finds in 2016/17.



52. The average return on investments in 2016/17 was 21.19% a significant increase compared to 0.86% in 2015/16.

53. The Lothian Pension Funds have consistently performed above the average figure.

54. The graph above focuses on the short term performance of the Scottish Pension Funds but the Funds investment programme recognises that long term performance is key to ensure the sustainability of the Funds. Consequently the Funds review performance against benchmark over one, five and ten years.

55. The Funds were slightly behind the one year benchmark on Lothian Pension Fund and Lothian Buses Pension Fund. The performance over the longer term is consistently meeting or exceeding benchmark which indicates the investment portfolio is being managed appropriately.

| | 1 year | | 5 years | | 10 Years | |
|----------------------|--------|-----------|---------|-----------|----------|-----------|
| | Return | Benchmark | Return | Benchmark | Return | Benchmark |
| Lothian Pension Fund | 21.7% | 24.8% | 12.9% | 11.4% | 8.2% | 6.6% |
| Lothian Buses | 23.7% | 24.2% | 13.2% | 11.5% | 9.6% | 8.0% |
| Scottish Homes | 18.9% | 18.7% | 10.8% | 10.7% | 9.1% | 9.1% |

Financial Position

56. The net assets of the Fund continued to increase in 2016/17, reflecting the level of returns achieved in year and the relatively strong position of the market in year.

| | 2016/17 £m | 2015/16 £m | % Movement |
|----------------------|---------------|---------------|---------------|
| Lothian Pension Fund | 6,594 | 5,434 | 21.3% |
| Lothian Buses | 488 | 394 | 19% |
| Scottish Homes | 171 | 150 | 14% |

57. Although the net assets position is increasing the Funds' actuary, Hymans Robertson estimated that the present value of the promised retirement benefits had risen across Lothian Pension Fund and Lothian Buses Pension Fund by approximately 31%. Scottish Homes had a smaller increase of only 12%.

58. The actuarial calculations are based on the 2014 Actuarial Valuation rolled forward. It was noted by the Actuary in their report that the performance of real bond yields has declined in recent years meaning the funding levels set in 2014 are likely to be worse than predicted and the liability increased.

59. The liability figures do not appear in the primary financial statements and appear only in the notes to the accounts. This is in line with the options in the CIPFA Code of Practice on Local Authority Accounting.

60. This recognises that the liabilities are recognised on the employing bodies' balance sheets. However, the financial environment continues to be challenging and following the 2017 Actuarial Valuation it may become increasingly difficult for employers to meet the contribution demands of the Funds.

61. In addition to this there are a number of employers within the Lothian Pension Fund with fewer than 5 employees who may be in a position where the debt crystallises on the cessation of active members. Due to the low market yields it is anticipated that cessation valuations would show sizable deficits.

62. This has increased the risk of employers defaulting on the exit payments required to cover the liability attributable to their employees.

63. The Funds have recognised this as a significant risk and are taking steps to mitigate this risk. Lothian Pension Fund is working with the at risk employers to ensure they can continue to meet the contribution demands of the fund or can meet the cessation liability.

64. Lothian Pension Fund currently has a contingent asset of £0.33 million relating to unsecured assets due from ceased employers.

65. As this is deemed to be a significant risk to Lothian Pension Fund we recommend that increased disclosure around the nature of the risk, the level of at risk employers within the Fund and the potential impact on the funding level is included in the financial statements.

Action Plan Point 3

The Funds have effective budget setting and monitoring arrangements

66. We have considered the Funds' system of budgetary control and financial management and did not identify any significant deficiencies.

67. The Funds align their financial regulations and policies with the City of Edinburgh Council. The financial regulations were last subject to review in 2017 and were approved by the Council in June 2017.

68. The Pensions Committee consider the investments control environment and performance over the annual committee cycle in line with a formal long term agenda plan. Over the course of the financial year the Pensions Committee has taken reports on the investment strategy panel, investment principles and the performance of the Funds.

69. The Pensions Committee also receive a report on the financial performance of the Funds in year, encompassing the contributions received and pensions paid

along with the administration costs. Where there are variances adequate narrative is provided to ensure the Pensions Committee have an understanding of the reason for the movement and the action being taken by the Funds.

Prevention and detection of fraud and irregularity

70. Our audit was planned to provide a reasonable expectation of detecting material misstatements in the financial statements resulting from fraud and irregularity. We found the Funds' arrangements for the prevention and detection of fraud and other irregularities to be adequate.

Financial sustainability4



Financial Sustainability

Overall Conclusion

The Funds have effective arrangements in place to ensure the ongoing sustainability of the pension funds.

71. The Funds have a responsibility to pay pensions to members until the end of their life. The payments required are based on the contributions made by members over the course of their employment.
72. Overall we have concluded that the Funds have effective arrangements in place to ensure the ongoing sustainability of the pension funds. When assessing financial sustainability we have considered the contribution rates set, the Funding Strategy Statement and the Investment Strategies in place for the Funds.

Triennial Valuation

73. The Funds' undertook an actuarial valuation in 2014 in line with the requirements of the Local Government Pension Scheme Regulations 2014. The 2014 Actuarial Valuation was a triennial valuation with the purpose of setting rates for the three year period commencing 1 April 2015.
74. The 2014 Actuarial Valuation was undertaken by Hymans Robertson in accordance with Regulation 32 of the Local Government Pension Scheme (Administration) (Scotland) Regulations 2008 as amended.
75. At the 2014 Actuarial Valuation the funding level reduced for Lothian Pension Fund but increased across Lothian Buses Pension Fund and Scottish Homes Pension Fund. The Lothian Buses Pension Fund was the only fund achieving its target funding level.

Funding level

| | Actual 2014 (%) | Target (%) |
|----------------------|-----------------|------------|
| Lothian Pension Fund | 91.3% | 100% |
| Lothian Buses | 117% | 100% |
| Scottish Homes | 88.8% | 91.5% |

76. In light of the funding levels the 2016/17 financial statements show that the Lothian Pension Fund has now moved to a position where payments exceed contributions received.

| | Lothian Pension | Lothian Buses | Scottish Homes |
|-----------------------------|-----------------|----------------|----------------|
| Contributions and transfers | 201,849 | 9,801 | 675 |
| Payments (including admin) | (211,085) | (12,522) | (7,540) |
| Net position | (9,236) | (2,721) | (6,865) |

77. Lothian Buses and Scottish Homes have operated at a net withdrawals position for a number of years. This is due to the fact both schemes are now closed to members, with Scottish Homes having no active members. The Funds are managing their investment strategy to ensure there is adequate investment income to cover payments.

78. The next detailed actuarial valuation for the Funds will be carried out as at 31 March 2017 and at this stage the contribution rates required to support the Lothian Pension Fund back to fully funded status will be considered.

Funding Strategy Statement

79. The longer term sustainability of the Funds' is considered in the Funding Strategy Statement which was prepared in 2015 concurrently with the triennial actuarial valuation and creates a different strategy for each of the funds.

| | Pension Fund Membership | Funding Strategy | | | | | | | | | | |
|-----------------------------|---|------------------|------------|--------|-----|------------|-----|----------|-----|------------|----|---|
| Lothian Pension Fund | <table border="1"> <caption>Lothian Pension Fund Membership</caption> <thead> <tr> <th>Category</th> <th>Percentage</th> </tr> </thead> <tbody> <tr> <td>Active</td> <td>43%</td> </tr> <tr> <td>Pensioners</td> <td>29%</td> </tr> <tr> <td>Deferred</td> <td>23%</td> </tr> <tr> <td>Dependants</td> <td>5%</td> </tr> </tbody> </table> | Category | Percentage | Active | 43% | Pensioners | 29% | Deferred | 23% | Dependants | 5% | <p>Lothian Pension Fund is open to new members with active members still being the highest proportion of members. Lothian Pension Fund has adopted a long term investment strategy split into 2 strategies. Strategy 1 applies to 99% of the employee liability and aims to maximise the investment return within reasonable and considered risk parameters.</p> <p>The second strategy invests in a portfolio of UK index linked gilts to reduce funding level and contribution rate risk to a level appropriate to their circumstances.</p> |
| Category | Percentage | | | | | | | | | | | |
| Active | 43% | | | | | | | | | | | |
| Pensioners | 29% | | | | | | | | | | | |
| Deferred | 23% | | | | | | | | | | | |
| Dependants | 5% | | | | | | | | | | | |
| Lothian Buses Pension Fund | <table border="1"> <caption>Lothian Buses Pension Fund Membership</caption> <thead> <tr> <th>Category</th> <th>Percentage</th> </tr> </thead> <tbody> <tr> <td>Active</td> <td>28%</td> </tr> <tr> <td>Pensioners</td> <td>34%</td> </tr> <tr> <td>Deferred</td> <td>29%</td> </tr> <tr> <td>Dependants</td> <td>9%</td> </tr> </tbody> </table> | Category | Percentage | Active | 28% | Pensioners | 34% | Deferred | 29% | Dependants | 9% | <p>Lothian Buses Pension Fund is closed to new members and the liabilities are expected to mature. A revised strategy was approved in March 2016 to be implemented over the period from 2016 to 2021. The revised strategy reduces the Fund's allocation to equities and increases the allocation to index gilts and fixed income assets. The revised strategy is designed to reduce risk in order to take account of the maturing employee liability.</p> |
| Category | Percentage | | | | | | | | | | | |
| Active | 28% | | | | | | | | | | | |
| Pensioners | 34% | | | | | | | | | | | |
| Deferred | 29% | | | | | | | | | | | |
| Dependants | 9% | | | | | | | | | | | |
| Scottish Homes Pension Fund | <table border="1"> <caption>Scottish Homes Pension Fund Membership</caption> <thead> <tr> <th>Category</th> <th>Percentage</th> </tr> </thead> <tbody> <tr> <td>Active</td> <td>17%</td> </tr> <tr> <td>Pensioners</td> <td>55%</td> </tr> <tr> <td>Deferred</td> <td>28%</td> </tr> <tr> <td>Dependants</td> <td>0%</td> </tr> </tbody> </table> | Category | Percentage | Active | 17% | Pensioners | 55% | Deferred | 28% | Dependants | 0% | <p>Scottish Homes Pension Fund currently has a funding arrangement in place with the Scottish Government, where the government is acting as guarantor for the scheme and provides funding on an annual basis to help fund the employee liability.</p> <p>A bespoke Investment strategy is in place to reduce the level of funding in equities and increase the level of funds invested in bonds. In line with this strategy the investments in equities reduced from 30% to 17.5% in 2016/17.</p> |
| Category | Percentage | | | | | | | | | | | |
| Active | 17% | | | | | | | | | | | |
| Pensioners | 55% | | | | | | | | | | | |
| Deferred | 28% | | | | | | | | | | | |
| Dependants | 0% | | | | | | | | | | | |

■ Active
■ Deferred
■ Pensioners
■ Dependants

- 80.** As part of the triennial valuation process the Funds' Funding Strategy Statement is being reviewed and revised. In line with the Scheme Regulations the Funds' are making arrangements for consultation with scheme employers. The draft Funding Strategy Statement will be issued for consultation in late 2017.

Investment Strategy Panel

- 81.** The Pensions Committee has delegated responsibility for investment strategy to an Investment Strategy Panel made up of:
- Head of Finance, City of Edinburgh Council;
 - Chief Executive, LPFE Ltd;
 - Chief Investment Officer, LPFE Ltd;
 - Chief Finance Officer, LPFE Ltd; and
 - three external investment consultants.
- 82.** In 2016/17 Lothian Pension Fund set up a joint working arrangement with Falkirk Pension Fund which includes a joint Investment Strategy Panel. The role of this panel will be to advise the Finance Directors of each administering authority on the implementation of investment strategy. There has been collaborative investment in 2016/17 with 7 investments being made alongside Falkirk Pension Fund.
- 83.** The Funds' are committed to reducing costs thereby improving longer term sustainability through increasing collaboration with other Scottish Local Authorities.

5

Governance & transparency

Governance & transparency

84. Governance and transparency is concerned with the adequacy of governance, leadership and decision making, and transparent reporting of financial and performance information. The Funds are responsible for ensuring the proper conduct of their affairs including compliance with relevant guidance, the legality of activities and transactions and for monitoring the adequacy and effectiveness of these arrangements.

Overall conclusion

85. The Funds have appropriate governance arrangements in place. Our audit work has included reviewing corporate governance arrangements as they relate to the corporate governance framework in place, the information provided to the Pension Committee and Audit Sub-Committee and the risk management arrangements in place.

Governance Structure

86. The Pensions Committee, supported by an Audit Sub-Committee, has been delegated responsibility for governance by the City of Edinburgh Council, the administering authority.
87. As outlined by the City of Edinburgh Council Scheme of Delegation the Pensions Committee has responsibility for the administration, management and investment strategy for the Funds.
88. From 1 April 2015 all pension funds were required to introduce local pension boards in line with the Public Service Pension Act 2013. This is the second year of operation of the Pension Board.
89. The Pension Board meet quarterly on a concurrent basis with the Pension Committee.
90. The remit of the Pension Board is to support the Pension Committee in compliance with regulations and the requirements of the Pension Regulator. In line with legislation if more than half of the members of the Pension Board disagree with a decision of

the Pension Committee then they can request in writing that the Pension Committee review that decision. There have been no requests to review decisions in 2016/17.

Risk Management

91. A developed and integrated approach to risk management is a key feature of a robust system of internal control. The Pension Funds maintain a risk register in line with the City of Edinburgh Council Risk Management Policy and Procedures.
92. Risk management arrangements are firmly embedded in the governance process. The Pensions Committee receive a risk management update on a quarterly basis which provides information of the movement in risks and the actions being taken on the most notable risks.
93. The Pensions Audit Sub-Committee reviews the risk management process on an annual basis to ensure it is appropriate.
94. From our review of the risk management arrangements in place we have concluded that there are adequate arrangements in place at the Funds.

Internal Audit

95. An effective internal audit service is an important element of the Funds' governance arrangements. The Funds' internal audit service is provided by the City of Edinburgh Council via a co-source arrangement with PricewaterhouseCoopers (PwC).
96. Internal audit completed three reviews in year as follows:
- internally managed investments;
 - a vulnerability assessment for online modules accessible to employers and members of the Funds; and
 - governance of the Lothian Pension Fund Group.

97. The Internal Audit Plan was subject to scrutiny at the Pensions Audit Sub-Committee in December 2016. The Committee were satisfied that the level of review would provide them with adequate assurance in 2016/17.

98. During our audit we considered the work of internal audit wherever possible to avoid duplication of effort and make the most efficient use of the Funds' audit resource.

Standards of conduct

99. In our opinion the Funds' arrangements in relation to standards of conduct and the prevention and detection of bribery and corruption are adequate.

| | | | |
|---|---|---|---|
| All non-executives should receive a formal induction | Boards should review the skills and expertise required on the Board and attract people to plug the gaps | Performance of non-executives should be assessed on a regular basis | Scrutiny efforts should be focused on organisational performance, financial and risk management |
| Performance information provided to the Board could be improved | Boards should aim to maximise openness and accessibility of papers | Declarations of interest should be considered at every meeting | Boards should review the use of Committees and ensure delegation levels are appropriate |

102. As part of our audit work in 2016/17 we followed up on the Funds' response to the issues highlighted by Audit Scotland. Our aim was to identify any causes for concern or areas of good practice. Our detailed findings were submitted to Audit Scotland and are summarised below.

103. In our opinion arrangements for scrutiny and decision making are appropriate.

104. The Pensions Committee and Board members receive an induction which includes specific training on the activity of pension funds and investment management. Following the local elections in May 2017 there were 2 new Councillors elected to the Pensions Committee. Appropriate training for new members is scheduled for September 2017.

100. Our conclusion has been informed by a review of the arrangements for adopting and reviewing standing orders, financial regulations and schemes of delegation and for complying with national and local codes of conduct.

The Role of Boards

101. In September 2010 the Auditor General for Scotland published a report aiming to assess the role and work of boards across 67 public bodies and 39 colleges. The report made a number of recommendations as follows:

105. Due to the specialised nature of the Funds, it is vital that members have the appropriate knowledge and understanding to provide appropriate challenge and operate effectively. Training is therefore seen as a fundamental requirement for all Committee and Board members. Our review found that all Pension Committee and Board members met the requirement to have a minimum of 21 hours training during 2016/17.

106. The Pensions Committee and Pensions Audit Sub-Committee meetings are held in public, papers are available in advance and minutes of the meetings are published on the City of Edinburgh Council's website. Information about the Funds is published on the Funds' website including key strategic documents. Overall we have concluded there is a good level of transparency around the pension fund business.

6

Value for Money

Value for money

Introduction

107. Value for money is concerned with the appropriate use of resources and ensuring continuous improvement of services delivered.

Overall conclusions

108. The Funds have appropriate arrangements in place to monitor performance of investments and the administration of the Funds. Our review was informed by the information provided to the Pensions Committee and the operations in place at the Pension Fund.

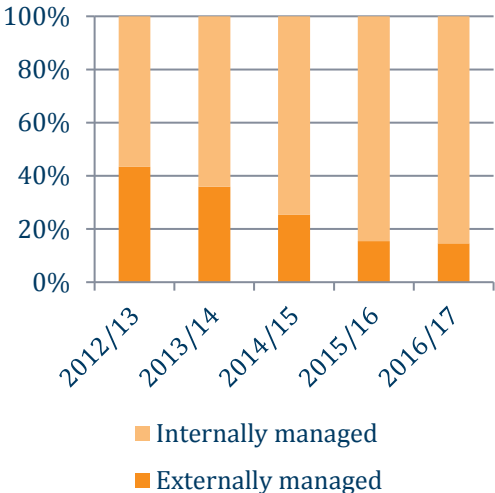
Investment operations

109. In October 2014 the Pensions Committee and City of Edinburgh Council agreed to the creation of two special purpose vehicles: LPFE Ltd and LPFI Ltd. Both companies were wholly owned and controlled by the Council.

110. In 2016/17 LPFI Ltd obtained Financial Conduct Authority authorisation (LPFE Ltd obtained this in 2015/16). The special purpose vehicles were established to support the investment programme of the in-house investment team by providing operational efficiencies.

111. Investments at the Funds are managed through a combination of external fund managers and the Funds' investment management team. The proportion of funds managed internally has increased over recent years.

Lothian Pension Fund proportion of internally managed Funds



112. The Funds' have used the internal investment team to drive efficiencies in year including a reduction of investment managers expenses as a proportion of net return on investment from 9% to 1% for Lothian Pension Fund.

113. Lothian Buses Pension Fund and Scottish Homes Pension Fund have followed the same pattern with a decrease in the level of externally managed investments by 12.9% and 54.9% respectively. Both funds have also seen a reduction of investment manager's expenses as a proportion of net investment to below 1%.

Monitoring investment performance

114. There is an annual review of investment performance in June. Due to the elections in 2017 the Pension Committee was cancelled, however, a briefing meeting was held for the newly formed Committee. From our attendance at this briefing and the Pensions Committee in year we concluded that Pension Committee and Board Members are engaged in monitoring the performance of investments.
115. In addition to monitoring at a Committee level the Funds' performance is reviewed by an external provider on a monthly basis. The external provider compiles information covering monthly, quarterly, yearly and 3 yearly performance measures. This information is presented to the Investment Strategy Panel to allow for scrutiny investment performance of the Funds.

Administrative Performance

116. The Funds' have developed a Service Plan covering the period 2016- 2018 which focuses on four key objectives:
- We put our customers first and aim to provide the very best service
 - Our people are at the very heart of our business and we work together to deliver our service
 - We strive to improve our services by thinking ahead and developing new solutions
 - We are committed to supporting a culture of honesty and transparency.
117. The Pensions Committee receive updates on the service plan at each meeting. The annual results for 2016/17 are presented in the Funds' Management Commentary. The Performance Report highlights that the Fund are meeting the majority of their targets (81%) with only 2 areas where performance was not in line with target levels:

- Overall staff satisfaction decreased in year from 73% to 70% which was below the target level of 75%.
- The target for the proportion of active members receiving their annual benefit statement by 31 August 2016 was 100% but the Funds' achieved a level of 99.6%. The issue of annual benefits statements by 31 August is a requirement of the Local Government Pension Scheme (Scotland) 2014. The statements not issued related to members employed on a casual basis prior to March but who did not contribute to the scheme up to the end of the year. The members should consider whether they deem this an issue which should be self-referred to the Pension Regulator.

Action Plan point 4

Tendering for Services

118. The Funds make use of a range of service providers including investment managers, an actuary and a custodian. In order to ensure the Funds are achieving value for money it is good practice to tender for services at set intervals.
119. The Funds follow the City of Edinburgh Council procurement procedures and maintain a contract register.
120. It was noted that two contracts were currently in their extension period and were due to go out to tender in 2017/18. We will consider the adequacy of this process as part of our 2017/18 audit procedures.

7

Appendices

Appendix 1: Management action plan

Our action plan details the control weaknesses and opportunities for improvement that we have identified during our audit.

It should be noted that the weaknesses identified in this report are only those that have come to our attention during the course of our normal audit work. The audit cannot be expected to detect all errors, weaknesses or opportunities for improvements in management arrangements that may exist. The weaknesses or risks identified are only those which have come to our attention during our normal audit work, and may not be all that exist.

Communication of the matters arising from the audit of the annual report and accounts or of risks or weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.

Action plan grading structure

To assist the Funds in assessing the significance of the issues raised and prioritising the action required to address them, the recommendations have been rated. The rating structure is summarised as follows:

| | |
|----------------|--|
| Grade 5 | Very high risk exposure – major concerns requiring Board attention |
| Grade 4 | High risk exposure – material observations requiring senior management attention |
| Grade 3 | Moderate risk exposure – significant observations requiring management attention |
| Grade 2 | Limited risk exposure – minor observations requiring management attention |
| Grade 1 | Efficiency / housekeeping point |

| Action plan point | Issue & Recommendation | Management Comments |
|-------------------------------------|---|---|
| 1. Authorisation of journals | <p>Observation Our review of the journals environment found that there was a lack of segregation of duties over the posting of journals. Journals are currently posted by individuals without an authorisation process. Journals can be used to override controls and create fraudulent errors therefore it is crucial there are strong controls in place.</p> <p>Recommendation Whilst we were able to obtain alternative audit evidence to provide assurance that there were no material issues with regards to the posting of journals, we recommend that a review process for all journals is put in place.</p> | <p>Agreed the fund will undertake a review of the journals processes.</p> <p>All parties that use the Council's financial systems are affected by this finding. The Fund awaits the Council's response to the issue.</p> <p>The Fund is satisfied that there are sufficient controls in place to prevent an actual cash payment leaving the Fund without full authorisation and that the ability to post journals is limited to staff authorised to do so. The system also records the username of the person posting the journal.</p> <p>Action owner: John Burns</p> <p>Due Date: 31 January 2018</p> |
| Rating | | |
| Grade 3 | | |
| Paragraph ref | | |
| 25 | | |

| Action plan point | Issue & Recommendation | Management Comments |
|---------------------------------------|--|---|
| 2. Annual Governance Statement | <p>Observation We have reviewed the Funds' Annual Governance Statement and identified that improvements could be made. To be fully compliant with the Delivering Good Governance in Local Government guidance an action plan outlining the actions the Funds' will take to progress improvements in the Funds' governance process should be disclosed.</p> <p>Recommendation We recommend the Funds' consider the disclosures in the Annual Governance Statement to ensure they are meeting applicable guidance.</p> | <p>Agreed to review for next year's accounts</p> <p>Action owner: Struan Fairbairn</p> <p>Due Date: 31 March 2018</p> |
| Rating | | |
| Grade 3 | | |
| Paragraph ref | | |
| 40 | | |

| Action plan point | Issue & Recommendation | Management Comments |
|--|---|--|
| 3. Employer cessation liabilities | <p>Observation Lothian Pension Fund has identified that there are significant pressures facing the employing body members of the Fund. This has increased the risk of employers defaulting on payments required to cover the liability attributable to their employees.</p> <p>Recommendation We recommend that increased disclosure around the nature of the risk, the level of at risk employers within the Fund and the potential impact on the funding level is included in the financial statements.</p> | <p>Agreed to review disclosures in management commentary for next year's accounts after the completion of the 2017 triennial actuarial valuation.</p> <p>Contingent assets in respect of Funding Agreements for employers which have terminated membership of the Fund are disclosed to the extent that such default protection is provided to any aligned body (as defined in the Funding Strategy Statement) or other employers in the Fund. Such contingent assets do not have a material impact on net liabilities.</p> <p>Action owner: John Burns</p> <p>Due Date: 31 March 2018</p> |
| Rating | | |
| Grade 3 | | |
| Paragraph ref | | |
| 63 | | |

| Action plan point | Issue & Recommendation | Management Comments |
|--------------------------------------|--|---|
| 4. Annual benefits statements | <p>Observation The issue of all annual benefit statements by 31 August 2016 is a requirement of the Local Government Pension Scheme (Scotland) Regulations 2014. In 2016/17 the Funds' achieved 99.6% of the annual benefits statements by the deadline.</p> <p>Recommendation The Pension Committee members should consider whether they deem this to be an issue which should be self-referred to the Pension Regulator.</p> | <p>The Funds have considered this in line with the Pensions Regulator guidance and do not feel this would be of material significance and therefore have deemed it unnecessary to declare the breach to the Pensions Regulator.</p> |
| Rating | | |
| Grade 2 | | |
| Paragraph ref | | |
| 116 | | |

Appendix 2: Unadjusted differences

Board representations

We have requested that the signed representation letter, covering a number of issues, be presented to us at the date of signing the financial statements. We identified one unadjusted difference during our audit work. These differences are not considered to be material to the financial statements individually or in aggregate. The unadjusted items are included within the representation letter and shown below:

| Unadjusted differences | Fund Account | | Net Asset Statement | |
|---|--------------|-------------|---------------------|-------------|
| | DR £'000 | CR £'000 | DR £'000 | CR £'000 |
| Investment Management Expenses | 509 | | | |
| Creditors | | | | 509 |
| <i>Being the under declaration of output tax dating back to 2011.</i> | | | | |

Appendix 3: Respective responsibilities of the Pensions Committee and the Auditor

Responsibility for the preparation of the annual report and accounts

It is the responsibility of the Pensions Committee and the Chief Finance Officer, as Accountable Officer, to prepare financial statements in accordance with the Local Government (Scotland) Act 1973 and directions made thereunder.

In preparing the annual report and accounts, the Pensions Committee and the Chief Finance Officer, as Accountable Officer are required to:

- apply on a consistent basis the accounting policies and standards;
- make judgements and estimates on a reasonable basis;
- state whether applicable accounting standards as set out in the Code of Practice on Local Authority Accounting (the Code) have not been followed where the effect of the departure is material;
- prepare the accounts on a going concern basis unless it is inappropriate to presume that the Lothian Pension Fund will continue to operate.

The Chief Finance Officer is also responsible for

- keeping proper accounting records which are up to date; and
- taking reasonable steps for the prevention and detection of fraud and other irregularities.

Auditor responsibilities

We audit the annual report and accounts and give an opinion on whether:

- give a true and fair view, in accordance with applicable law and the Code, of the state of the affairs of the Funds as at 31 March 2016 and of the income and expenditure of the Council and its group for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union, as interpreted and adapted by the Code;
- they 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;

- the information given in the Management Commentary is consistent with the annual accounts.

We are also required to report by exception if, in our opinion

- adequate accounting records have not been kept;
- we have not received all the information and explanations we require for our audit;
- there has been a failure to achieve a prescribed financial objective.

Wider scope of audit

The special accountabilities that attach to the conduct of public business, and the use of public money, mean that public sector audits must be planned and undertaken from a wider perspective than in the private sector. This means providing assurance, not only on the annual accounts, but providing audit judgements and conclusions on the appropriateness, effectiveness and impact of corporate governance and performance management arrangements and financial sustainability.

The Code frames a significant part of our wider scope responsibilities in terms of four audit dimensions. As part of our annual audit we will consider and report against these four dimensions: financial management; financial sustainability; governance and transparency; and value for money.

Independence

We are required by International Standards on Auditing to communicate on a timely basis all facts and matters that may have a bearing on our independence. We can confirm that we have complied with the Financial Reporting Council's Ethical Standard. In our professional judgement the audit process has been independent and our objectivity has not been compromised. In particular, there have been no relationships between Scott-Moncrieff and the Pensions Committee or senior management that may reasonably be thought to bear on our objectivity and independence.



Scott-Moncrieff
business advisers and accountants

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Lothian Pension Fund
Lothian Buses Pension Fund
Scottish Homes Pension Fund

**Audited Annual Report and
Financial Statements 2016/17**



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Foreword

Head of Finance, City of Edinburgh Council

Welcome to the Annual Report and Financial Statements for 2016/17 for the Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund. The report keeps members, employers and other interested stakeholders informed about the activities and performance of the pension funds, as well as their investments and financial statements.

This year has seen no let-up in the challenges and pace of change both across the pensions sector generally and within the LGPS specifically. The Pensions Committee, Pension Board, together with officers of the Fund are ever mindful of our responsibilities to our 81,000 scheme members and 94 active employers. Therefore our decision making is always clearly focussed on working together to deliver the best outcomes for all our stakeholders.



We know that pensions can be difficult for scheme members to understand, and increasingly complex and challenging for employers to manage; they are a significant cost and short term decisions can have very long term effects. Our average pension in payment is £5,392, reflecting the earnings and work profile of our membership. We believe the LGPS offers a very safe way of saving for a secure income in retirement, particularly important for part time or lower paid employees. We remain committed to helping scheme members and employers understand the LGPS, to enable them to make informed and timely decisions. We continue to focus on investing in people and technology in order to maintain and drive up our high standards of service and performance. I am delighted that our service has been accredited by the Pension Administration Standards Association (PASA), the first Local Government Pension Fund to achieve this.

The LGPS is a Scotland-wide scheme and we continue to take a leading role nationally. Councillor Alasdair Rankin had served on the Scottish LGPS Scheme Advisory Board. Officers also provide advice to the Scheme Advisory Board.

The Scottish Government is encouraging LGPS funds to collaborate with each other. Our authorisation from the Financial Conduct Authority has enabled the expansion of our collaborative efforts over the year, enabling other LGPS funds to benefit from the Funds' expertise in infrastructure. A new collaborative model has been agreed with Falkirk Pension Fund which should bring further opportunities and efficiencies.

I would like to take this opportunity to record my thanks for the hard work of the Pensions Committee, Pension Board, fund advisers, employers and staff.

Hugh Dunn
Head of Finance
The City of Edinburgh Council

Report by the Chair of the Pension Board

The Pension Board comprises both employer and member representatives, and undertakes an important role in helping to ensure the correct governance and functioning of the Lothian Pension Funds.

Having on the 1st April 2016 taken on the role of Chairperson (the first 'employee' representative to do this) I am now able to provide the following information relating to the Board and it's work for the preceding year.

During this time, the Board itself has undergone some changes in membership, but I can confirm that none of these changes detracted in any way from the continuing and important work the Board undertook during the course of the year.

As an example of its diligence, all the Board members have undertaken the extensive training required to ensure their understanding of their role, general pensions issues and the operations of the Funds themselves, and as a result, even those Board Members who joined us late in the year fully met the LPGA Pension Board Members training requirements.



Report by the Chair of the Pension Board cont'd

The Board has, in the past 12 months, undertaken a considerable amount of work attending not only all of the meetings of the Pensions Committee and Pensions Audit Sub-Committee, but also ensuring their active participation at the Board's own quarterly meetings.

As part of its remit, the Board members have also maintained a positive involvement in relation to the funds governance and its consideration of the various environmental, social and governance (ESG) issues being brought to its attention.

During the course of the year, the Scottish Public Pensions Agency (SPPA) instigated a major review of the 'effectiveness of the governance' arrangements for all pension funds, in which the Board was fully and pro-actively involved. We provided both feedback on the Board's work so far in supporting the Funds and in respect of the actual remit of the review' itself and then ultimately provided in-depth feedback on the reviews findings.

The Board has also taken a very keen and active interest in the many ESG matters that were brought before the Pensions Committee for consideration during the year, and we have been instrumental in ensuring that the Funds and its managers continue to consider fairly these important issues whilst maintaining a clear perspective in relation to both its legal fiduciary duties and also its duty of care towards all its various Fund members.

I am grateful to all my Pension Board colleagues for their ongoing commitment to supporting the Board over the last year and for ensuring that both scheme members and employers continue to be well represented within the governance and running of the fund.

As required by the constitution, the chair of the Pension Board rotates annually between employer and member representatives, and Darren May, (an employer member from Scottish Water), was selected by the Board to take on this important role as and from 1 April 2017. I therefore take this opportunity to wish Darren well in his new role as our Chair for the incoming year and I look forward to continuing working with him and the Pension Board members along with the LGPS funds in the coming year.

Jim Anderson

Member Representative and Chair of the Pension Board

Report by the Independent Professional Observer

This is my third year as Independent Professional Observer for the pension funds. My function is to assist the Pensions Committee and Pension Board undertake their governance responsibilities effectively and efficiently. My role as a pension trustee and knowledge of institutional investment allows me to support the Committee and Board in ensuring the Funds comply with relevant pension legislation and requirements set out by The Pensions Regulator.

During the year, I held surgeries to assist the Pensions Committee and Pension Board in working collaboratively and efficiently together in their joint oversight of the pension funds. Topics such as funding, investment and collaboration have been considered in addition to the normal business of the funds.

The quality of engagement and discussion over the year has demonstrated a high standard of governance within the funds. I look forward to working with the new Pensions Committee following the Local Government Elections in May 2017 to provide continuity, knowledge and guidance to them.



Sarah Smart

Independent Professional Observer

Management commentary

Introduction

Customer Service

The quality of membership data has been a key area of focus for the Funds over recent years to ensure we meet The Pensions Regulator's standards. All but three employers are now providing monthly contribution data for each member which is enabling us to see changes in membership quickly and hence provide a better service. Work was also undertaken to tackle historic leavers where information had not been provided by their employer at the time of leaving.

The Funds also registered for the national Tell Us Once service which means we can now be informed about the death of a member notified to another public service. This makes it easier for relatives of deceased members to deal with us, as well as reducing the risk of over-paying pensions.

Over the year, the City of Edinburgh Council undertook a voluntary redundancy exercise as part of a significant transformation project. In view of the scale of this exercise, we reviewed the way we deal with retirements to maximise the use of our online service and speed up the process. As well as reducing the administration work involved, customer satisfaction also improved.

The Funds continue to monitor movements in membership numbers, in particular the impact of early retirement initiatives and auto-enrolment. The number of pensioners from the City of Edinburgh Council has increased significantly over the year because of the transformation project. Over the year, the numbers of pensioner members rose by 922. The number of active members for the Lothian Pension Fund has increased marginally by 378 due to auto enrolment.

Funding & Investment

Changes in membership of the Funds have implications for cashflow. On retirement there are immediate outflows due to the payment of tax free lump sums and pensions and a reduction to inflows as contributions cease. However, payment of strain costs by employers on early retirements helps to mitigate current cashflow pressures.

Lothian Pension Fund is now in a negative cash flow position where payments exceed contributions received. The Fund has targeted increased investment income in recent years and this is expected to exceed net cashflow for the foreseeable future. It is therefore not anticipated that the sale of investments will be required to meet this funding requirement. Lothian Buses and Scottish Homes Pension Funds expenditure continues to exceed income as both funds are closed to new members with Scottish Homes Pension Fund having no members paying in to the scheme. Investment income funds these shortfalls, together with asset sales for Scottish Homes Pension Fund.

All three Funds delivered strong investment performance over the year. Lothian Pension Fund's assets have increased by £1,161million, with investments returning 21.7% over the year, slightly behind the benchmark of 24.8%. The internal team manages a significant proportion of assets of all three pension funds in-house. For Lothian Pension Fund this includes approximately £3.4billion of listed equity assets and a currency hedging programme specifically designed to provide downside protection in times of market stress while participating in some, though not necessarily all, of any upward movement. The underperformance relative to the benchmark this year follows on from a period of significant outperformance (+6.2%) in the prior year (2015/16) and over longer term periods the Fund is meeting its objective, exceeding the benchmark but with lower volatility.

Despite this strong performance, liability values have grown faster as discount yields have fallen. Hence, overall funding levels have fallen. In advance of the 2017 actuarial valuations, Lothian Pension Fund's Actuary reviewed the suitability of the Contribution Stability Mechanism used for setting the employer contribution rates for long-term secure employers. The Actuary concluded that despite changes to market conditions and reducing certainty of full funding due to the outlook for investment returns, at present the Contribution Stability Mechanism remains appropriate for long-term secure employers. However, its ongoing suitability will be reviewed ahead of the 2020 actuarial valuation.

During the 2014 actuarial valuation, Lothian Pension Fund addressed the previous inconsistency between the actuarial and cessation valuations to raise awareness of pension deficits and reduce the risk of employers being unable to pay deficits when their last active member leaves. During 2016/17, the Fund, in consultation with external advisers, has drawn up a funding agreement to address repayment of the cessation debt in order to avoid employer default or insolvency.

This agreement allows for repayment of the cessation debt over longer terms, and in special circumstances, for repayment of less than the full cessation debt. The standard agreement is tailored to each employer's circumstances, taking into consideration the employer's financial circumstances and ability, where applicable, to offer security over assets.

The Pensions Committee regularly considers the legal responsibilities of administering the Funds and its fiduciary duty to members and employers. During the year, the Scheme Advisory Board of the Scottish Local Government Pension Scheme sought a legal opinion on how Pension Committees in Scotland should exercise their fiduciary duty when investing pension fund money. The Committee considered this legal opinion and agreed that it reaffirmed that the approach taken by the Funds is appropriate. Non-compliance with the fiduciary duty could leave the Council and Pensions Committee open to legal challenge or otherwise have an adverse impact on the Council, the Funds and their stakeholders. However, there has been a significant increase in lobbying from external interest groups on certain investments and the Funds continue to engage with these groups as appropriate.

Collaboration with other Pension Funds

LPFI Limited, was granted FCA authorisation in June 2016 which facilitates collaboration with other pension fund investors to bring economies of scale. A new corporate structure, including two new companies (LPFI Limited and LPFE Limited), was introduced in 2015 to support the in-house investment team and create efficiencies. LPFE Limited, employs staff and facilitates separate governance and control for the in-house investment team. Collaboration allows other funds to benefit from the commercial advantage that the existing in-house team has in the market to bring tangible benefits through scale investing. In addition, sharing costs between collaborating funds allows reinvestment in the systems and in-house team to improve long-term sustainability.

Lothian Pension Fund has provided Falkirk Council Pension Fund with support on investment matters, including assisting with infrastructure investing, for the past five years. With Lothian's recent FCA authorisation, a review of the arrangements and a new collaborative model, including a joint Investment Strategy Panel, has been agreed. The Pensions Committee of Falkirk Council will agree investment strategy but will now delegate the implementation of strategy, including selection of investment managers, to officers. This governance model is similar to that of Lothian Pension Fund. The new joint Investment Strategy Panel will advise the Finance Directors of each administering authority (the City of Edinburgh Council and Falkirk Council) on implementation of investment strategy. The assets of Lothian Pension Funds and Falkirk Council Pension Fund will remain separate and investment strategy decisions retained by the respective Pensions Committees.

During 2016/17, Lothian Pension Fund has made seven investments alongside Falkirk Council Pension Fund and one with Northern Ireland Local Government Officers' Superannuation Committee. Further collaboration with other Scottish Local Government Pension Scheme partners is expected in 2017/18.

Awards

During the year, we retained the Customer Service Excellence award once again demonstrating commitment to customers. In March 2017, we became the first UK Local Government Pension Scheme fund to be awarded accreditation from Pension Administration Standards Association (PASA), which promotes a high standard for administration services for UK pension schemes. Accreditation involved a three-day site visit undertaken by two independent assessors. The award means the Fund has been independently recognised by PASA for delivering good quality administration, and showing a commitment to ongoing improvement. We use the standards to improve various areas of our service including procedure manuals, performance reporting and business continuity planning.

We also received five pension industry awards this year. At the Local Government Investment Awards 2016 we won Fund of the Year (over £5billion) for Lothian Pension Fund and Fund of the Year (under £750million) for Lothian Buses Pension Fund. At the Professional Pension's Pension Scheme of the Year Awards we were winner in the Defined Benefit Communications category and in the LAMP magazine investment awards, we were successful in the categories Investment Performance, Small LGPS Fund and Investment Strategy.

Challenges

Continuing budgetary constraints across the public and charity sectors are expected to lead to further accelerated increases in pensioner numbers and an increasing number of admitted bodies seeking to exit Lothian Pension Fund. There is also a risk that members decide to opt-out of the Funds on grounds of affordability or lack of appreciation of the value of pension benefits. Together with the new pension freedoms and pension auto-enrolment, these will further impact on the Funds membership, liabilities and cashflow.

Despite strong investment performance since the last actuarial valuation, liability values have grown faster as discount yields have fallen. Hence, the overall funding levels have fallen and the 2017 actuarial valuation is likely to prove

challenging. Further, there is greater oversight and scrutiny of funding plans for all LGPS funds as a result of the Public Service Pensions Act 2013. The Government Actuary's Department has carried out a dry-run analysis on the 2014 valuations in Scotland. The results identified differences in the way information is presented and work is ongoing amongst actuarial firms and funds to address inconsistencies. They noted different financial assumptions, which may reflect local circumstances, although the evidence at this stage is limited. The analysis may influence the approach to the 2017 actuarial valuation.

There has always been interest from members and specific campaign groups in investments and over recent years this has increased significantly. There is an ongoing need to be clear, open and transparent in communicating investment strategy and the way in which the Funds must invest in the best interests of members and employers.

To ensure we meet these challenges we have four objectives for our service:

- We put our customers first and aim to provide the very best service
- Our people are at the very heart of our business and we work together to deliver our service
- We strive to improve our services by thinking ahead and developing new solutions
- We are committed to supporting a culture of honesty and transparency.



Hugh Dunn
Head of Finance
The City of Edinburgh Council
27 September 2017



Clare Scott
Chief Executive
Lothian Pension Fund
27 September 2017

Governance

The City of Edinburgh Council is the administering authority for the Funds and delegates pension matters to the Pensions Committee and Pensions Audit Sub-Committee. The Pensions Committee members act as 'quasi trustees' and held four meetings during the year with the Pensions Audit Sub-Committee meeting three times.

The table below shows the membership of the Committees to 31 March 2017 and the current membership following the Local Government elections held on 4 May 2017.

| 1 April 2016 to 3 May 2017 | May Election 2017 |
|---|---|
| Pensions Committee | Pensions Committee |
| Councillor Alasdair Rankin (Convener) | Councillor Alasdair Rankin (Convener) |
| Councillor Maureen Child | Councillor Maureen Child |
| Councillor Jim Orr | Councillor Cameron Rose |
| Councillor Bill Cook | Councillor Adam McVey |
| Councillor Cameron Rose | Councillor Claire Miller |
| John Anzani (member representative, Midlothian Council) | John Anzani (member representative, Midlothian Council) |
| Richard Lamont (employer representative, VisitScotland) | Richard Lamont (employer representative, VisitScotland) |
| | |
| Pensions Audit Sub-Committee | Pensions Audit Sub-Committee |
| Councillor Cameron Rose (Convener) | Councillor Cameron Rose |
| Councillor Jim Orr | Councillor Maureen Child |
| Councillor Bill Cook | John Anzani (member representative, Midlothian Council) |

The Pension Board

The Pension Board was set up on the 1 April 2015 as a result of the Public Services Pensions Act 2013 and the Local Government Pension Scheme (Governance) (Scotland) Regulations 2014.

The role of the Pension Board is to help ensure that the operation of the Funds is in accordance with the applicable law and regulation. The Board attends all Pensions Committee meetings and has appointed two representatives to attend Pensions Audit Sub-Committee meetings. The membership comprises of ten members, five representatives appointed from the employer bodies and five members appointed by trade unions representing the membership of the Funds.

The Pension Board membership for the period 1 April 2016 to 31 March 2017 membership was as follows. There were two member vacancies at 31 March 2017.

Member representatives

| | |
|----------------------|----------------------------|
| Jim Anderson (Chair) | Unison |
| Catrina Warren | Unison |
| Thomas Carr Pollock | GMB |
| Graeme Turnbull | UCATT (to 26 January 2017) |
| John Rodgers | Unite (to 14 March 2017) |

Employer representatives

| | |
|-----------------|---|
| Eric Adair | EDI Group |
| Darren May | Scottish Water |
| Sharon Dalli | Police Scotland (from 23 September 2016) |
| Paul Ritchie | East Lothian Council (from 5 September 2016) |
| Alan Williamson | Edinburgh College (from 2 September 2016) |
| Simon Belfer | Napier University (to 10 June 2016) |
| Linda McDonald | Handicabs (to 1 July 2016) |
| Rucelle Soutar | The Royal Edinburgh Military Tattoo (to 20 July 2016) |

Pensions Committee and Pension Board training

The Committee and Board members must attend no less than 21 hours of training per year as outlined in the Funds' training policy which is available on our website at www.lpf.org.uk. All new members of the Pensions Committee and Pension Board attend induction training. Other training included fiduciary duty, investment markets after Brexit, collaboration and investment pooling. All members of the Committee and Board achieved the required training hours during 2016/17. Pensions Committee members collectively attended 322 hours of training over the year and members of the Pension Board undertook 288 training hours.

Investment Strategy Panel

The Pensions Committee sets the overall investment strategy with the implementation of that strategy, including investment monitoring, delegated to the Executive Director of Resources who takes advice from the Investment Strategy Panel. The Investment Strategy Panel meets quarterly and comprises the Executive Director of Resources of the City of Edinburgh Council, the Chief Executive of Lothian Pension Fund, Chief Financial Officer of Lothian Pension Fund and Chief Investment Officer of Lothian Pension Fund along with external advisers. The external advisers are currently Gordon Bagot, Scott Jamieson and KPMG, represented by David O'Hara.

Lothian Pension Fund staff

The day-to-day running of the three pension Funds is carried out by the Investment and Pensions service division of the Resources Directorate within the City of Edinburgh Council. The Division functions include investment, pension administration, communications and accounting. The investment responsibilities include carrying out in-house investment management and the monitoring and selection of external investment managers.

In February 2015, two limited companies (LPFE Limited and LPFI Limited) were established to facilitate the development of the internal investment capabilities and improve governance as well as delivering efficiencies for the administration of the Funds. Both companies are wholly owned and controlled by the City of Edinburgh Council as the administering authority of the Funds. LPFI Limited has been established to support the investment programme of the in-house investment team by providing operational and other efficiencies. LPFI Limited was authorised by the Financial Conduct Authority (FCA) in June 2016.

In 2015, key investment staff were transferred to LPFE Limited. As part of the transfer new terms and conditions were introduced which includes increased notice periods to reduce the risks facing the Funds. A second phase to transfer the remaining staff to LPFE Limited is currently ongoing. This will result in a more streamlined organisation better able to facilitate the collaborative efforts with other local government pension funds that are currently being explored.

Over the year, senior officers were:

- Hugh Dunn, Acting Executive Director of Resources, The City of Edinburgh Council
- Clare Scott, Chief Executive of Lothian Pension Fund
- Bruce Miller, Chief Investment Officer of Lothian Pension Fund
- Struan Fairbairn, Chief Risk Officer of Lothian Pension Fund
- John Burns, Chief Finance Officer of Lothian Pension Fund
- Esmond Hamilton, Financial Controller of Lothian Pension Fund.

Scheme Advisory Board

The Scheme Advisory Board for the Local Government Pension Scheme in Scotland was set up following the Public Service Pensions Act 2013. The Board's main function is to advise Scottish Ministers, when requested, on the desirability of changes to the Scheme. They can also provide advice to scheme managers and pension boards in relation to effective and efficient administration and management of the Scheme in Scotland.

The membership of the Scheme Advisory Board comprises of seven member representatives and seven employer representatives and a Joint Secretary is appointed in support of each of the Member and Employer groups. Councillor Rankin was a member of the Scheme Advisory Board over the year. Officers of Lothian Pension Fund have also been called upon to advise the Board and its Joint Secretaries. There is more information on the Scheme Advisory Board at www.lgpsab.scot.

Investments

Investment Markets

UK economic growth moderated further in 2016, slowing from 2.2% in 2015 to 1.8% in 2016, with political events dominating the news over the year.

Towards the end of June, the UK voted to leave the European Union, a result which was largely unanticipated by most investors. Global equity markets fell for two days before steadying and recovering most of their ground by the end of the month. However, the pound weakened sharply following the result, declining by almost 15% against the dollar, contributing to an increase in expected inflation over the next year. UK bond markets rose on fears of weaker economic growth.

Anticipating a potential slowdown in the economy, the Bank of England cut interest rates in August to a historic low of 0.25%. Subsequent economic news pointed to the UK economy faring better than expected, with the Bank revising its 2017 growth forecasts upwards from 1.4% in November 2016 to 2.0% in February 2017.

Following the EU referendum, investor attention focused on the November US Presidential election. Having fallen prior to the election, equity markets then recovered strongly following another unexpected result, confounding those that had predicted market turmoil accompanying a Trump victory. Signaling its confidence in the state of the US economy, the US Federal Reserve raised interest rates during December 2016 and then again in March 2017. While signalling that further rate rises would be likely over the remainder of 2017, the chair of the Federal Reserve Bank also noted that the outlook remained uncertain.

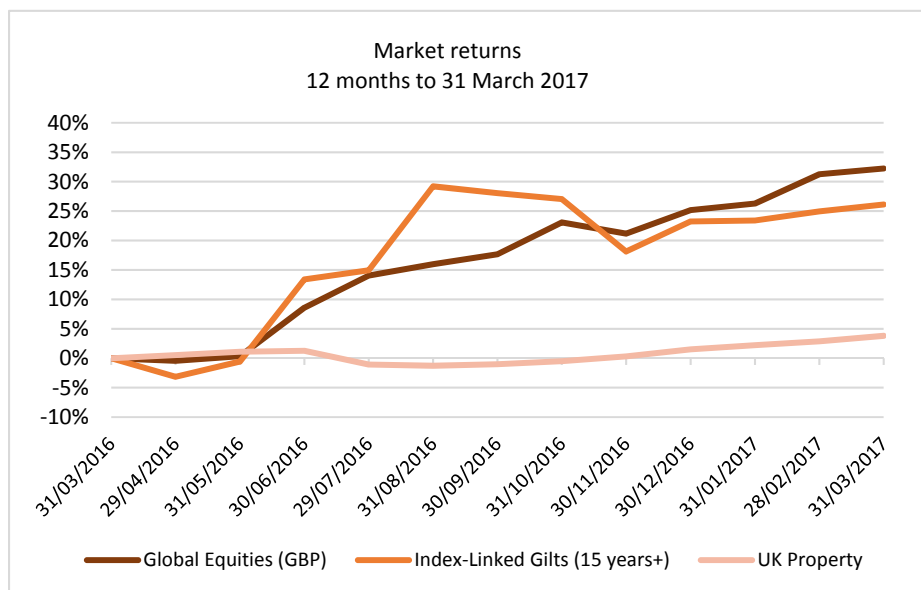
In December, the European Central Bank (ECB) voted to extend its quantitative easing programme by a further nine months to the end of 2017, as estimates suggested inflation would remain below its 2% target in 2019. The Bank of Japan left its bank rate unchanged over the year and maintained its ongoing quantitative easing programme.

For the 12 months to 31 March 2017, equity market returns for sterling-based investors were boosted by the immediate drop in the currency after the referendum, and then further weakness as investors priced in the likelihood of an unpleasant Brexit in economic terms. Index-linked bonds delivered strong returns over the year, as bond investors also priced in the likelihood of weaker UK economic growth. The weaker UK outlook also contributed to subdued returns from UK property, with rental income offsetting a small decline in capital values.

The outlook for the global economy – steady developed market growth and mixed conditions across emerging markets – has remained broadly constant over the past year. Recent divergence in central bank monetary policy suggests the US is ahead of the rest of the world in its economic cycle. Trump's pre-election promises of higher infrastructure spending and tax reform has been positive for equities but negative for US bonds.

However, the prospect of the US turning inwards to support its domestic economy also looms, which would be negative for global growth and raise the risk of a global recession.

The year ahead also sees potential for further surprises on the political front, most notably in Europe, where elections in France, the UK, and Germany fall due.



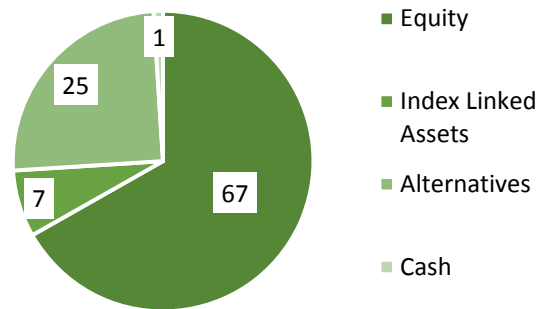
Investment strategies

The review of investment strategies for all three Funds during 2012 resulted in long term plans to achieve a reduction in investment risk as the Funds mature. The investment strategies were again reviewed during 2015/16, taking into account the results of the 2014 actuarial valuations. As at 31 March 2017, the three funds (Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund) were invested broadly in line with their target asset allocations, as expected.

To provide suitable investment strategies for the differing requirements of employers, **Lothian Pension Fund** currently operates two investment strategies.

Most employer liabilities are funded under Strategy 1, which adopts a long-term investment strategy, aiming to maximise the investment return within reasonable and considered risk parameters and hence minimise the cost to the employer. The investment strategy is set at the broad asset class level of Equities, Index-Linked Gilts and Alternatives, which are the key determinants of investment risk and return.

Lothian Pension Fund Actual Asset Allocation Strategy 1 (%) at 31 March 2017

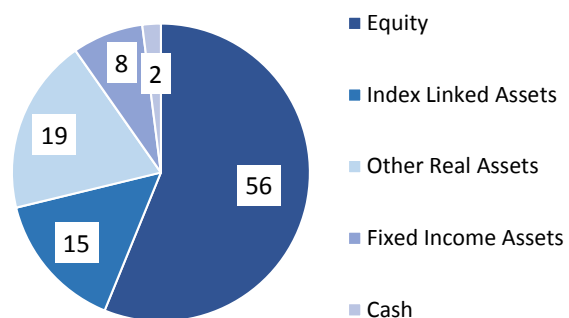


In 2015, the Pensions Committee agreed that there was no reason to amend the planned changes to Strategy 1. Lothian Pension Fund will continue to implement that strategy over 2017, and undertake a further review when the results of the 2017 actuarial valuation are available.

A small number of employers are funded in Strategy 2, which invests in a portfolio of UK index-linked gilts to reduce funding level and contribution rate risk to a level appropriate to their circumstances. The liabilities funded by Strategy 2 represent less than 1% of total Lothian Pension Fund liabilities.

For **Lothian Buses Pension Fund**, the review of strategy had greater implications. In March 2016, the Pensions Committee agreed a revised long term strategy allocation for the five-year period 2016-21. This involves making meaningful changes to asset allocation over that timeframe reflecting the requirement for greater funding stability as the Fund matures. (The Fund is closed to new entrants and is maturing at a faster pace than the Lothian Pension Fund.) In addition, as Lothian Buses Pension Fund is defined in regulations as a sub-fund of Lothian Pension Fund, the Pensions Committee agreed that the option for it to be merged into Lothian Pension Fund would be explored in consultation with stakeholders. This will be progressed during 2017, and the investment strategy implemented gradually over 2016-21.

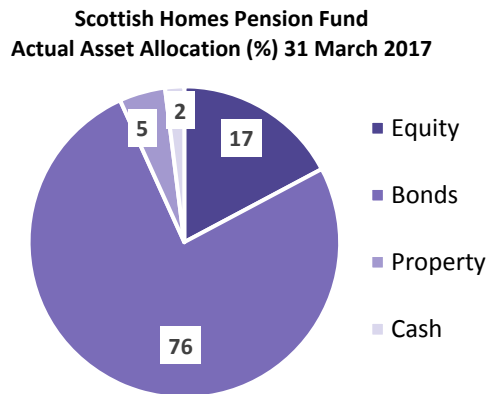
Lothian Buses Pension Fund Actual Asset Allocation (%) at 31 March 2017



During the year to end March 2017, Lothian Pension Fund and Lothian Buses Pension Fund continued to reduce equity holdings and to make new commitments to alternative assets, including infrastructure investments in the UK and overseas. The two funds invest in private markets, selecting specialist managers to access a wide range of opportunities that are not available in the public markets. Over the past 10+ years, the funds has built a portfolio of private market assets in equity, debt, real estate, timber and especially in infrastructure, which is the largest proportion of the private market assets held and is described in more detail below. For the Lothian Buses Pension Fund, the remaining externally managed index-linked gilts mandate was brought in-house during the year to be managed internally, reducing risk and resulting in savings on ongoing investment fees.

For **Scottish Homes Pension Fund**, the strategic review concluded that a less prescriptive investment and funding strategy would allow a higher-yielding investment strategy and a more flexible approach to setting contributions from the Scottish Government.

The current investment strategy adjusts asset allocation based on the evolution of the funding level. The Fund's current strategy is bond-focused and generates an annual income yield of less than 2% and, given its maturity, it is required to sell assets on a regular basis to pay pensions.



The Scottish Homes Pension Fund investment strategy was adjusted through the year as its funding level continued to improve, resulting in a reduced equity target allocation of 17.5% at 31 March 2017, compared to 30% at the previous year-end.

In addition, during March 2017, the assets previously managed by State Street were transferred to be managed internally. Management of the bond portfolios was brought in-house to improve cash-flow matching of the assets with future liability payments and management of the equity portfolios was brought in-house to improve the cash-flow generation of the equity assets.

Strategies for all three funds are implemented and monitored by an experienced internal team of investment professionals supported by external advisers. Over recent years, the internal team has expanded with very positive effects on costs and capabilities. This is reflected in two structural shifts. Firstly, the percentage of Lothian Pension Fund's listed equity assets managed internally has risen from 23% to more than 85% and most publicly traded bond assets are also now managed internally. Secondly, the Fund has altered the construction of the listed equity portfolios, increasing the global mandates from 32% to more than 85%. Despite these large changes in the Fund, performance equity returns have been ahead of benchmark by 1.5% per year over the last five years and this has been achieved with lower risk. The Fund's guiding principle is to use strong internal investment capabilities to their maximum potential and to retain external managers for specialist mandates.

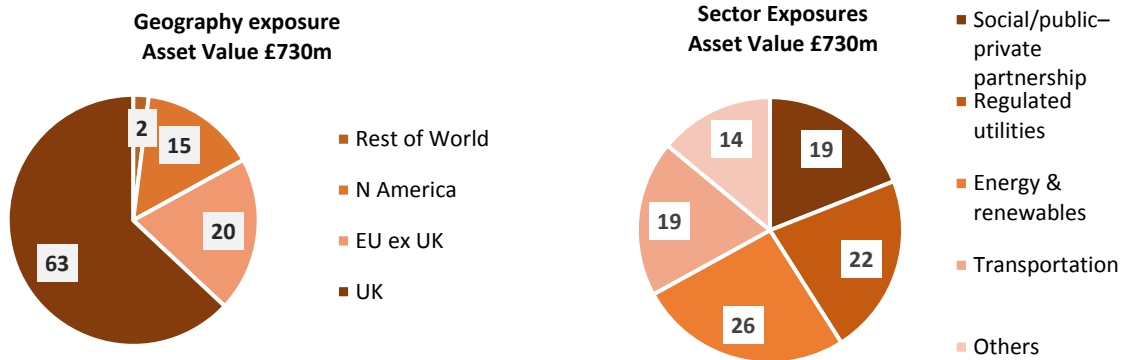
Infrastructure Investment

Infrastructure investment continues to receive publicity as the UK and Scottish governments encourage Local Government Pension Schemes to increase their investment in this area. Infrastructure investments may offer the potential to generate attractive risk-adjusted returns based on cash flows that are often linked to inflation and can play a diversifying role in the Funds' strategies.

Over the last decade, the Fund has developed its reputation, networking and execution capabilities to secure access to investment opportunities within this market niche. The Funds' experienced team appraises, models and invests in primary and secondary funds as well as co-investments to achieve its target allocation in a cost-effective manner. An important element of the implementation strategy is to work with managers to ensure execution certainty and to fully understand transaction fees.

Infrastructure investments represented 10% of the value of the Lothian Pension Fund at 31 March 2017, one of the largest and most diversified allocations compared with other UK Local Government Pension Funds. Lothian Buses Pension Fund investments in infrastructure accounted for 9% at 31 March 2017. Of the combined £730 million (31 March 2016: £439m) invested in infrastructure, 63% is invested in a diverse range of projects in the UK.

Lothian Pension Fund and Lothian Buses Pension Fund combined infrastructure investment allocations are illustrated below.



The market value of infrastructure investments in the UK at 31 March 2017 was £461million. The map and table shows the location of the major UK infrastructure investments.



| Location | Sector - Subsector | % |
|-------------|--------------------|-----|
| Worthing | Utility - Water | 6.5 |
| Walsall | Utility - Water | 5.3 |
| Various | Renewables - Solar | 5 |
| Manchester | Energy meters | 4.7 |
| Redhill | Roads | 4.7 |
| Livingston | Energy meters | 4.6 |
| Liverpool | Ports | 4.5 |
| Isle of Man | Utility - Gas | 4.5 |
| Perth | Renewables - Hydro | 4.3 |
| Warwick | Utility - Gas | 4 |
| London | Sewage system | 3.4 |
| Barnsley | Utility - Water | 2.3 |
| North Sea | Pipeline | 2.3 |
| London | Utility - Water | 2.2 |
| Edinburgh | Ports | 2.1 |

| Location | Sector - Subsector | % |
|-----------------|-----------------------|-----|
| West Lothian | Renewables - Wind | 1.9 |
| Newport Pagnell | Motorway service | 1.8 |
| Dudley | Healthcare | 1.6 |
| Winchester | Telecommunication | 1.3 |
| Dundee | Education | 1.2 |
| Suffolk | Utility - Electricity | 1.2 |
| Tayside | Healthcare | 1.1 |
| London | Utility - Gas | 0.8 |
| Birmingham | Roads | 0.8 |
| London | Roads | 0.7 |
| Nottinghamshire | Healthcare | 0.7 |
| North Wales | Utility - Electricity | 0.6 |
| Essex | Education | 0.6 |
| London | Healthcare | 0.6 |
| Corsham | Defence | 0.6 |

During 2016/17, Lothian Pension Fund and Lothian Buses Pension Fund completed two primary fund investments, acquired two secondary fund interests at material discounts to net asset value and invested in eight co-investment and/or specified asset investment vehicles. Approximately £245 million has been invested over the year in UK, European and infrastructure assets, including UK utilities, concessions and contracted infrastructure.

Over the last year, Lothian collaborated with Falkirk Council Pension Fund on seven infrastructure investments. A staff secondment arrangement shares internal staff costs between the Funds, supporting Falkirk's strategy to increase its allocation to UK infrastructure and giving both Funds greater scale and so access to opportunities that would not have otherwise been available.

During the year, Financial Conduct Authority approval was granted to LPFI Limited to enable us to more effectively collaborate in this sector, and for Lothian to benefit from scale in the market whilst further supporting other institutional pension funds in accessing infrastructure markets.

Responsible Investment

The Funds' policy on responsible investment stems from its fiduciary duty to its members and employers, which was endorsed by a legal opinion in September 2016 on the responsibilities of Scottish Local Government Pension Scheme funds (available to view at www.lgpsab.scot). The Funds are regularly approached by groups that lobby for the divestment of the shares of companies operating in certain industries, most recently those in defence and fossil fuels. The issues raised often involve complex social, legal and moral issues.

The Fund invests only in legal businesses and is an active shareholder with a view to enhancing the long-term value of its investments. Environmental, social and governance (ESG) issues are taken into consideration in the investment process in a manner which is consistent with the fiduciary duty to provide the highest standard of stewardship on behalf of the members and employers.

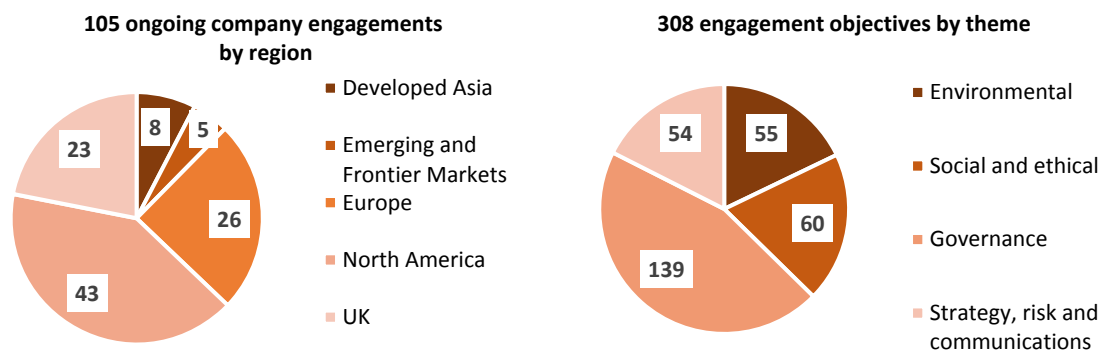
Robust arrangements are in place to ensure that the Funds' shareholdings are monitored and appropriate voting and engagement activity is undertaken with the aim of bringing about positive long term change at companies through a focused and value oriented approach. Share ownership brings with it the right to engage with management to affect strategic change in a positive direction. Divestment relinquishes that right. The Funds, however, do disinvest from shares where financial risk of loss is expected to outweigh reward.

The Funds have been a signatory to the Principles for Responsible Investment (PRI) since 2008. The PRI undertakes a detailed annual assessment of the Funds and their responsible investment activities. It publishes Transparency and Assessment Reports on the Funds, both of which can be found on the Fund’s website. The Assessment Report benchmarks performance against the Funds’ history and against peers, and the latest report published in 2016 is very favourable. The Funds are also a Tier 1 signatory to the Financial Reporting Council (FRC) UK Stewardship Code.

During 2016/17, voting and engagement activities related to the Funds’ shareholdings were largely undertaken by Hermes Equity Ownership Services (EOS). Baillie Gifford and State Street also took direct responsibility for stewardship issues for the investments they managed for the Funds.

Hermes EOS collates voting and engagement data for the Funds and reports this for calendar year periods. During calendar year 2016, the Funds voted at the annual meetings of the 541 companies in which it was invested. There were votes on 7,525 resolutions, and the Fund opposed 524 of them. In addition, Hermes EOS engaged on the Funds’ behalf with companies across the world on topics such as board structure, executive compensation and climate change. These are summarised in the charts below. By collaborating with Hermes and their other clients and other local authorities, the Fund’s influence is much enhanced with investee companies.

Engagement activities are also undertaken on behalf of the Fund and approximately 70 other local authority pension schemes in the UK by the Local Authority Pension Fund Forum. Councillor Alasdair Rankin, Convener of the Pensions Committee, was nominated to the Executive Committee of the LAPFF. He replaces Pensions Committee Member Councillor Cameron Rose, who had served on LAPFF’s Executive Committee for 10 years, latterly as Vice Chair. Membership of the LAPFF Executive entails meeting with the boards of companies and attending company Annual General Meetings to represent shareholders’ interests.



There has been notable success in engagement surrounding the ‘Aiming for A’ initiative that was launched last year. ‘Aiming for A’ seeks to implement strategies to limit man-made climate change to 2°C, and to demand that companies explain how they plan to achieve this. A resolution filed at the Chevron meeting and supporting these goals garnered over 40% votes in favour (the highest ever for a shareholder resolution for that company) and engagement with French oil company Total led to the company to announce goals in line with the ‘Aiming for A’ objectives.

The Fund continues to monitor the evidence on the impact of ESG on investment returns, and notes evidence that the shares of companies with improving ESG ratings provide better investments than those that are simply highly rated. As such, engaging with companies to improve ESG practices can lead to better long term outcomes for the Funds.

In summary, the Pensions Committee undertakes regular training to understand the legal responsibilities that its fiduciary duty to its members, and to its employers, entails. The Funds are committed to responsible investment with a view to raising corporate standards. It does this by voting on all stocks and engages with companies with poor corporate practices. It engages individually and collectively with other investors to maximise its influence as a shareholder to enhance shareholder returns and effect positive change for society.

Funding Strategy Statement

The Funding Strategy Statement sets out how we balance the potentially conflicting aims of affordability and stability of employers' pension contributions whilst taking a prudent long-term view of funding pension liabilities. The Funding Strategy Statement was revised at the 2014 Actuarial Valuation and further revised in November 2015. It can be viewed on our website at www.lpf.org.uk/publications. The Statement covers the funding strategies of each of the three Funds.

The Funding Strategy Statement will be reviewed at the 2017 Actuarial Valuation with the Actuary in consultation with employers.

The Fund is seeking to enhance the transparency of the fund assets attributable to each employer and, to that end, has introduced a system of investment unitisation (asset tracking). This enables investment assets for each employer to be tracked monthly, with the cash flow of an employer resulting in either a purchase or sale of units. The aim is to implement this change at the 2017 actuarial valuation, and data has been loaded to the system retrospectively in readiness. Another benefit of the system is that it also facilitates the future provision of more tailored investment strategies for employers if required.

Financial performance

Administrative expenses

A summary of the Funds' administrative expenditure for 2016/17, against the budget approved by Pensions Committee, is shown in the table below.

The budget focuses on controllable expenditures and therefore excludes all benefit payments and transfers of pensions from the Funds. Similarly, income does not include contributions receivable and pension transfers to the Funds. The total net cost outturn of £8,385k against budgeted of £12,242k represented an underspending of £3,855k (31.5%) for the Funds. The key budget variances serving to generate this underspending were:-

- Investment management fees – Invoiced - £2,534k underspend. This saving arose from continued greater use of in-house investment management expertise, with assets transferred from an external global equity manager in March 2016. The budget for external fund management costs was set prior to this in-sourcing having been anticipated.
- Other third party payments - £651k underspend. This saving arose primarily from investment broker research costs continuing to be paid via commission, rather than being invoiced directly. The Funds also had an underspend on budgeted broken deal costs in relation to its co-investment infrastructure investments.
- Employees - £467k underspend. This arose from savings in unfilled posts, partly due to the timing of recruitment during the financial year.

| | Approved budget | Actual outturn | Variance |
|---|-----------------|----------------|----------------|
| | £000 | £000 | £000 |
| Employees | 2,906 | 2,439 | (467) |
| Property | 195 | 211 | 16 |
| Plant and Transport | 41 | 38 | (3) |
| Supplies and Services | 1,195 | 1,102 | (93) |
| Investment Managers Fees - Invoiced | 7,120 | 4,586 | (2,534) |
| Other Third Party Payments | 1,375 | 724 | (651) |
| Capital funding - Depreciation | 87 | 84 | (3) |
| Direct Expenditure | 12,919 | 9,184 | (3,735) |
| Support Costs | 300 | 265 | (35) |
| Income | (977) | (1,062) | (85) |
| Total net controllable cost to the Funds | 12,242 | 8,385 | (3,855) |

Reconciliation to total costs

| | Actual outturn |
|---|----------------|
| | £000 |
| Actual outturn on budgeted items above | 8,385 |
| Add back securities lending revenue included in income above | 877 |
| Investment property administration costs | 559 |
| Investment transaction costs | 1,029 |
| Investment management fees deducted from capital | 20,473 |
| Securities lending management fee | 176 |
| IAS19 LPFE retirement benefits | 505 |
| LPFE deferred tax on retirement benefits | (80) |
| Total cost to the Funds (inclusive of full investment management fees) | 31,924 |
| Per Fund Accounts | |
| Lothian Pension Fund group | 29,666 |
| Lothian Buses Pension Fund | 1,978 |
| Scottish Homes Pension Fund | 280 |
| Total | 31,924 |

Cash-flow

Cashflow to and from a pension fund is very dependent upon the profile of its membership. Specifically, a maturing membership, where the proportion of active to deferred and pensioner members is reducing, would be expected to see a reduction in contributions received, together with additional outlays on payments to pensioners.

Significantly, Lothian Pension Fund experienced a net reduction in value from its dealings with members. Despite active membership numbers rising marginally, reflecting pensions auto-enrolment, pensioner numbers increased more significantly, driven mainly by continuing early retirement initiatives by employers. Outlays exceeded receipts by £9.2million representing a £20.6million change in position from 31 March 2016 (net addition of £11.4million).

As a fund which is closed to new entrants, the income and expenditure of Lothian Buses Pension Fund reflect this relative maturity. As at 31 March 2017, outlays from dealing with members remained in excess of receipts, by £2.7million for 2016/17. This represents a change of £1.4million on the position as at 31 March 2016, where net outlays totaled £1.3million. Primarily, this was the result of significant outgoings due to the early payment of retirement benefits.

Scottish Homes Pension Fund is a mature fund with no active members. As a result, pension outlays are met from investment income and funding from the Scottish Government, supplemented by asset sales. Net pension outlays were £6.9million, a decrease of £0.1million (1.4%) on the previous year.

Membership statistics for the three Funds and funding statements from the Actuary are provided in the Fund accounts sections.

Investment management cost transparency

Local authorities are required to account for pension funds in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom (the Code). The Code is based on approved accounting standards issued by the International Accounting Standards Board and interpretations of the International Financial Reporting Interpretations Committee, except where these are inconsistent with specific statutory requirements. The Code also draws on approved accounting standards issued by the International Public Sector Accounting Standards Board and the UK Financial Reporting Council where these provide additional guidance. The Code now requires that preparers have regard to CIPFA guidance "Accounting for Local Government Pension Scheme Management Costs".

CIPFA published this guidance in July 2014, which promoted greater transparency of investment management fees. These principles were adopted as best practice in the presentation of the Lothian Pension Fund audited Annual Report 2015. In June 2016, CIPFA revised its guidance including the following "Investment costs incurred by a separate legal entity, or in respect of investment decisions over which the pension fund has no control, should not be included in the Fund Account." The revised guidance changed the disclosure of fees for fund of funds investment arrangements. A "fund of funds" is an investment holding a portfolio of other investment funds rather than investing directly in funds. Typically fees are payable to the "fund of funds" manager as well as to the managers of the underlying funds. Generally, under the revised guidance from CIPFA, the second and third layer of fees would not be disclosed with just the fees from the "fund of funds" manager stated.

In the preparation of the Funds' Annual Report for 2014/15 and 2015/16, the Funds made efforts to be completely transparent on the totality of costs incurred for managing its investment assets. The Funds disclosures included all layers of fees. At its meeting on 28 September 2016, the Pensions Committee agreed to instruct the Committee Clerk to communicate to the Chartered Institute of Public Finance and Accountancy (CIPFA), Audit Scotland and the Scottish Local Government Pension Scheme Advisory Board (SLGPSAB), the Committee's and Convener's disquiet with the relaxation of the principle of full cost transparency of investment management fees, as explicit in CIPFA's revised guidance "Accounting for Local Government Pension Scheme Management Costs".

On 18 November 2016, the Scottish LGPS Scheme Advisory Board issued Circular 01/2016, entitled "Transparency Code". This stated that it welcomed the "Code of Transparency for LGPS Asset Managers", as developed by its counterpart in England and Wales, and asked "pension funds in Scotland to promote the code with their own asset managers". This Code is voluntary with asset managers encouraged to demonstrate their commitment to transparent reporting of costs. The financial statements of Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund continue, however, to include full transparency of all investment management fees.

| | Investment management expenses in compliance with CIPFA guidance | Investment management expenses per 2016/17 financial statements | Disclosure in excess of CIPFA guidance |
|-----------------------------|---|--|---|
| | £000 | £000 | £000 |
| Lothian Pension Fund | 23,555 | 27,712 | 4,157 |
| Lothian Buses Pension Fund | 1,555 | 1,880 | 325 |
| Scottish Homes Pension Fund | 212 | 212 | 0 |
| TOTAL | 25,322 | 29,804 | 4,482 |

Investment cost benchmarking

In an effort to provide stakeholders with some comfort that the Fund is carefully managing and fully understands investment costs, Lothian Pension Fund provides data to a benchmarking expert for analysis. Investment strategy focuses on risk adjusted returns, net of costs. The Fund has participated in investment cost benchmarking provided by CEM, an independent benchmarking expert for global pension funds with a database of 297 global pension funds representing £5.6 trillion in assets. To provide a fair comparison, CEM calculates a benchmark based on fund size and asset mix, which are key drivers of investment costs.

The latest analysis shows Lothian Pension Fund's investment costs of 0.36% of Fund assets are significantly lower than CEM's benchmark cost of 0.45%, an equivalent annual saving of approximately £4.4m. This saving largely reflects the fact that the Fund manages a relatively high percentage of assets internally compared with other similar pension funds and that it has low exposure to fund-of-fund investment vehicles.

Risk management

The Funds are committed to a strong control environment to ensure that risks are identified, understood, managed and monitored appropriately. The risks faced by the Funds change over time and ongoing management of risk is crucial. The Funds also have a compliance policy and each manager is responsible for ensuring compliance within their area of responsibility.

As at 31 March 2017, the most significant risks (after taking account of risk reduction controls), as assessed using a score out of 10 by the Funds' management team, were as follows:

| Description | Impact | Likelihood | Risk score |
|---|---------------|-------------------|-------------------|
| Adverse investment performance leading to pressure on employer contributions | 5 | 4 | 20 |
| Adverse movement against non-investment funding assumptions leading to pressure on employer contributions | 5 | 7 | 35 |
| Collapse/restructuring of an employer body leading to pressure on other employers | 4 | 8 | 32 |
| Failure of IT leading to poor ICT responsiveness, legal exposure and cost/risk implications. | 6 | 7 | 42 |

Performance

The Funds have a strong commitment to customer service which drives the continual development of our services to ensure the best possible service for customers whilst recognising potential demands of the future. Our vision, objectives and key actions are shown in our service plan along with how we measure their success. Our progress is reported regularly to the Pensions Committee and Pension Board.

In 2016/17 we have delivered the following achievements:

- Received Financial Conduct Authority registration of LPFI Limited
- Begun collaborative working on infrastructure with other LGPS funds
- Achieved Pensions Administration Standards Association accreditation
- Commenced implementation of investment unitisation system
- Continued work to undertake Guaranteed Minimum Pension (GMP) reconciliation with HMRC
- Continued to provide a shared service to Falkirk Pension Fund.

We also measure our performance against a set of behaviours, values and attitudes:



- We put our customers first and aim to provide the very best service
- Our people are at the very heart of our business and we work together to deliver our service
- We strive to improve our services by thinking ahead and developing new solutions
- We are committed to supporting a culture of honesty and transparency.



We put our customers first and aim to provide the very best service.

| | Target | Actual |
|---|--------|----------|
| Maintain Customer Service Excellence Standard | Retain | Retained |
| Overall satisfaction of employers, active members and pensioners with our services as measured by surveys | 88% | 90% |
| Proportion of active members receiving a benefit statement by 31 August 2016 | 100% | 99.6% |

Customer Service Excellence

To maintain our commitment to customer service, we use the Customer Service Excellence (CSE) framework which ensures we are continuously making improvements. We are assessed annually by an external assessor and at our assessment in February 2016, we retained the CSE award for another year. We also gained an additional Compliance Plus award bringing the number held to five for areas such as complaint handling and working with employers.

In 2017, the assessor said, "Lothian Pension Fund has been a long-term holder of both the Charter Mark and CSE standards, and this is clearly shown in the outcome of this year's rolling programme review. The service has continued to show that it consults with its customers and adapts its services to reflect their growing expectations. The approach to complaints resolution continues to be of the highest standard, and the service demonstrated a robust approach to root cause analysis to prevent repetition of failures."

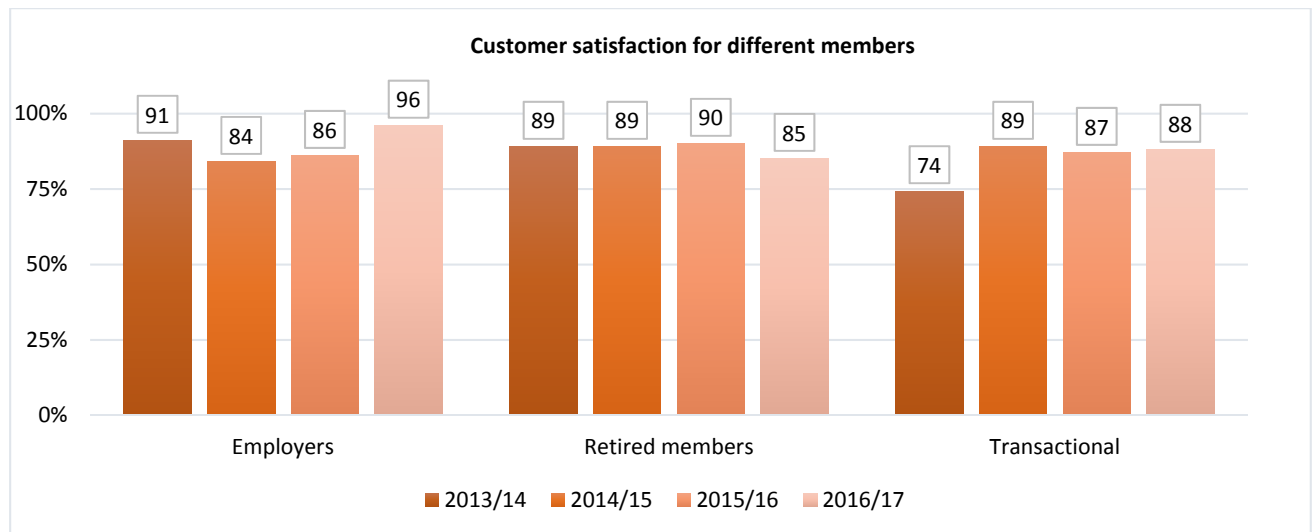
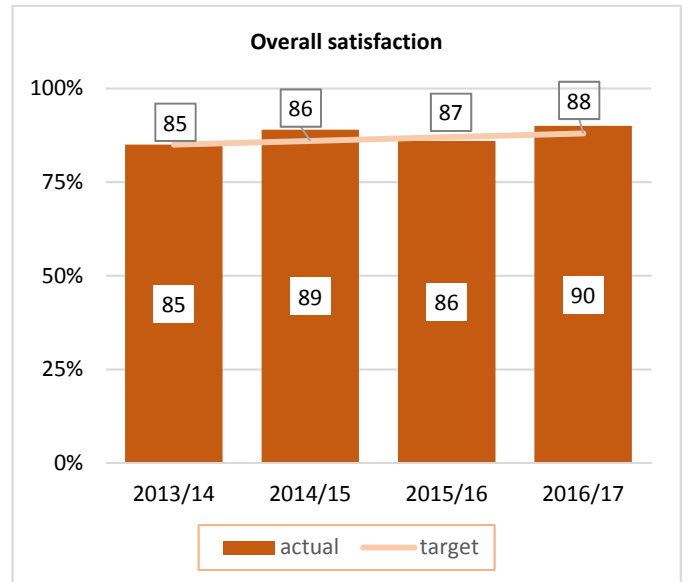


Customer satisfaction

Our overall customer satisfaction has increased steadily over recent years and was 90% in 2016/17, exceeding the target of 88%.

The chart below shows the satisfaction of different customer groups.

We received over 7,300 emails about general pension issues and have worked hard to improve our service provided via email by improving the quality of responses and reducing the time taken to respond. We also received over 6,000 emails about registering for our online service with some members reporting difficulties registering for the service. We have worked with our IT supplier to address these issues.



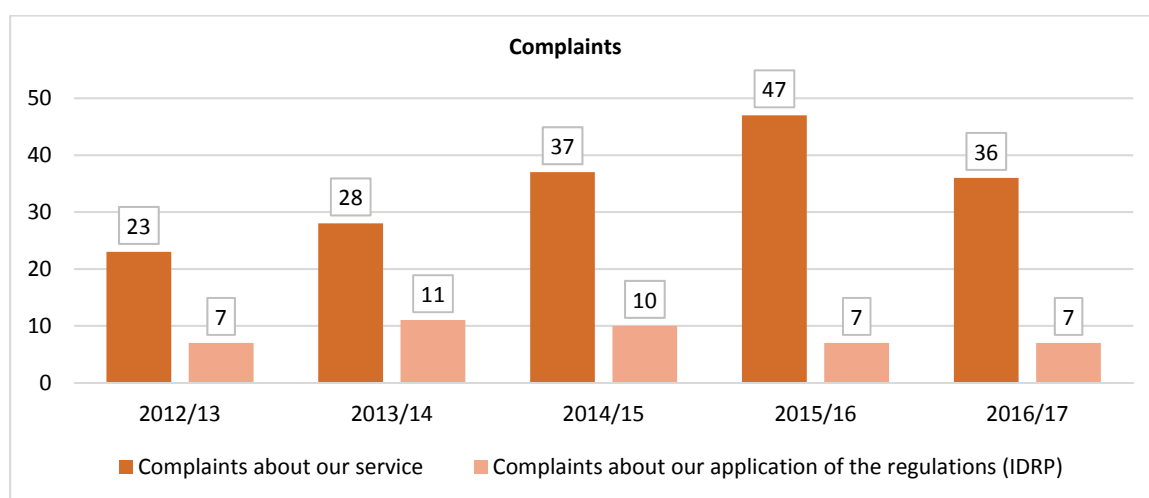
Complaints

We monitor complaints we receive and ensure they are responded to promptly. We investigate and learn from complaints to improve the service. We categorise our complaints in two ways:

- Complaints about our service
- Complaints about our application of the regulations

The graph shows the number of complaints in each of the categories. These represent less than 0.1% percentage of the procedures (over 23,000) we carried out in 2016/17.

The Funds responds, and where possible resolves, complaints within 20 working days. In 2015/16, there was an increase in complaints resulting from delays in processing requests to transfer out of the fund. This year, the number of complaints has reduced and related to a broader range of issues including the differences in pension entitlements, late payment of benefits and changes to the State Pension and ending of contracting out.



Annual benefit statements and data quality

We issued 99.6% of benefit statements by 31 August 2016 meeting The Pension Regulator's target for the issuing benefit statements. A small number of statements were not issued where the member was employed on a casual basis prior to March but did not do any work up to the end of the year. During the year, most employers submitted monthly contribution data to the Funds, leading to cleaner membership data, quicker services to members and fewer queries at the end of the year. Three employers who did not supply data to us monthly had a fine imposed under section 8.2 of our Pensions Administration Strategy.

Along with our employer web portal, introduced to assist with the transfer of data, we have adopted other initiatives to improve member information. We use Tell Us Once, the Department of Work and Pension service which allows the relatives of a person who has died to inform central and local government services of the death all at one time rather than having to contact each service individually. We also participate in specialist longevity and data analyses through "Club Vita", a service provided by the Funds' Actuary. We also carry out quarterly checks with the General Register Office and participate in the National Fraud Initiative. In 2014, we carried out a matching exercise for deferred members where we have lost touch with them. The project is currently being followed up with contact being made where a possible match has been found.

Following the end of contracting-out of the Second State Pension (S2P) on 5 April 2016, pension schemes need to reconcile the Guaranteed Minimum Pension (GMP) values they hold for members with those calculated by HMRC. Schemes will be obliged to pay whatever GMPs are attributed to them, even those that may be incorrectly calculated or have been transferred out. An initial assessment shows 54% of member records matching those of the Government's and reconciliation is underway for the remainder.



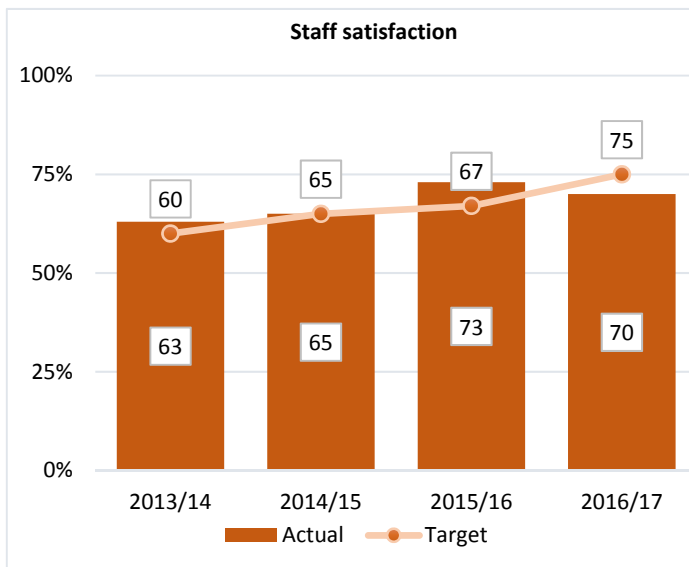
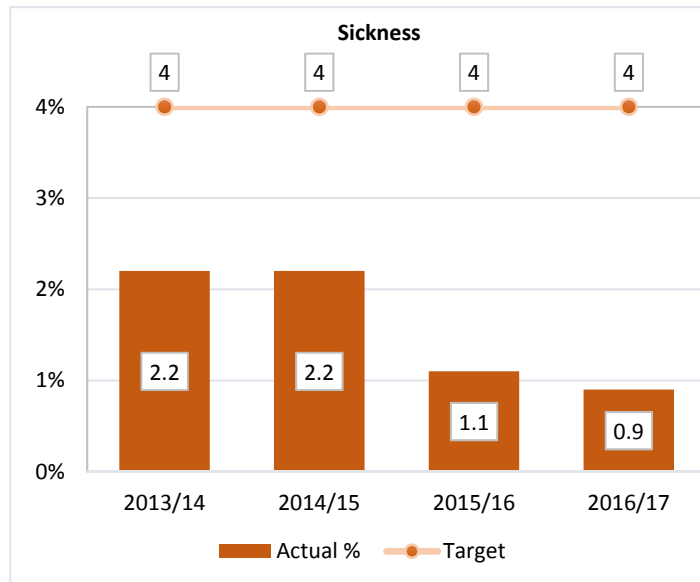
Our people are at the very heart of our business and we work together to deliver our service.

| | Target | Actual |
|--|--------|--------|
| All staff complete at least two days training a year | Yes | Yes |
| Level of sickness absence | 4% | 0.9% |
| Staff survey satisfaction | 75% | 70% |

Over the last financial year, staff participated in regular training. As well as attendance at external seminars and studying for qualifications, we held in-house sessions covering topics such as investments, annual accounts and funding.

The sickness absence rate was very low again at 0.9%.

We also participate in the Modern Apprentice programme, which offers paid employment and workplace training for those who have left school in the past three years, and the Job, Education and Training Programme (JET) for school pupils which is a work-based learning programme which combines school education with vocational training and real-life work experience.



In our annual staff survey in 2016, 96% of staff responded with overall satisfaction decreasing marginally from 73% to 70% which is lower than the target of 75%. The graph shows the comparison figures since 2013/14.

This year's survey also included questions regarding views on collaboration with other pension funds. 86% said they understood the reasons for collaboration and 66% felt that Lothian Pension Fund should look to collaborate with other funds.



We strive to improve our services by thinking ahead and developing new solutions.

| | Target | Actual |
|--|------------------|--------|
| Proportion of critical pensions administration work completed within standards | Greater than 90% | 93% |

Our in-house pension administration team provides a dedicated service for the three pension Funds. We monitor the time taken to complete our procedures. Key procedures include processing of retirement and dependent benefits, providing information for new members, transfers and retirement quotes.

The introduction of the career average pension scheme in April 2015 has meant that pension administration has become more complex for both the Fund and employers. We continue to review our processes to improve our performance so that the Fund can meet new challenges and deliver an excellent service to members.

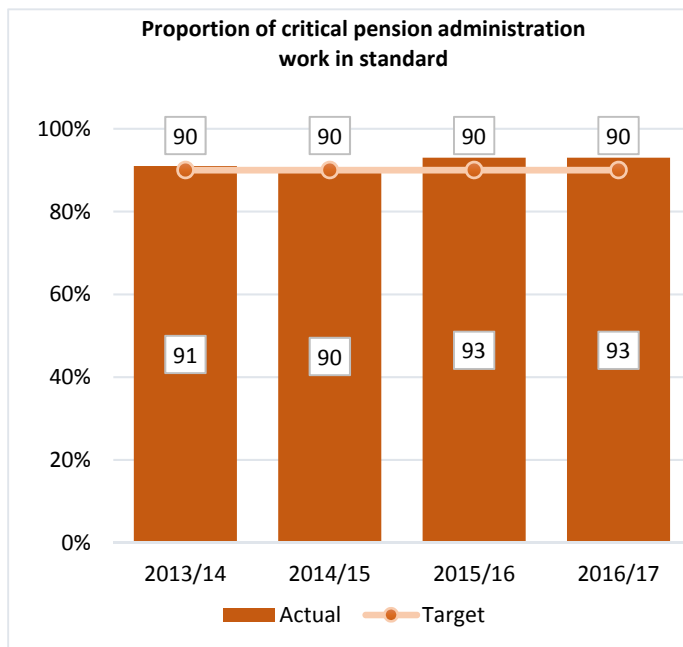
Despite the challenging environment, 93% of key procedures in 2016/17 were completed in target.

The Pensions Administration Strategy sets out the roles and responsibilities of both the Funds and employers specifying the levels of services the parties will provide to each other, and making reference to four key areas where the Funds will pass on the costs of poor performance from employers:

- Late payment of contributions
- Late submission of membership information at the end of the year
- Failure to supply the Funds with information required to provide members with pensions savings statements
- Failure to provide details of member contributions on a monthly basis.

These areas are particularly important to ensure compliance with legislation, including accurate data to administer the new career average pension scheme and the requirement to provide members with a pension forecast by 31 August each year. Charges for late payment of contributions are as stated in the Scheme regulations whilst other charges have been set to reflect the additional time spent in resolving queries and pursuing late information.

The Funds monitors employer performance against the standards set out in the Pension Administration Strategy. Results are reported to employers by way of an annual performance, with more regular reporting for larger employers.



Overall employer performance for 2016/17 is shown below, with 2015/16 shown for comparison purposes.

| Case type | Target (working days) | 2015/16 | | | 2016/17 | | |
|-------------------|-----------------------|-----------------|----------------------|-----------------|-----------------|----------------------|-----------------|
| | | Number received | Number within target | % within target | Number received | Number within target | % within target |
| New members | 20 | 4,653 | 4,074 | 88% | 4,737 | 4,052 | 86% |
| Leavers | 20 | 2,377 | 1,207 | 51% | 3,425 | 1,421 | 42% |
| Retirements | 20 | 1,156 | 398 | 34% | 1,244 | 440 | 35% |
| Deaths in Service | 10 | 40 | 11 | 28% | 29 | 21 | 72% |

The majority of new member information continued to be received within target and the increase in numbers is due to auto-enrolment. Information provided within the 20-day target of the member leaving fell this year. As part of the Fund's drive to improve data, over 1,000 members who had left without the employer supplying details have been targeted within the last six months and we appreciate the support and effort employers have made to address this issue.

Retirement information was provided late than target in a significant proportion of cases and the primary reason for this was due to employers making decisions at short notice for cases such as voluntary redundancy. We have introduced a process for large scale early retirement exercises to handle up to 500 quotes in one quarter with our online facility allowing members to see potential benefits before applying for voluntary redundancy. This has significantly reduced work for both employers and the Funds reducing the numbers who apply speculatively. We also provide voluntary redundancy estimates online and email members the answer to frequently asked questions to help them understand their options.



We are committed to supporting a culture of honesty and transparency.

| | Target | Actual |
|--|---------------------|--------|
| Audit of Annual Report and Financial Statements | Unqualified opinion | Yes |
| Monthly pension payroll paid on time | Yes | Yes |
| Data quality - compliance with best practice as defined by The Pensions Regulator | Fully compliant | YES |
| Contributions received within 19 days of the end of the month to which they relate | 99.0% | 99.3% |

Our 2015/16, Annual Report and Financial Statements were audited by Audit Scotland and received an unqualified audit. The Funds also paid over £216million of pension benefits and lump sums to our members, primarily into the local economy where most of our members live.

Pension record keeping standards are measured against The Pension Regulator’s best practice guidance. The Pension Regulator has amended their guidance and now does not provide a target. However, for this year we have used the target set previously. Significant work has been complete to ensure data is up to date. We have also carried out tracing of members where we do not hold a current address. An action plan to meet the additional guidance going forward will be prepared with overall and individual targets set in the future to give a clear indication of any areas that require further work.

| | Target | Actual |
|--|---------------|---------------|
| Common data | 100% | 99.9% |
| Conditional and numerical data Fund specific measurement including date of joining, pensionable remuneration, date of leaving and reasons for leaving etc. | 98% | 99.9% |

The Pensions Act 1995 requires employers to pay pension contributions by the 19th of the month following the deduction from an employee’s pay. This requirement is highlighted in the Fund’s Pensions Administration Strategy. We monitor this requirement via our key performance indicators to ensure compliance with the Act. The target for 2016/17 year was 99% pension contributions paid in time. 99.3% of contributions by value were paid on time. Of the 1,180 payments made to the Fund in 2016/17, in total 46 were paid later than the target of the 19th of the month. The number of late payments for each employer is provided below.

| Employer | Number of late payments | Employer | Number of late payments |
|----------------------------------|--------------------------------|-------------------------------------|--------------------------------|
| Baxterstorey | 1 | Homes for Life | 1 |
| Canongate Youth [1] | 2 | Keymoves | 1 |
| Centre for Moving Image | 1 | Mitie | 1 |
| Dean Orphanage | 3 | Museums Galleries Scotland | 1 |
| Donaldson Trust | 2 | Open Door Accommodation Project | 1 |
| Edinburgh Leisure | 2 | Pilton Equalities Project | 2 |
| Edinburgh Rape Crisis Centre [1] | 1 | Police Scotland | 2 |
| Edinburgh World Heritage Trust | 1 | Royal Edinburgh Military Tattoo | 2 |
| Enjoy East Lothian | 4 | Scotland’s Learning Partnership [1] | 5 |
| Festival City Theatres Trust [1] | 2 | Scottish Futures Trust | 1 |
| Forth and Oban | 1 | Skanska [1] | 3 |
| Four Square | 1 | Victim Support Scotland | 1 |
| Granton Information Centre | 1 | Visit Scotland | 1 |
| Homeless Action Scotland | 2 | TOTAL | 46 |

[1] includes contributions paid in part

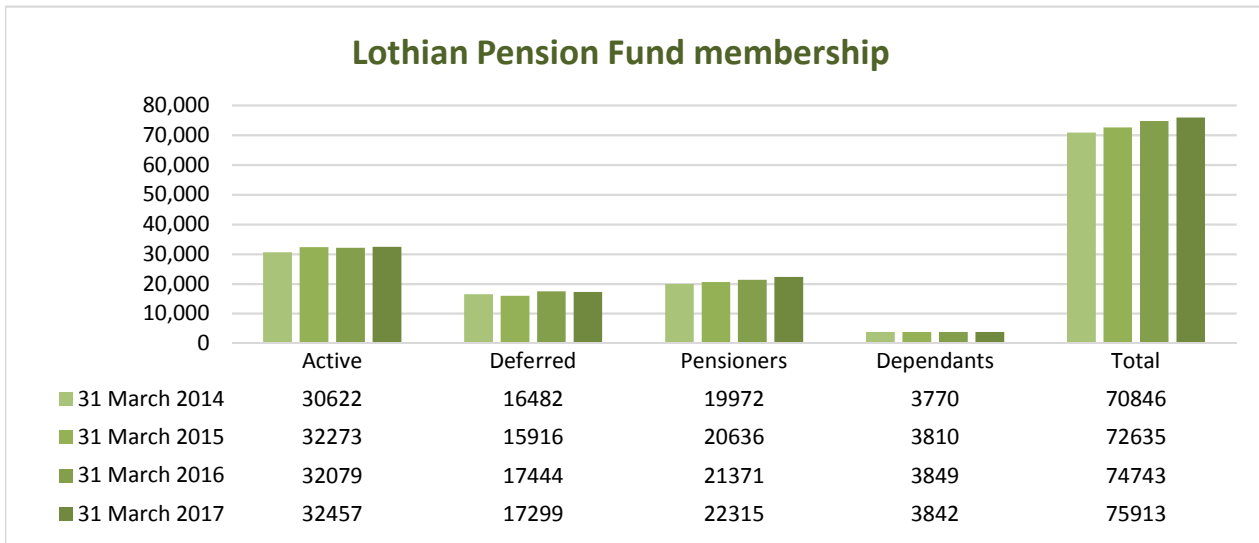
Management commentary approved by:

ANDREW KERR
Chief Executive
The City of Edinburgh Council
27 September 2017

CLARE SCOTT
Chief Executive
Lothian Pension Fund
27 September 2017

JOHN BURNS
Chief Financial Officer
Lothian Pension Fund
27 September 2017

Lothian Pension Fund



Investment Strategy

Following completion of the 2014 Actuarial Valuation, the Investment Strategy Panel and Pensions Committee reviewed the Fund's investment strategy in light of developments in pension fund membership, expected cash flow, funding level, investment risk and returns.

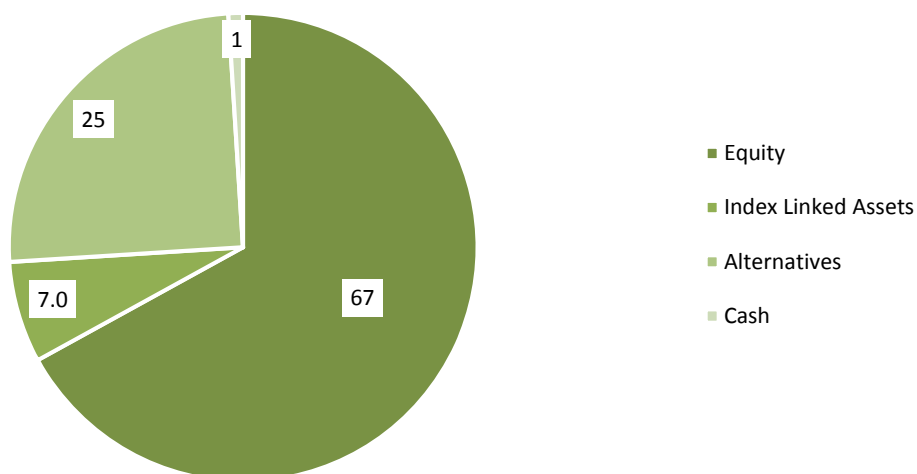
Lothian Pension Fund manages two investment strategies, which provides employers with access to an appropriate level of risk dependent on their individual characteristics (covenant strength, funding position, liability profile and time horizon). Most employer liabilities are funded in Strategy 1, which invests in a diversified portfolio of assets that are expected to generate positive real returns over the long term, but which will be volatile over shorter periods. Employers accounting for less than 1% of the Fund's liabilities are funded on a 'gilts' basis in Strategy 2, which invests in a portfolio of index-linked gilts to minimise risk for these employers.

Following completion of the 2014 Actuarial Valuation, the Fund's Investment Strategy was reviewed. The Pensions Committee agreed in December 2015 that the Investment Strategy 2012-17 remained appropriate for the vast majority of employer liabilities. This strategy, Strategy 1, reduces the allocation to equities (including private equity) from 71.5% at the end of 2012 to 65% by the end of 2017 and increases the allocation to index-linked assets and alternatives. (Alternatives include property, infrastructure, timber and fixed income assets, such as corporate bonds and other debt investments.) The strategy recognises a gradually changing risk profile for the Fund, but retains significant exposure to investments, such as index-linked assets and equities, which have a history of protecting or enhancing purchasing power after the effects of inflation have been taken into account.

The long term strategy for 2012-17 is set out in the table below along with the current interim strategy allocation and the asset allocation limits under normal financial conditions.

| Strategy 1 | Strategic Allocation 31/03/2017 % | Long term Strategy 2012 - 2017 % | Permitted ranges % |
|---------------------|---|--|-----------------------|
| Equities | 66 | 65 | 50 - 75 |
| Index Linked Assets | 7 | 7 | 0 - 20 |
| Alternatives | 26.5 | 28 | 20 - 35 |
| Cash | 0.5 | 0 | 0 - 10 |
| Total | 100 | 100 | n/a |

Actual Asset Allocation (%) at 31 March 2017



The implementation of the Investment Strategy 2012-17 continued to proceed at a measured pace over 2016/17 as investment opportunities became available and as research on opportunities was completed. Progress towards the long term strategy allocation involves the interim strategy allocation and the actual asset allocation changing gradually over time. The pace of change can be accelerated or slowed depending on asset prices, the availability of alternative investments and research conclusions on new investment opportunities.

A key objective of the Fund's investment strategy is to reduce risk, including risk within the equity pool of assets, and has involved a shift from a regional to a global manager structure. Significant steps have been taken in this regard in prior years. As such, 2016/17 represented much more of a "steady state" in terms of the structure within the equity exposure. The only notable change to report over the year was within one of the internally managed regional portfolios. The Europe (ex UK) is being managed using an investment process created by the internal portfolio management team. Almost 90% of the Fund's equities are now managed internally with the majority of these in low cost, low turnover strategies, which are expected to enhance the Fund's risk-adjusted returns over the long term. The Fund continues to outsource a small proportion of investment management services which complement the portfolio strategies employed internally.

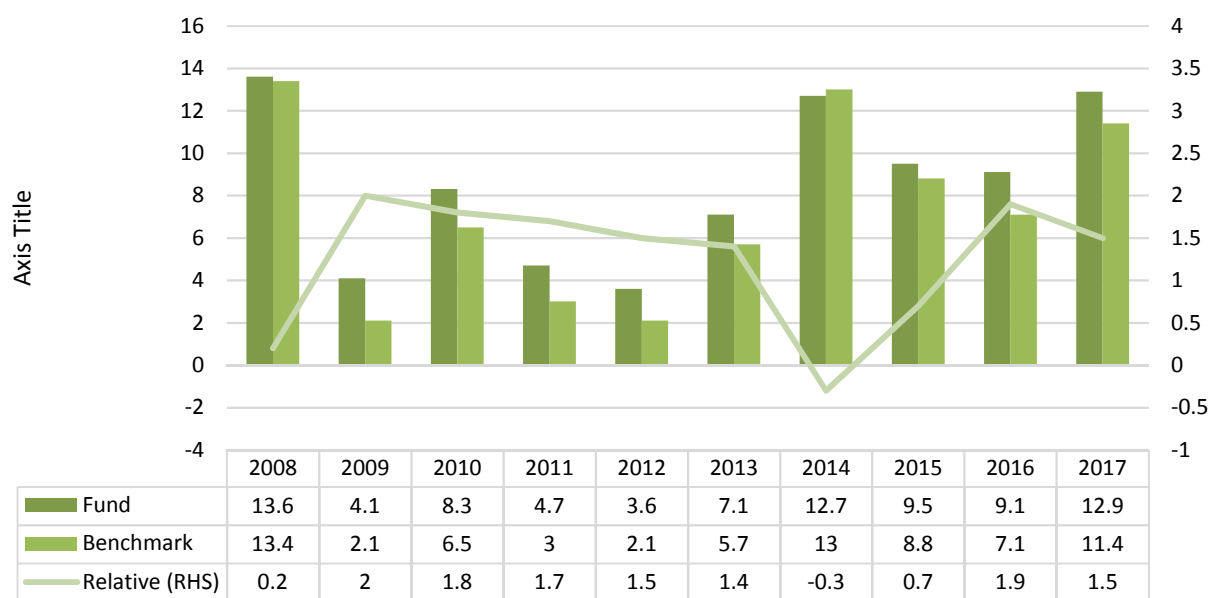
Investment performance

| Annualised returns to 31 March 2017 (% per year) | 1 year | 5 year | 10 years |
|---|--------|--------|----------|
| Lothian Pension Fund - Strategy 1 | 21.7 | 12.9 | 8.2 |
| Benchmark* | 24.8 | 11.4 | 6.6 |
| Lothian Pension Fund - Strategy 2 (from 2015) | 19.9 | - | - |
| Benchmark | 19.9 | - | - |
| Actuarial Valuation Assumptions - Strategy 1 ** | 5.0 | 5.5 | 5.8 |
| Actuarial Valuation Assumptions - Strategy 2 ** | 3.5 | 4.9 | 5.5 |
| Retail Price Index (RPI) | 3.1 | 2.3 | 2.8 |
| Consumer Price Index (CPI) | 2.3 | 1.4 | 2.3 |
| National Average Earnings | 2.4 | 1.9 | 2.0 |

*Comprises equity, index-linked gilts and cash indices as well as an inflation-linked index for the alternatives allocation

**estimated

Annualised 5 yearly returns ending 31 March for Strategy 1 (% per year)



The objectives of the Fund are:

- over long-term economic cycles (typically 5 years or more) the achievement of the same return as that generated by the strategic allocation
- over shorter periods, the Fund should perform better than the strategic allocation if markets fall significantly.

Lothian Pension Fund's assets have increased by £1,161million, with investments returning 21.7% over the year, slightly behind the benchmark of 24.8%. The internal team manages a significant proportion of assets of all three pension funds in-house. For Lothian Pension Fund this includes approximately £3.4billion of listed equity assets and a currency hedging programme specifically designed to provide downside protection in times of market stress while participating in some, though not necessarily all, of any upward movement. The underperformance relative to the benchmark this year follows on from a period of significant outperformance (+6.2%) in the prior year (2015/16) and over longer term periods the Fund is meeting its objective, exceeding the benchmark but with lower volatility.

Returns relative to the benchmark over a one year period need to be placed in the context that there are no ideal benchmarks for many of the assets held in the Fund, especially the Alternatives. The true value and returns on the unlisted investments in the Alternatives portfolio will not be known until assets are realised, perhaps not for several years. Investments are made in Alternative asset classes due to the attractive expected long-term returns and the diversification they provide. Additionally, the low risk equity exposure is specifically designed to provide downside protection in times of market stress while participating in some, though not necessarily all, of any upward movement. It is therefore likely that returns may deviate meaningfully from the benchmark over shorter time periods. The Investment Strategy Panel assesses the underlying risks of the portfolios that make up the asset allocation to ensure that these are consistent with the long-term objectives of the Fund.

Lothian Pension Fund Group

Fund Account for year ended 31 March 2017

This statement shows a summary of the income and expenditure that the Pension Fund has generated and consumed in delivering the Local Government Pension Scheme. Included is the income generated from employers' and employees' contributions and investment income, as well as the cost of providing benefits and administration of the Fund.

| Lothian Pension Fund Parent | Lothian Pension Fund Group | | Lothian Pension Fund Parent | Lothian Pension Fund Group |
|--------------------------------|-------------------------------|--|--------------------------------|-------------------------------|
| 2015/16 | 2015/16 | | 2016/17 | 2016/17 |
| £000 | £000 | Note | £000 | £000 |
| Income | | | | |
| 159,872 | 159,872 | Contributions from employers | 153,735 | 153,735 |
| 42,800 | 42,800 | Contributions from members | 42,578 | 42,578 |
| 2,780 | 2,780 | Transfers from other schemes | 5,536 | 5,536 |
| 205,452 | 205,452 | | 201,849 | 201,849 |
| Less: expenditure | | | | |
| 133,624 | 133,624 | Pension payments including increases | 141,778 | 141,778 |
| 46,315 | 46,315 | Lump sum retirement payments | 48,895 | 48,895 |
| 5,336 | 5,336 | Lump sum death benefits | 6,384 | 6,384 |
| 519 | 519 | Refunds to members leaving service | 615 | 615 |
| 417 | 417 | Premiums to State Scheme | 361 | 361 |
| 6,075 | 6,075 | Transfers to other schemes | 11,098 | 11,098 |
| 1,743 | 1,766 | Administrative expenses | 1,895 | 1,954 |
| 194,029 | 194,052 | | 211,026 | 211,085 |
| 11,423 | 11,400 | Net (withdrawals)/additions from dealing with members | (9,177) | (9,236) |
| Returns on investments | | | | |
| 134,113 | 134,113 | Investment income | 153,016 | 153,016 |
| 216,646 | 216,646 | Change in market value of investments | 1,044,952 | 1,044,952 |
| (34,400) | (34,520) | Investment management expenses | (27,375) | (27,712) |
| 316,359 | 316,239 | Net returns on investments | 1,170,593 | 1,170,256 |
| 327,782 | 327,639 | Net increase in the Fund during the year | 1,161,416 | 1,161,020 |
| 5,106,232 | 5,106,232 | Net assets of the Fund at 1 April 2016 | 5,434,014 | 5,433,871 |
| 5,434,014 | 5,433,871 | Net assets of the Fund at 31 March 2017 | 6,595,430 | 6,594,891 |

Lothian Pension Fund Group

Net Assets Statement as at 31 March 2017

This statement provides a breakdown of type and value of all net assets at the year end.

| Lothian Pension Fund Parent | Lothian Pension Fund Group | | Lothian Pension Fund Parent | Lothian Pension Fund Group |
|--------------------------------|-------------------------------|--|--------------------------------|-------------------------------|
| 31 March 2016 | 31 March 2016 | | 31 March 2017 | 31 March 2017 |
| £000 | £000 | Note | £000 | £000 |
| Investments | | | | |
| 5,413,590 | 5,413,590 | Assets | 6,570,547 | 6,570,547 |
| (14,627) | (14,627) | Liabilities | (1,798) | (1,798) |
| 5,398,963 | 5,398,963 | Net investment assets | 6,568,749 | 6,568,749 |
| | | | | |
| Non current assets | | | | |
| 451 | 451 | Debtors | 259 | 259 |
| 332 | 332 | Computer systems | 248 | 248 |
| - | - | Share Capital | 50 | - |
| - | 36 | Deferred tax | - | 117 |
| 783 | 819 | | 557 | 624 |
| Current assets | | | | |
| 4,287 | 4,287 | The City of Edinburgh Council | 4,467 | 4,467 |
| 41,327 | 41,331 | Cash balances | 27,278 | 27,362 |
| 12,670 | 12,703 | Debtors | 14,938 | 14,965 |
| 58,284 | 58,321 | | 46,683 | 46,794 |
| Non current liabilities | | | | |
| - | (180) | Retirement benefit obligation | - | (685) |
| - | (180) | | - | (685) |
| Current liabilities | | | | |
| (24,016) | (24,052) | Creditors | (20,559) | (20,591) |
| (24,016) | (24,052) | | (20,559) | (20,591) |
| 5,434,014 | 5,433,871 | Net assets of the Fund at 31 March 2017 | 6,595,430 | 6,594,891 |

The unaudited accounts were issued on 28 June 2017 and the audited accounts were authorised for issue on 27 September 2017.

JOHN BURNS FCMA CGMA

Chief Finance Officer, Lothian Pension Fund

27 September 2017

Notes to the net asset statement

The financial statements summarise the transactions of the Fund during the year and its net assets at the year end. They do not take account of the obligations to pay pensions and benefits which fall due after the end of the year. The actuarial position of the Fund, which does take account of such obligations, is discussed in the Actuarial Valuation section of this report and 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.

Notes to the Accounts

1 Statement of Accounting Policies

The statement of accounting policies for all Funds can be found on page 112.

2 Lothian Pension Fund Group

Basis of consolidation, presentation of financial statements and notes

Commencing with the year ended 31 March 2016, Consolidated Financial Statements have been prepared for Lothian Pension Fund. The Financial Statements of Lothian Buses Pension Fund and Scottish Homes Pension Fund continue to be prepared on a single entity basis.

The Consolidated Financial Statements for Lothian Pension Fund are prepared by combining the Financial Statements of the Fund (the parent entity) and its controlled entities (LPFE Limited and LPFI Limited) as defined in accounting standard IAS27 - Consolidated and Separate Financial Statements. Consistent accounting policies are employed in the preparation and presentation of the Consolidated Financial Statements. All inter-entity balances and transactions between entities, including any unrealised profits or losses, have been eliminated on consolidation.

Because the controlled entities activities are primarily focused on the provision of services to the Fund, its consolidation has a limited impact on the figures included in the Fund Account and Net Assets Statement of Lothian Pension Fund. An additional column has been added in both the Fund Account and Net Assets Statement, with the figures prior to consolidation being identified as "Parent" and after consolidation as "Group". In the notes to the accounts, where there is a difference between the parent and group figures they are identified as either "Parent " or "Group".

| Note | Description |
|------|---|
| 28 | Related party transactions and balances Describes transactions during the year and balances at year end which relate to the parent and the companies. |
| 29a | Consolidated Lothian Pension Fund group - LPFE Limited - deferred tax Describes the deferred tax non-current asset of the Company. See 2 f) ii) in the Statement of Accounting Policies and General notes for more information. |
| 29b | Consolidated Lothian Pension Fund group - LPFE Limited and LPFI Limited - share capital Describes the share capital of the Company. |
| 30 | Retirement benefits obligation - group Provides the information on the retirement benefits obligation of the Company as required under IAS19 - Employee Benefits. See 2 q) ii) in the Statement of Accounting Policies and General notes for more information. |

3 Events after the Reporting Date

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

Notes to the Accounts

4 Contributions from employers

The total contributions receivable for the administering authority, other scheduled bodies and admitted bodies were as follows:-

| By category | 2015/16 £000 | 2016/17 £000 |
|-------------------------|-----------------|-----------------|
| Future service rate | 133,035 | 133,301 |
| Past service deficit | 7,357 | 7,668 |
| Strain costs | 9,984 | 12,558 |
| Cessation contributions | 9,496 | 208 |
| | 159,872 | 153,735 |

| By employer type | 2015/16 £000 | 2016/17 £000 |
|-----------------------------|-----------------|-----------------|
| Administering Authority | 63,459 | 63,542 |
| Other Scheduled Bodies | 77,198 | 71,426 |
| Community Admission Bodies | 18,784 | 18,312 |
| Transferee Admission Bodies | 431 | 455 |
| | 159,872 | 153,735 |

Employer contributions, as calculated by the Fund Actuary, comprise two elements:

- An estimate of the cost of benefits accruing in the future, referred to as the "future service rate", which is expressed as a percentage of payroll and;
- an adjustment for the solvency of the Fund based on the benefits already accrued. If there is a surplus, there may be a contribution reduction; if there is a deficit there may be a contribution increase. For all employers, contributions to cover any Past Service Deficit are expressed as a fixed monetary sum, rather than as a percentage of payroll and are payable on a monthly basis that is one twelfth of the annual total.

Where an employer makes certain decisions which result in benefits being paid early, this results in a "strain" on the Fund. The resulting pension strain costs are calculated and recharged in full to that employer.

Any employer that ceases to have at least one actively contributing member is required to pay cessation contributions.

5 Contributions from members

| By employer type | 2015/16 £000 | 2016/17 £000 |
|-----------------------------|-----------------|-----------------|
| Administering Authority | 16,389 | 15,345 |
| Other Scheduled Bodies | 20,226 | 20,993 |
| Community Admission Bodies | 6,074 | 6,099 |
| Transferee Admission Bodies | 111 | 141 |
| | 42,800 | 42,578 |

6 Transfers in from other pension schemes

| | 2015/16 £000 | 2016/17 £000 |
|----------------------|-----------------|-----------------|
| Group transfers | - | - |
| Individual transfers | 2,780 | 5,536 |
| | 2,780 | 5,536 |

Notes to the Accounts

7 Pensions payable

| By employer type | 2015/16 £000 | 2016/17 £000 |
|-----------------------------|-----------------|-----------------|
| Administering Authority | 65,447 | 70,547 |
| Other Scheduled Bodies | 56,115 | 58,364 |
| Community Admission Bodies | 11,902 | 12,687 |
| Transferee Admission Bodies | 160 | 180 |
| | 133,624 | 141,778 |

Local Government (Discretionary Payments and Injury Benefits) (Scotland) Regulations 1998 [Section 31] allows employers to pay additional pensions on a voluntary basis.

As is typical within the Local Government Pension Schemes (LGPS), arrangements exist whereby additional teachers' pensions and employee pensions are paid with the payment of funded pensions. In order that such are not regarded as "unauthorised payments" by HMRC these pension payments are met by the administering authority through a general fund bank account and recharged to the body or service which granted the benefits.

As "unfunded payments" are discretionary benefits, they are not relevant to the sums disclosed in the Fund accounts. As such Lothian Pension Fund provides payment and billing services to certain employers on a no charge agency agreement basis.

8 Lump sum retirement benefits payable

| By employer type | 2015/16 £000 | 2016/17 £000 |
|-----------------------------|-----------------|-----------------|
| Administering Authority | 27,160 | 26,340 |
| Other Scheduled Bodies | 15,336 | 18,503 |
| Community Admission Bodies | 3,685 | 3,900 |
| Transferee Admission Bodies | 134 | 152 |
| | 46,315 | 48,895 |

9 Lump sum death benefits payable

| By employer type | 2015/16 £000 | 2016/17 £000 |
|-----------------------------|-----------------|-----------------|
| Administering Authority | 2,745 | 2,578 |
| Other Scheduled Bodies | 1,964 | 3,312 |
| Community Admission Bodies | 627 | 488 |
| Transferee Admission Bodies | - | 6 |
| | 5,336 | 6,384 |

10 Transfers out to other pension schemes

| | 2015/16 £000 | 2016/17 £000 |
|----------------------|-----------------|-----------------|
| Group transfers | - | 173 |
| Individual transfers | 6,075 | 10,925 |
| | 6,075 | 11,098 |

Notes to the Accounts

11a Administrative expenses

| | LPF Parent 2015/16 £000 | LPF Group 2015/16 £000 | LPF Parent 2016/17 £000 | LPF Group 2016/17 £000 |
|--|----------------------------------|---------------------------------|----------------------------------|---------------------------------|
| Employee Costs | 992 | 994 | 1,093 | 1,098 |
| The City of Edinburgh Council - other support costs | 133 | 133 | 132 | 132 |
| System costs | 228 | 228 | 231 | 231 |
| Actuarial fees | 50 | 50 | 64 | 64 |
| External audit fees | 44 | 44 | 41 | 49 |
| Legal fees | 15 | 15 | 60 | 60 |
| Printing and postage | 77 | 77 | 79 | 79 |
| Depreciation | 57 | 57 | 57 | 57 |
| Office costs | 108 | 108 | 110 | 110 |
| Sundry costs less sundry income | 39 | 39 | 28 | 18 |
| IAS19 retirement benefit adjustments - see note 30 | - | 27 | - | 66 |
| Deferred tax on retirement benefit obligation - see note 29a | - | (6) | - | (10) |
| Corporation tax losses utilised by CEC group - see note 28 | - | - | - | - |
| | 1,743 | 1,766 | 1,895 | 1,954 |

The Investment and Pensions Service of the Council is responsible for administering the three pension Funds. The Service receives an allocation of the overheads of the Council. In turn the Service allocates administration and investment costs to the three pension funds. Costs directly attributable to a specific fund are charged to the relevant Fund, costs that are common to all three funds are allocated on a defined basis. Other costs are allocated on the basis of the number of members in each pension fund.

11b Investment management expenses

| | LPF Parent 2015/16 £000 | LPF Group 2015/16 £000 | LPF Parent 2016/17 £000 | LPF Group 2016/17 £000 |
|---|----------------------------------|---------------------------------|----------------------------------|---------------------------------|
| External management fees - | | | | |
| invoiced | 7,123 | 7,123 | 3,970 | 3,970 |
| deducted from capital (direct investment) | 15,603 | 15,603 | 15,245 | 15,245 |
| deducted from capital (indirect investment) | 6,775 | 6,775 | 4,157 | 4,157 |
| Securities lending fees | 212 | 212 | 155 | 155 |
| Transaction costs - Equities | 2,201 | 2,201 | 956 | 956 |
| Property operational costs | 497 | 497 | 558 | 558 |
| Employee costs | 961 | 963 | 1,116 | 1,149 |
| Custody fees | 304 | 304 | 300 | 300 |
| Engagement and voting fees | 76 | 76 | 82 | 82 |
| Performance measurement fees | 46 | 46 | 50 | 50 |
| Consultancy fees | 78 | 78 | 64 | 64 |
| System costs | 185 | 185 | 245 | 245 |
| Legal fees | 103 | 103 | 210 | 210 |
| The City of Edinburgh Council - other support costs | 124 | 124 | 111 | 111 |
| Depreciation | 7 | 7 | 7 | 7 |
| Office costs | 71 | 71 | 85 | 85 |
| Sundry costs less sundry income | 34 | 34 | 64 | (1) |
| IAS19 retirement benefit adjustments - see note 30 | - | 153 | - | 439 |
| Deferred tax on retirement benefit obligation - see note 29 | - | (30) | - | (70) |
| Corporation tax losses utilised by CEC group - see note 28 | - | (5) | - | - |
| | 34,400 | 34,520 | 27,375 | 27,712 |

Notes to the Accounts

11b Investment management expenses (cont)

Investment costs directly attributable to a specific fund are charged to the relevant Fund, costs that are common to all three funds are allocated based on the value of the Funds as at the year end.

Any indirect costs incurred through the bid-offer spread on some pooled investment vehicles are reflected in the cost of investment acquisitions or in the proceeds of investment sales (see note 14 - Reconciliation of movements in investments and derivatives).

The external investment management fees (deducted from capital) above include £4.0m (£3.9m direct, £0.1m indirect) in respect of performance-related fees compared to £12.0m in 2015/16 (£7.9m direct, £4.1m indirect).

It should be noted that Lothian Pension Funds disclosure on investment management fees goes further than CIPFA's LGPS Management Cost revised guidance on cost transparency which came into effect from 1st April 2016. Consistent with previous years, the Fund recognises fees deducted from investments not within its direct control (such as fund of fund fees) to give a full picture of its investment management costs. Further details can be found on page 19. This further disclosure highlights an extra £4.2m in costs (2016 £6.8m).

11c Total management expenses

| | LPF Parent 2015/16 £000 | LPF Group 2015/16 £000 | LPF Parent 2016/17 £000 | LPF Group 2016/17 £000 |
|--------------------------------|----------------------------------|---------------------------------|----------------------------------|---------------------------------|
| Administrative costs | 1,570 | 1,582 | 1,686 | 1,719 |
| Investment management expenses | 32,814 | 32,900 | 26,345 | 26,592 |
| Oversight and governance costs | 1,759 | 1,804 | 1,239 | 1,355 |
| | 36,143 | 36,286 | 29,270 | 29,666 |

In accordance with CIPFA, the above analysis looks at the combined administration and investment management expenses in note 11a and b and splits out the costs to include a third heading covering oversight and governance expenditure.

12 Investment income

| | 2015/16 £000 | 2016/17 £000 |
|--|-----------------|-----------------|
| Income from fixed interest securities | 3,898 | 3,589 |
| Dividends from equities | 94,637 | 120,326 |
| Unquoted private equity and infrastructure | 13,581 | 5,646 |
| Income from pooled investment vehicles | 1,026 | 1,111 |
| Gross rents from properties | 20,914 | 23,085 |
| Interest on cash deposits | 1,237 | 597 |
| Stock lending and sundries | 1,142 | 775 |
| | 136,435 | 155,129 |
| Irrecoverable withholding tax | (2,322) | (2,113) |
| | 134,113 | 153,016 |

Notes to the Accounts

13 Net investment assets

| | Region | 31 March 2016 £000 | 31 March 2017 £000 |
|---|----------|-----------------------|-----------------------|
| Investment Assets | | | |
| Bonds | | | |
| Public sector fixed interest | Overseas | 153,740 | - |
| Public sector fixed interest | UK | - | 156,876 |
| Public sector index linked gilts quoted | UK | 380,290 | 502,439 |
| | | 534,030 | 659,315 |
| Equities | | | |
| Quoted | UK | 561,064 | 655,522 |
| Quoted | Overseas | 2,887,886 | 3,564,953 |
| | | 3,448,950 | 4,220,475 |
| Pooled investment vehicles | | | |
| Private equity, infrastructure, private debt & timber | UK | 165,547 | 457,647 |
| Private equity, infrastructure, private debt & timber | Overseas | 550,617 | 556,623 |
| Property | UK | 82,453 | 67,969 |
| Other | UK | 17,275 | 19,191 |
| | | 815,892 | 1,101,430 |
| Properties | | | |
| Direct property | UK | 356,281 | 356,741 |
| | | 356,281 | 356,741 |
| Derivatives | | | |
| Derivatives - forward foreign exchange | | - | 1,081 |
| | | - | 1,081 |
| Cash deposits | | | |
| Deposits | | 227,409 | 216,036 |
| | | 227,409 | 216,036 |
| Other investment assets | | | |
| Due from broker | | 18,648 | 1,320 |
| Dividends and other income due | | 12,380 | 14,521 |
| | | 31,028 | 15,841 |
| Total investment assets | | 5,413,590 | 6,570,919 |
| Investment liabilities | | | |
| Derivatives | | | |
| Derivatives - forward foreign exchange | | (13,183) | (424) |
| | | (13,183) | (424) |
| Other financial liabilities | | | |
| Due to broker | | (1,444) | (1,746) |
| | | (1,444) | (1,746) |
| Total investment liabilities | | (14,627) | (2,170) |
| Net investment assets | | 5,398,963 | 6,568,749 |

Notes to the Accounts

14a Reconciliation of movement in investments and derivatives

| | Market value at 31 March 2016 £000 | Purchases at cost & derivative payments £000 | Sale & derivative receipts £000 | Change in market value £000 | Market value at 31 March 2017 £000 |
|---|---------------------------------------|---|------------------------------------|--------------------------------|---------------------------------------|
| Bonds | 534,030 | 596,611 | (595,768) | 124,442 | 659,315 |
| Equities | 3,448,949 | 591,687 | (573,782) | 753,621 | 4,220,475 |
| Pooled investment vehicles | 815,893 | 266,289 | (140,168) | 159,416 | 1,101,430 |
| Property | 356,280 | 4,675 | (2,358) | (1,856) | 356,741 |
| Derivatives - futures | - | (484) | (7,113) | 7,597 | - |
| Derivatives - forward foreign exchange | (13,183) | 42,385 | (8,823) | (19,722) | 657 |
| | 5,141,969 | 1,501,163 | (1,328,012) | 1,023,498 | 6,338,618 |
| Other financial assets / liabilities | | | | | |
| Margin balances | - | | | - | - |
| Cash deposits | 227,409 | | | 21,837 | 216,036 |
| Broker balances | 17,205 | | | (383) | (426) |
| Dividend due etc | 12,380 | | | - | 14,521 |
| | 256,994 | | | 21,454 | 230,131 |
| Net financial assets | 5,398,963 | | | 1,044,952 | 6,568,749 |

The change in market value of investments during the year comprises all increases and decreases in the market value of investments held at any time during the year, including profits and losses realised on sales of investments during the year.

Any indirect costs incurred through the bid-offer spread on some pooled investment vehicles are reflected in the cost of investment acquisitions and in the proceeds from sales and are therefore included in the tables above.

| | Market value at 31 March 2015 £000 | Purchases at cost & derivative payments £000 | Sale & derivative receipts £000 | Change in market value £000 | Market value at 31 March 2016 £000 |
|---|---------------------------------------|---|------------------------------------|--------------------------------|---------------------------------------|
| Bonds | 414,330 | 308,910 | (202,855) | 13,645 | 534,030 |
| Equities | 3,267,975 | 1,256,575 | (1,143,580) | 67,979 | 3,448,949 |
| Pooled investment vehicles | 633,040 | 141,787 | (81,080) | 122,146 | 815,893 |
| Property | 316,169 | 25,153 | (2,295) | 17,253 | 356,280 |
| Derivatives - futures | - | 5 | 87 | (92) | - |
| Derivatives - forward foreign exchange | 29,800 | 4,316 | (40,895) | (6,404) | (13,183) |
| | 4,661,314 | 1,736,746 | (1,470,618) | 214,527 | 5,141,969 |
| Other financial assets / liabilities | | | | | |
| Margin balances | - | | | - | - |
| Cash deposits | 400,497 | | | 1,751 | 227,409 |
| Broker balances | (384) | | | 368 | 17,205 |
| Dividend due etc | 11,157 | | | - | 12,380 |
| | 411,270 | | | 2,119 | 256,994 |
| Net financial assets | 5,072,584 | | | 216,646 | 5,398,963 |

Notes to the Accounts

14d Reconciliation of fair value measurements within level 3

| | Market value at 31 March 2016 | Level 3 transfers | | Purchases at cost & derivative payments | Sales & derivative receipts | Unrealised gains / (losses) | Realised gains / (losses) | Market value at 31 March 2017 |
|---------------------------|-------------------------------|-------------------|-----|---|-----------------------------|-----------------------------|---------------------------|-------------------------------|
| | | in | out | | | | | |
| Pooled investments | | | | | | | | |
| Infrastructure | 384,028 | - | - | 260,926 | (57,620) | 63,921 | 11,939 | 663,194 |
| Property | 64,743 | - | - | 5,492 | (25,306) | (19,320) | 19,811 | 45,420 |
| Private Equity | 168,904 | - | - | 6,939 | (72,534) | (30,882) | 56,884 | 129,311 |
| Timber | 125,313 | - | - | - | (11,956) | 2,491 | 16,684 | 132,532 |
| Private debt | 37,919 | - | - | 52,535 | (3,866) | 23 | 2,622 | 89,233 |
| Freehold Property | 348,375 | - | - | 3,955 | - | (1,832) | - | 350,498 |
| Unlisted equity | 566 | - | - | - | - | - | (566) | - |
| | 1,129,848 | - | - | 329,847 | (171,282) | 14,401 | 107,374 | 1,410,188 |

Unrealised and realised gains and losses are recognised in the profit and losses on disposal and changes in the market value of investments line of the fund account.

15 Derivatives - forward foreign exchange

Summary of contracts held at 31 March 2017

| Contract settlement within | Currency bought | Currency sold | Local currency bought 000 | Local currency sold 000 | Asset value £000 | Liability value £000 |
|----------------------------|-----------------|---------------|------------------------------|----------------------------|---------------------|-------------------------|
| Up to one month | GBP | AUD | 54,622 | 90,014 | - | (261) |
| Up to one month | GBP | CAD | 99,825 | 164,694 | 1,081 | - |
| Up to one month | CAD | GBP | 4,872 | 3,033 | - | (112) |
| Up to one month | USD | JPY | 28 | 3,116 | - | - |
| One to six months | USD | AUD | 868 | 1,186 | - | (29) |
| One to six months | USD | CHF | 4,154 | 4,143 | - | (22) |

Open forward currency contracts at 31 March 2017

| | |
|-------|-------|
| 1,081 | (424) |
|-------|-------|

Net forward currency contracts at 31 March 2017

| |
|-----|
| 657 |
|-----|

Prior year comparative

Open forward currency contracts at 31 March 2016

| | |
|---|----------|
| - | (13,183) |
|---|----------|

Net forward currency contracts at 31 March 2016

| |
|----------|
| (13,183) |
|----------|

The above table summarises the contracts held by maturity date, all contracts are traded on an over-the-counter basis.

In order to maintain appropriate diversification of investments in the portfolio and take advantage of wider opportunities, the Lothian Pension Fund invests over half of the fund in overseas markets. A currency hedging programme, using forward foreign exchange contracts, has been put in place to reduce the extent to which the Fund is exposed to certain currency movements.

Notes to the Accounts

16 Investment managers and mandates

| Manager | Mandate | Market value at 31 March 2016 £000 | % of total 31 March 2016 % | Market value at 31 March 2017 £000 | % of total 31 March 2017 % |
|--|-------------------------|--|-------------------------------------|--|-------------------------------------|
| In-house | UK all cap equities | 106,884 | 2.0 | 130,362 | 2.0 |
| In-house | UK mid cap equities | 105,980 | 2.0 | 121,061 | 1.8 |
| Total UK equities | | 212,864 | 4.0 | 251,423 | 3.8 |
| In-house | European ex UK equities | 105,479 | 2.0 | 120,393 | 1.8 |
| In-house | US equities | 117,119 | 2.2 | 150,941 | 2.3 |
| Total regional overseas equities | | 222,598 | 4.2 | 271,334 | 4.1 |
| In-house | Global high dividend | 759,254 | 14.1 | 928,720 | 14.1 |
| In-house | Global low volatility | 966,835 | 17.8 | 1,162,921 | 17.7 |
| In-house | Global value | 824,967 | 15.2 | 985,286 | 15.0 |
| Harris | Global equities | 186,652 | 3.5 | 263,263 | 4.0 |
| Nordea | Global equities | 223,912 | 4.1 | 280,815 | 4.3 |
| Total global equities | | 2,961,620 | 54.7 | 3,621,005 | 55.1 |
| In-house | Currency hedge | (12,370) | (0.2) | 708 | - |
| Total currency overlay | | (12,370) | (0.2) | 708 | - |
| Total listed equities | | 3,384,712 | 62.6 | 4,144,470 | 63.0 |
| In-house | Private equity unquoted | 168,904 | 3.1 | 129,311 | 2.0 |
| In-house | Private equity quoted | 57,145 | 1.1 | 75,902 | 1.2 |
| Total private equity | | 226,049 | 4.2 | 205,213 | 3.2 |
| Total equity | | 3,610,761 | 66.8 | 4,349,683 | 66.2 |
| In-house | Index linked gilts | 357,163 | 6.6 | 450,833 | 6.9 |
| In-house | Gold | 17,020 | 0.3 | 19,652 | 0.3 |
| Total inflation linked bonds and gold | | 374,183 | 6.9 | 470,485 | 7.2 |
| In-house | Property | 50,003 | 0.9 | 38,038 | 0.6 |
| Standard Life | Property | 422,452 | 7.8 | 414,574 | 6.3 |
| Total property | | 472,455 | 8.7 | 452,612 | 6.9 |
| In-house | Infrastructure unquoted | 384,028 | 7.1 | 663,194 | 10.1 |
| In-house | Infrastructure quoted | 30,060 | 0.6 | 23,548 | 0.4 |
| In-house | Timber | 125,313 | 2.3 | 132,532 | 2.0 |
| Total other real assets | | 539,401 | 10.0 | 819,274 | 12.5 |
| In-house | Secured loans | 13,770 | 0.3 | 14,142 | 0.2 |
| In-house | Treasury bills | 134,399 | 2.5 | - | 0.0 |
| In-house | Private debt | 37,918 | 0.7 | 89,233 | 1.4 |
| In-house | Other bonds | - | 0.0 | 159,307 | 2.4 |
| Total other bonds | | 186,087 | 3.5 | 262,682 | 4.0 |

Notes to the Accounts

16 Investment managers and mandates (cont)

| Manager | Mandate | Market value at 31 March 2016 £000 | % of total 31 March 2016 % | Market value at 31 March 2017 £000 | % of total 31 March 2017 % |
|------------------------------------|-----------------------|--|-------------------------------------|--|-------------------------------------|
| In-house | Cash | 137,886 | 2.6 | 159,645 | 2.4 |
| In-house | Transitions | 32,905 | 0.6 | 92 | 0.0 |
| Total cash and sundries | | 170,791 | 3.2 | 159,737 | 2.4 |
| Strategy A financial assets | | 5,353,678 | 99.2 | 6,514,473 | 99.2 |
| In-house | Mature employer gilts | 45,285 | 0.8 | 54,276 | 0.8 |
| Strategy B financial assets | | 45,285 | 0.8 | 54,276 | 0.8 |
| Net financial assets | | 5,398,963 | 100.0 | 6,568,749 | 100.0 |

17 Investments representing more than 5% of the net assets of the Fund or 5% of any investment class

| | Market value at 31 March 2016 £000 | % of asset class 31 March 2016 | Market value at 31 March 2017 £000 | % of asset class 31 March 2017 |
|-------------------------------------|--|---|--|---|
| Bonds | | | | |
| UK Gov 1.5% Senior Gilt 22/07/26 | - | - | 156,875 | 23.8 |
| UK Gov 1.125% Index Linked 22/11/37 | 29,311 | 5.5 | 78,952 | 12.0 |
| UK Gov 0.125% Index Linked 22/03/44 | 47,630 | 8.9 | 62,332 | 9.5 |
| UK Gov 0.125% Index Linked 22/03/68 | 36,048 | 6.8 | 50,312 | 7.6 |
| UK Gov 1.25% Index Linked 22/11/55 | 41,499 | 7.8 | 49,488 | 7.5 |
| UK Gov 0.125% Index Linked 22/03/58 | 34,099 | 6.4 | 39,287 | 6.0 |
| UK Gov 1.25% Index Linked 22/11/32 | - | - | 34,847 | 5.3 |
| UK Gov 0.625% Index Linked 22/03/40 | - | - | 33,551 | 5.0 |
| UK Gov 1.25% Index Linked 22/03/50 | - | - | 32,615 | 5.0 |
| US Treasury Bill 0.375% 31/05/16 | 133,396 | 25.0 | - | - |
| Pooled funds | | | | |
| Stafford Elm Inc | 45,094 | 5.5 | 50,421 | 4.6 |
| Macquarie Infrastructure A & B LP | 43,748 | 5.4 | 51,480 | 4.7 |
| Property | | | | |
| London, 119-125 Wardour St | 28,050 | 7.9 | 27,100 | 7.6 |
| Martlesham Heath, Retail Park | 24,650 | 6.9 | 24,250 | 6.8 |
| London, 100 St John Street | 22,500 | 6.3 | 21,000 | 5.9 |
| Sheffield, Bochum Parkway | 19,850 | 5.6 | 20,200 | 5.7 |
| Exeter, David Lloyd Leisure | 17,875 | 5.0 | 18,825 | 5.3 |

Over the last two years no single investment represented more than 5% of the net assets of the Fund.

Notes to the Accounts

18 Securities lending

During the year Lothian Pension Fund participated in a securities lending arrangement with the Northern Trust Company. As at 31 March 2017, £220.3m (2016 £49.8m) of securities were released to third parties. Collateral valued at 104.6% (2016 107.6%) of the market value of the securities on loan was held at that date.

19 Property holdings

| | 2015/16 £000 | 2016/17 £000 |
|----------------------------|-----------------|-----------------|
| Opening balance | 316,169 | 356,280 |
| Additions | 25,153 | 4,675 |
| Disposals | (2,295) | (2,358) |
| Net change in market value | 17,253 | (1,856) |
| Closing balance | 356,280 | 356,741 |

As at 31 March 2017, there were no restrictions on the realisability of the property or the remittance of income or sale proceeds. The Fund is not under any contractual obligations to purchase or construct any of these properties. However, at year end the Fund does have funding approval in place for the development of Waterfront North Leisure Park, Walsall. The build period is 26 weeks, with practical completion anticipated in July 2017.

The future minimum lease payments receivable by the Fund are as follows

| | 2015/16 £000 | 2016/17 £000 |
|----------------------------|-----------------|-----------------|
| Within one year | 22,018 | 22,526 |
| Between one and five years | 67,158 | 67,195 |
| Later than five years | 94,517 | 99,741 |
| | 183,693 | 189,462 |

20 Financial Instruments

20a Classification of financial instruments

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

All financial instruments are marked to market (at fair value) in the Fund's accounting records, hence there is no difference between the carrying value and fair value.

Notes to the Accounts

20a Classification of financial instruments (cont)

Classification of financial instruments - parent

| | 31 March 2016 | | | 31 March 2017 | | |
|---|--|--------------------------|---|--|--------------------------|---|
| | Designated as fair value through fund account | Loans and receivables | Financial liabilities at amortised cost | Designated as fair value through fund account | Loans and receivables | Financial liabilities at amortised cost |
| | £000 | £000 | £000 | £000 | £000 | £000 |
| Investment assets | | | | | | |
| Bonds | 534,030 | - | - | 659,316 | - | - |
| Equities | 3,448,950 | - | - | 4,220,475 | - | - |
| Pooled investments | 815,892 | - | - | 1,101,430 | - | - |
| Property Leases | 7,905 | - | - | 6,243 | - | - |
| Derivative contracts | - | - | - | 1,081 | - | - |
| Margin balances | - | - | - | - | - | - |
| Cash | - | 227,409 | - | - | 216,036 | - |
| Other balances | - | 31,029 | - | - | 15,841 | - |
| | 4,806,777 | 258,438 | - | 5,988,545 | 231,877 | - |
| Other assets | | | | | | |
| City of Edinburgh Council | - | 4,287 | - | - | 4,467 | - |
| Cash | - | 41,327 | - | - | 27,278 | - |
| Share Capital | - | - | - | - | 50 | - |
| Debtors - current | - | 12,670 | - | - | 14,937 | - |
| Debtors - non-current | - | 451 | - | - | 259 | - |
| | - | 58,735 | - | - | 46,991 | - |
| Assets total | 4,806,777 | 317,173 | - | 5,988,545 | 278,868 | - |
| Financial liabilities | | | | | | |
| Investment liabilities | | | | | | |
| Derivative contracts | (13,183) | - | - | (424) | - | - |
| Other investment balances | (1,444) | - | - | (1,746) | - | - |
| | (14,627) | - | - | (2,170) | - | - |
| Other liabilities | | | | | | |
| Creditors | - | - | (24,016) | - | - | (20,559) |
| Liabilities total | (14,627) | - | (24,016) | (2,170) | - | (20,559) |
| Total net assets | 4,792,150 | 317,173 | (24,016) | 5,986,375 | 278,868 | (20,559) |
| Total net financial instruments | | | 5,085,307 | | | 6,244,684 |
| Amounts not classified as financial instruments | | | 348,707 | | | 350,746 |
| Total net assets - parent | | | 5,434,014 | | | 6,595,430 |

Notes to the Accounts

20a Classification of financial instruments (cont)

Classification of financial instruments - adjustments to parent to arrive at group

| | 31 March 2016 | | | 31 March 2017 | | |
|---|--|--------------------------|---|--|--------------------------|---|
| | Designated as fair value through fund account | Loans and receivables | Financial liabilities at amortised cost | Designated as fair value through fund account | Loans and receivables | Financial liabilities at amortised cost |
| | £000 | £000 | £000 | £000 | £000 | £000 |
| Other assets | | | | | | |
| Cash | - | 4 | - | - | 84 | - |
| Share Capital | - | - | - | - | (50) | - |
| Debtors - current | - | 33 | - | - | 27 | - |
| Debtors - non-current | - | 36 | - | - | 117 | - |
| | - | 73 | - | - | 178 | - |
| Assets total | - | 73 | - | - | 178 | - |
| Other liabilities | | | | | | |
| Retire. benefit obligation | - | - | (180) | - | - | (685) |
| Creditors | - | - | (36) | - | - | (32) |
| Liabilities total | - | - | (216) | - | - | (717) |
| Total net assets | - | 73 | (216) | - | 178 | (717) |
| Total adjustments to net financial instruments | | | (143) | | | (539) |
| Total net assets - group | | | 5,433,871 | | | 6,594,891 |

20b Net gains and losses on financial instruments

| | 2015/16 | 2016/17 |
|---|---------|-----------|
| | £000 | £000 |
| Designated as fair value through fund account | 197,274 | 1,025,354 |
| Loans and receivables | 2,119 | 21,454 |
| Financial liabilities at amortised cost | - | - |
| Total | 199,393 | 1,046,808 |
| Gains and losses on directly held freehold property | 17,253 | (1,856) |
| Change in market value of investments per fund account | 216,646 | 1,044,952 |

20c Fair Value Hierarchy

The valuation of financial instruments has been classified into three levels, according to the quality and reliability of information used to determine fair values.

Level 1

Financial instruments 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 and unit trusts.

Quoted investments are shown at bid prices. The bid value of the investment is based on the bid market quotation of the relevant stock exchange.

Notes to the Accounts

20c Fair Value Hierarchy (cont)

Level 2

Financial instruments 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 and where these techniques use inputs that are based significantly on observable market data.

Level 3

Financial instruments 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. Such instruments would include unquoted equity investments, which are valued using various valuation techniques that require significant judgement in determining appropriate assumptions.

The values of the investments in unquoted private equity, infrastructure, timber and European real estate are based on valuations provided by the general partners to the funds in which the Fund has invested.

These valuations are prepared in accordance with the International Private Equity and Venture Capital Valuation Guidelines or similar guidelines provided by the British Venture Capital Association, which follow the valuation principles of International Financial Reporting Standards (IFRS). The valuations are typically undertaken annually at the end of December. Cash flow adjustments are used to roll forward the valuations to 31 March as appropriate.

| | 31 March 2017 | | | |
|--|------------------|-----------------|------------------|------------------|
| | Level 1 £000 | Level 2 £000 | Level 3 £000 | Total £000 |
| Investment assets | | | | |
| Designated as fair value through fund account | 4,269,539 | 659,316 | 1,059,690 | 5,988,545 |
| Non-financial assets at fair value through profit and loss | - | - | 350,498 | 350,498 |
| Loans and receivables | 231,877 | - | - | 231,877 |
| Total investment assets | 4,501,416 | 659,316 | 1,410,188 | 6,570,920 |
| Investment liabilities | | | | |
| Designated as fair value through fund account | (2,171) | - | - | (2,171) |
| Total investment liabilities | (2,171) | - | - | (2,171) |
| Net investment assets | 4,499,245 | 659,316 | 1,410,188 | 6,568,749 |

| | 31 March 2016 | | | |
|--|------------------|-----------------|------------------|------------------|
| | Level 1 £000 | Level 2 £000 | Level 3 £000 | Total £000 |
| Investment assets | | | | |
| Designated as fair value through fund account | 3,491,275 | 534,030 | 781,472 | 4,806,777 |
| Non-financial assets at fair value through profit and loss | - | - | 348,375 | 348,375 |
| Loans and receivables | 258,438 | - | - | 258,438 |
| Total investment assets | 3,749,713 | 534,030 | 1,129,847 | 5,413,590 |
| Investment liabilities | | | | |
| Designated as fair value through fund account | (14,627) | - | - | (14,627) |
| Total investment liabilities | (14,627) | - | - | (14,627) |
| Net investment assets | 3,735,086 | 534,030 | 1,129,847 | 5,398,963 |

Notes to the Accounts

21 Nature and extent of risk arising from financial instruments

Risk and risk management

The Fund's primary aim is to ensure that all members and their dependants receive their benefits when they become payable. Investment strategy A aims to maximise the returns from investments within reasonable risk parameters and hence minimise the long-term cost to employers. It achieves this by investing in a diverse range of assets to reduce risk to an acceptable level. In addition, the Fund ensures that sufficient cash is available to meet all liabilities when they are due to be paid.

Responsibility for the Fund's overall investment strategies rests with the Pensions Committee. The Investment Strategy Panel and the internal investment team monitor investment risks on a regular basis. Investment risk management tools are used to identify and analyse risks faced by the Fund's investments.

Consideration of the Fund's investment risk is part of the overall risk management of the pensions operations. Risks are reviewed regularly to reflect changes in activity and market conditions.

Types of investment risk

There are various ways of considering investment risks for pension funds. For the purposes of this note, market risk is the potential for an investor to experience losses from falls in the prices of investments. All financial instruments, including cash deposits, present a risk of loss of capital and risks vary depending on different asset classes.

Market risk also changes over time as economic conditions and investor sentiment change. The Fund considers overall fluctuations in prices arising from a variety of sources: market risk, foreign exchange risk, interest rate risk, credit risk, etc. The different risks may, to some extent, offset each other.

The overall market risk of the Fund depends on the actual mix of assets and encompasses all the different elements of risk.

The Fund manages these risks in a number of ways:

- assessing and establishing acceptable levels of market risk when setting overall investment strategy. Importantly, risk is considered relative to the liabilities of the Fund
- diversification of investments in terms of type of asset, investment styles, investment managers, geographical and industry sectors as well as individual securities
- taking stewardship responsibilities seriously and pursuing constructive engagement with the companies in which we invest
- monitoring market risk and market conditions to ensure risk remains within tolerable levels
- using equity futures contracts from time to time to manage market risk. Options are not used by the Fund.

Sensitivity analysis

Asset prices have a tendency to fluctuate. The degree of such fluctuation is known as "volatility" and it differs by asset class. The table sets out the long-term volatility assumptions used in the Fund's asset-liability modelling undertaken by the Fund's investment adviser KPMG:

Notes to the Accounts

21 Nature and extent of risk arising from financial instruments (cont)

| Asset type | Potential price movement (+ or -) |
|------------------------------|-----------------------------------|
| Equities - Developed Markets | 20.5% |
| Equities - Emerging Markets | 30.0% |
| Private Equity | 30.0% |
| Timber and Gold | 18.0% |
| Secured Loans | 8.0% |
| Fixed Interest Gilts | 6.6% |
| Index-Linked Gilts | 10.9% |
| Infrastructure | 18.0% |
| Property | 13.0% |
| Cash | 1.1% |

Volatility is the standard deviation of annual returns. Broadly speaking, in two years out of three, the asset's change in value (which could be a gain or a loss) is expected to be lower than the volatility figure, but in one year out of three, the change in value is expected to be higher than the volatility figure.

Asset classes do not always move in line with each other. The extent to which assets move together is known as their "correlation". A lower correlation means that there is less risk of assets losing value at the same time.

The overall Fund benefits from "diversification" because it invests in different asset classes, which don't all move in line with each other. Consequently, the aggregate risk at the Fund level is less than the total risk from all the individual assets in which the Fund invests. The following table shows the risks at the asset class level and the overall Fund level, with and without allowance for correlation.

| | Value at 31 March 2017 £m | % of fund % | Potential Change +/- % | Value on increase £m | Value on decrease £m |
|-----------------------------------|---------------------------------|----------------|---------------------------------|----------------------------|----------------------------|
| Equities - Developed Markets | 3,855 | 58.7 | 20.5 | 4,645.3 | 3,064.7 |
| Equities - Emerging Markets | 290 | 4.4 | 30.0 | 377.0 | 203.0 |
| Private Equity | 205 | 3.1 | 30.0 | 266.5 | 143.5 |
| Timber and Gold | 152 | 2.3 | 18.0 | 179.4 | 124.6 |
| Secured Loan | 103 | 1.6 | 8.0 | 111.2 | 94.8 |
| Fixed Interest Gilts | 159 | 2.4 | 6.6 | 169.5 | 148.5 |
| Index-Linked Gilts | 505 | 7.7 | 10.9 | 560.0 | 450.0 |
| Infrastructure | 687 | 10.5 | 18.0 | 810.7 | 563.3 |
| Property | 453 | 6.9 | 13.0 | 511.9 | 394.1 |
| Cash and forward foreign exchange | 160 | 2.4 | 1.1 | 161.8 | 158.2 |
| Total [1] | 6,569 | 100.0 | 18.6 | 7,793.3 | 5,344.7 |
| Total [2] | | | 15.9 | 7,613.5 | 5,524.5 |
| Total [3] | | | 15.9 | 7,613.5 | n/a |

[1] No allowance for correlations between assets

[2] Including allowance for correlations between assets

[3] Including allowance for correlation between assets and liabilities.

The value on increase/decrease columns illustrate the monetary effect of the percentage change in the volatility column. The actual annual change in value is expected to be lower than this in two years out of three, but higher in one year out of three.

Notes to the Accounts

21 Nature and extent of risk arising from financial instruments (cont)

It can be seen that the risk to the overall Fund assets [2] is lower than the total of the risks to the individual assets.

However, because the purpose of a pension scheme is to make payments to scheme beneficiaries, the true risk of a pension scheme is not measured in absolute terms, but relative to its liabilities [3].

This risk analysis incorporates volatility from market, interest rate, foreign exchange, credit, and all other sources of risk, and, importantly, makes allowance for how these risks may offset each other.

Credit risk

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

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

Cash deposits, derivatives and securities lending are the major areas of credit exposure where credit risk is not reflected in market prices.

Cash deposits

At 31 March 2017, cash deposits represented £243.4m, 3.69% of total net assets. This was held with the following institutions:

| | Moody's Credit Rating at 31 March 2017 | Balances at 31 March 2016 £000 | Balances at 31 March 2017 £000 |
|--|--|-----------------------------------|-----------------------------------|
| Held for investment purposes | | | |
| Northern Trust Global Investment Limited - liquidity funds | Aaa-mf | 78,223 | 83,249 |
| Northern Trust Company - cash deposits | Aa2 | 66,450 | 40,697 |
| The City of Edinburgh Council - treasury management | See below | 82,736 | 92,090 |
| Total investment cash | | 227,409 | 216,036 |
| Held for other purposes | | | |
| The City of Edinburgh Council - treasury management | See below | 41,327 | 27,278 |
| Total cash - parent | | 268,736 | 243,314 |
| Cash held by LPFE/LPFI Limited | | | |
| Royal Bank of Scotland | A3 | 4 | 84 |
| Total cash - group | | 268,740 | 243,398 |

The majority of Sterling cash deposits of the Fund are managed along with those of the administering authority (the City of Edinburgh Council) and other related organisations which are pooled for investment purposes as a treasury cash fund. Management of the cash fund is on a low risk basis, with security of the investments the key consideration.

Notes to the Accounts

21 Nature and extent of risk arising from financial instruments (cont)

| | Moody's Credit Rating at 31 March 2017 | Balances at 31 March 2016 £000 | Balances at 31 March 2017 £000 |
|---|--|-----------------------------------|-----------------------------------|
| Money market funds | | | |
| Deutsche Bank AG, London | Aaa-mf | 117 | 652 |
| Goldman Sachs | Aaa-mf | 16,539 | 14 |
| Bank call accounts | | | |
| Bank of Scotland | A1 | 8,123 | 11,911 |
| Royal Bank of Scotland | A3 | 1,316 | 169 |
| Santander UK | Aa3 | 10 | 30 |
| Barclays Bank | A1 | 8,395 | 2 |
| Svenska Handelsbanken | Aa2 | 8,562 | 23 |
| HSBC Bank | Aa2 | 12 | 4 |
| UK Pseudo-Sovereign risk instruments | | | |
| Other Local Authorities [1] | Aa1 | 24,726 | 106,563 |
| UK Government Treasury Bills | Aa1 | 56,263 | - |
| | | 124,063 | 119,368 |

[1] Very few Local Authorities have their own credit rating but they are generally assumed to have a pseudo-sovereign credit rating (which in the UK at 31 March 2017 was 'Aa1').

The Council has in place institutional restrictions on investments and counterparty criteria. These include -

- UK Government and other UK local Authorities with no limit, other public bodies up to £20 million per organisation.
- Money market funds (MMFs) no more than £30 million or 15% with any one Fund.
- Financial Institutions: Banks and Building Societies with multiple criteria based on a range of short and long term credit ratings, as well as any security, provided from maximum of £60 million / 20% of assets under management (AUM) for institutions with the highest criteria to £10 million / 5% of AUM for institutions with the lowest acceptable criteria.

No breaches of the Council's counterparty criteria occurred during the reporting period and the Fund does not expect any losses from non-performance by any of its counterparties in relation to deposits.

Securities lending

The Fund participates in a securities lending programme as described above. The Fund is potentially exposed to credit risk in the event of the borrower of securities defaulting. This risk is mitigated by the contractual commitment that borrowers provide collateral in excess of 100% of the value of the securities borrowed. In addition, Northern Trust has signed an agreement requiring it to make good any losses arising from the lending programme.

Derivatives

The Fund transacts foreign currency derivatives over-the-counter and hence is exposed to credit risk in the event of a counterparty defaulting on the net payment or receipt that remains outstanding. This risk is minimised by the use of counterparties that are recognised financial intermediaries with acceptable credit ratings and by netting agreements. At 31 March 2017, the Fund was owed £0.7m on over-the-counter foreign currency derivatives.

Refinancing risk

Refinancing risk is the risk that the Fund will be bound to replenish a significant proportion of its pension fund financial instruments at a time of unfavourable interest rates. The Fund is not bound by any obligation to replenish its investments and hence is not exposed to refinancing risk.

Notes to the Accounts

21 Nature and extent of risk arising from financial instruments (cont)

Liquidity risk

Liquidity risk reflects the risk that the Fund will not be able to meet its financial obligations as they fall due. The Fund therefore ensures that there is adequate cash and liquid resources to meet its commitments. Cash flow projections are prepared on a regular basis to understand and manage the timing of the Fund's cash flows.

The majority (estimated to be approximately 78% (2016 79%)) of the Fund's investments could be converted to cash within three months in a normal trading environment.

22 Actuarial statement

The Scheme Actuary has provided a statement describing the funding arrangements of the Fund. This can be found at the end of this section.

23 Actuarial present value of promised retirement benefits

The actuarial value of promised retirement benefits at the accounting date, calculated in line with International Accounting Standard 19 (IAS19) assumptions, is estimated to be £8,210m (2016 £6,266m). This figure is used for statutory accounting purposes by Lothian Pension Fund and complies with the requirements of IAS26. The assumptions underlying the figure match those adopted for the Administering Authority's FRS17/IAS19 reports at each year end.

The figure is only prepared for the purposes of IAS26 and has no validity in other circumstances. In particular, it is not relevant for calculations undertaken for funding purposes and setting contributions payable to the Fund.

| | 31 March 2016 % p.a. | 31 March 2017 % p.a. |
|------------------------------------|-------------------------|-------------------------|
| Inflation / pensions increase rate | 2.2 | 2.4 |
| Salary increase rate | 4.2 | 4.4 |
| Discount rate | 3.5 | 2.6 |

Longevity assumptions

The life expectancy assumption is based on Fund specific statistical analysis with improvements in line with the CMI 2012 model, assuming that the current rate of improvements has reached a peak and will converge to a long term rate of 1.25% p.a.. Based on these assumptions, the average future life expectancies, in years, at age 65 are summarised below:

| | 31 March 2016 | | 31 March 2017 | |
|--|---------------|------------|---------------|------------|
| | Males | Females | Males | Females |
| Current pensioners | 22.1 years | 23.7 years | 22.1 years | 23.7 years |
| Future pensioners (assumed to be currently 45) | 24.2 years | 26.3 years | 24.2 years | 26.3 years |

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 for post-April 2009 service.

Notes to the Accounts

24 Non current debtors

| | LPF Parent 31 March 2016 £000 | LPF Group 31 March 2016 £000 | LPF Group 31 March 2017 £000 | LPF Group 31 March 2017 £000 |
|--|---|--|--|--|
| Contributions due - employers' cessation | 451 | 451 | 259 | 259 |
| | 451 | 451 | 259 | 259 |

Analysis of non current debtor

| | LPF Parent 31 March 2016 £000 | LPF Group 31 March 2016 £000 | LPF Parent 31 March 2017 £000 | LPF Group 31 March 2017 £000 |
|--------------------------------|---|--|---|--|
| Administering Authority | - | - | - | - |
| Other Scheduled Bodies | - | - | - | - |
| Community Admission Bodies | 451 | 451 | 259 | 259 |
| Transferee Admission Bodies | - | - | - | - |
| Other Local Authorities | - | - | - | - |
| Central Government Bodies | - | - | - | - |
| Other entities and individuals | - | - | - | - |
| | 451 | 451 | 259 | 259 |

25 Debtors

| | LPF Parent 31 March 2016 £000 | LPF Group 31 March 2016 £000 | LPF Parent 31 March 2017 £000 | LPF Group 31 March 2017 £000 |
|---|---|--|---|--|
| Contributions due - employers | 10,219 | 10,219 | 11,175 | 11,175 |
| Contributions due - members | 2,067 | 2,067 | 3,304 | 3,304 |
| Benefits paid in advance or recoverable | - | - | - | - |
| Sundry debtors | 109 | 137 | 160 | 193 |
| Corporation tax losses utilised by CEC group | - | 5 | - | 1 |
| Prepayments | 275 | 275 | 283 | 292 |
| LPFE & LPFI Limited Loan facility - see note 29 | - | - | 16 | - |
| | 12,670 | 12,703 | 14,938 | 14,965 |

Analysis of debtors

| | LPF Parent 31 March 2016 £000 | LPF Group 31 March 2016 £000 | LPF Parent 31 March 2017 £000 | LPF Group 31 March 2017 £000 |
|--------------------------------|---|--|---|--|
| Administering Authority | 6,987 | 6,992 | 6,081 | 6,081 |
| Other Scheduled Bodies | 3,526 | 3,526 | 6,477 | 6,477 |
| Community Admission Bodies | 1,812 | 1,812 | 1,899 | 1,899 |
| Transferee Admission Bodies | 26 | 26 | 35 | 35 |
| Other Local Authorities | - | 29 | 22 | 56 |
| Central Government Bodies | - | - | - | - |
| Other entities and individuals | 319 | 318 | 424 | 417 |
| | 12,670 | 12,703 | 14,938 | 14,965 |

Notes to the Accounts

26 Creditors

| | LPF Parent 31 March 2016 £000 | LPF Group 31 March 2016 £000 | LPF Parent 31 March 2017 £000 | LPF Group 31 March 2017 £000 |
|--|---|--|---|--|
| Benefits payable | 8,375 | 8,375 | 5,745 | 5,745 |
| VAT, PAYE and State Scheme premiums | 1,399 | 1,495 | 2,940 | 3,052 |
| Contributions in advance | 11,845 | 11,845 | 8,719 | 8,719 |
| Miscellaneous creditors and accrued expenses | 2,083 | 2,121 | 2,760 | 2,809 |
| Office - operating lease | 216 | 216 | 266 | 266 |
| LPFE Loan facility - see note 29 | 6 | - | 24 | - |
| Intra group creditor - see note 29 | 92 | - | 105 | - |
| | 24,016 | 24,052 | 20,559 | 20,591 |

Analysis of Creditors

| | LPF Parent 31 March 2016 £000 | LPF Group 31 March 2016 £000 | LPF Parent 31 March 2017 £000 | LPF Group 31 March 2017 £000 |
|--------------------------------|---|--|---|--|
| Administering Authority | 32 | 32 | 51 | 51 |
| Other Scheduled Bodies | 11,900 | 11,900 | 11,715 | 11,715 |
| Community Admission Bodies | 39 | 39 | 19 | 19 |
| Transferee Admission Bodies | 98 | - | - | - |
| Central Government Bodies | 1,359 | 1,455 | 2,889 | 3,001 |
| Other entities and individuals | 10,588 | 10,626 | 5,885 | 5,805 |
| | 24,016 | 24,052 | 20,559 | 20,591 |

27 Additional Voluntary Contributions

Active members of the Lothian Pension Fund have the option to pay additional voluntary contributions (AVCs). These AVCs are invested separately from the main funds, securing additional benefits on a money purchase basis for those members that have elected to contribute. The investment of the AVCs is managed by Standard Life and Prudential.

In accordance with regulation 4 (2) (b) of the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010, AVCs are not included in the pension fund financial statements.

| | 2015/16 £000 | 2016/17 £000 |
|---|-----------------------|-----------------------|
| Total contributions during year for Lothian Pension fund | | |
| Standard Life | 395 | 339 |
| Prudential | 1,593 | 1,816 |
| | 1,988 | 2,155 |
| | | |
| Total value at year end for Lothian Pension Fund | | |
| | 31 March 2016 £000 | 31 March 2017 £000 |
| Standard Life | 5,665 | 5,041 |
| Prudential | 3,863 | 5,097 |
| | 9,528 | 10,138 |

Notes to the Accounts

28 Related parties

The City of Edinburgh Council

The Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund are administered by the City of Edinburgh Council. Consequently there is a strong relationship between the Council and the Pension Funds.

The Investment and Pensions Service of the Council is responsible for administering the three Pension Funds. The Service receives an allocation of the overheads of the Council, based on the amount of central services consumed. In turn, the Service allocates its costs to the three Pension Funds. Costs directly attributable to a specific Fund are charged to the relevant Fund; costs that are common to all three Funds are allocated on a defined basis.

Transactions between the Council and the Fund are managed via a holding account. Each month the Fund is paid a cash sum leaving a working balance in the account to cover the month's pension payroll costs and other expected costs.

| | 31 March 2016 £000 | 31 March 2017 £000 |
|-------------------------------------|-----------------------|-----------------------|
| Year end balance of holding account | 4,287 | 4,467 |
| | 4,287 | 4,467 |

Part of the Fund's cash holdings are invested on the money markets by the treasury management operations of the Council, through a service level agreement. During the year to 31 March 2017, the fund had an average investment balance of £105.7m (2015/16 £219.0m). Interest earned was £427.4k (2015/16 £1,032.5k).

| Year end balance on treasury management account | 31 March 2016 £000 | 31 March 2017 £000 |
|---|-----------------------|-----------------------|
| Held for investment purposes | 82,736 | 92,090 |
| Held for other purposes | 41,327 | 27,278 |
| | 124,063 | 119,368 |

Scheme employers

All scheme employers to the fund are (by definition) related parties, a full list of employers can be found on page 64. The employer contributions for the ten largest scheme employers are as follows -

| | 31 March 2016 £000 | 31 March 2017 £000 |
|-----------------------------|-----------------------|-----------------------|
| City of Edinburgh Council | 63,459 | 63,542 |
| West Lothian Council | 22,053 | 22,214 |
| East Lothian Council | 12,897 | 13,267 |
| Midlothian Council | 11,096 | 11,849 |
| Scottish Water | 8,419 | 9,191 |
| Edinburgh Napier University | 4,864 | 5,001 |
| Scottish Police Authority | 3,084 | 3,519 |
| Heriot-Watt University | 3,058 | 3,077 |
| Edinburgh College | 2,984 | 2,924 |
| Audit Scotland | 1,826 | 2,020 |

Notes to the Accounts

28 Related parties (cont)

Governance

As at 31 March 2017, all members of the Pensions Committee, with the exception of Councillor Bill Cook and Richard Lamont, and all members of the Pensions Board, with the exception of Graham Turnbull, were active members of the Lothian Pension Fund or Lothian Buses Pension Fund.

Each member of the Pensions Committee and Pension Board is required to declare any financial and non-financial interests they have in the items of business for consideration at each meeting, identifying the relevant agenda item and the nature of their interest.

During the period from 1 April 2015 to the date of issuing of these accounts, a number of employees of the City of Edinburgh Council and its wholly owned subsidiary, LPFE Limited, held key positions in the financial management of the Lothian Pension Fund. With effect from 1 May 2015, all the employees listed below, with the exception of the Executive Director of Resources, were employed by LPFE Limited. These employees and their financial relationship with the Fund (expressed as cash-equivalent transfer values or CETV) are set out below:

| Name | Position held | Accrued CETV as at 31 March 2016 £000 | Accrued CETV as at 31 March 2017 £000 |
|------------------|---|--|--|
| Hugh Dunn* | Acting Executive Director of Resources, City of Edinburgh Council | 755 | 1,251 |
| Clare Scott* | Chief Executive, Lothian Pension Fund | 175 | 221 |
| Bruce Miller | Chief Investment Officer, Lothian Pension Fund | 185 | 267 |
| Struan Fairbairn | Chief Risk Officer, Lothian Pension Fund | 30 | 46 |
| John Burns | Chief Finance Officer, Lothian Pension Fund | 474 | 538 |
| Esmond Hamilton | Financial Controller, Lothian Pension Fund | 161 | 200 |

* Also disclosed in the financial statements of the City of Edinburgh Council.

Total compensation paid in relation to key management personnel employed by LPFE Limited during the period was as follows:

| | 31 March 2016 £000 | 31 March 2017 £000 |
|---|-----------------------|-----------------------|
| Short-term employee benefits | 318 | 380 |
| Post-employment benefits - employer pension contributions | 65 | 78 |

Key management personnel employed by LPFE, had accrued pensions totalling £81,825 (1 April 2016: £68,004) and lump sums totalling £100,185 (1 April 2016: £68,004) at the end of the period.

Staff are either employed by City of Edinburgh Council or LPFE Ltd, and their costs reimbursed by the Pension Fund. The Councillors, who are members of the Pensions Committee, are also remunerated by City of Edinburgh Council.

LPFE Limited & LPFI Limited- loan facility

LPFE & LPFI Limited are wholly owned by the City of Edinburgh Council as administrating authority of Lothian Pension Fund and have entered into a shareholder agreement with the Council to address governance matters. The companies have a loan facility agreement with the City of Edinburgh Council for the purpose of the provision of short term working capital. The current agreement covers the period to 1 May 2020 and provides that interest is payable at 2% above the Royal Bank of Scotland base lending rate on the daily balance. In order to minimise the amount of interest payable, the companies return any cash not immediately required and this can result in short periods when the companies have returned more cash than has been drawn. On such days the loan interest is negative, reducing the amount of interest payable.

Interest payable by LPFE Limited during the period was £720 of which £156 was due at the year end and for LPFI Limited interest payable was £99 of which £30 was due at year end. At 31 March 2017, the balance on the loan facility was £24k due to LPFE Limited and £16k due from LPFI Limited.

Notes to the Accounts

28 Related parties (cont)

LPFE Limited & LPFI Limited- corporation tax losses used by companies under common control

In 2015/16 Lothian Buses Limited (also a member of City of Edinburgh Council's Corporation Tax Group) utilised the £5k tax loss from LPFE limited activity during the year. The tax loss of the company is transferred to another company in the Tax Group in exchange for the cash amount. Due to year end timing differences £1k of the loss is still outstanding to Lothian Buses Limited.

LPFE Limited - staffing services

Staffing services are provided to Lothian Pension Fund for the purposes of administering the Funds under a intra-group resourcing agreement. The agreement also provides for the running costs of the company to be covered as part of a service charge and allows for the provision of staffing services to LPFI Limited. During the year to 31 March 2017, the Fund was invoiced £1,073k (2016 £820k) for the services of LPFE Limited staff, £105k (2016 £92k) of this remained payable at year end.

29a Consolidated Lothian Pension Fund group - LPFE Limited & LPFI Limited - deferred tax

Movement in deferred tax asset (Non-current asset)

| | LPF Group 2015/16 £000 | LPF Group 2016/17 £000 |
|---------------------------------|---------------------------------|---------------------------------|
| At 1 April 2016 | - | 36 |
| Credit for year to Fund Account | 36 | 81 |
| At 31 March 2017 | 36 | 117 |

Elements of closing deferred tax asset

| | LPF Group 31 March 2016 £000 | LPF Group 31 March 2017 £000 |
|-------------------|--|--|
| Pension liability | 36 | 117 |
| | 36 | 117 |

29b Shares in group companies - LPFE Limited & LPFI Limited

| | 31 March 2016 £ | 31 March 2017 £ |
|---|--------------------|--------------------|
| Allotted, called up and fully paid Ordinary shares of £1 each - LPFE Limited* | 1 | 1 |
| Allotted, called up and fully paid Ordinary shares of £1 each - LPFI Limited | - | 50,000 |
| | 1 | 50,001 |

*One ordinary share of £1 was issued to Lothian Pension Fund at par value on incorporation. Due to the low value this does not show on the Net Assets Statement.

30 Retirement benefits obligation - group

The retirement benefit obligation described in this note relates only to the employees of LPFE Limited. This is because obligation in respect of the staff employed by the City of Edinburgh Council is accounted for in the City of Edinburgh Council's Financial Statements.

On 1 May 2015 LPFE Limited commenced trading and its staff transferred their employment from the City of Edinburgh Council to the Company on that date. At that time, the Company also entered into appropriate admission arrangements with the City of Edinburgh Council with respect to the transferring individuals continuing to be members of the Lothian Pension Fund and in relation to its obligations as an employer in that Fund.

The present value of the defined benefit obligation, and related current service cost and past service cost, were measured using the Projected Unit Credit Method.

Notes to the Accounts

30 Retirement benefits obligation - group (cont)

Fund assets

The LPFE Limited's share of the fair value of the Fund's assets which are not intended to be realised in the short term and may be subject to significant change before they are realised, were comprised as follows:

| Asset | | Fair value at 31 March 2016 £000 | % of total 31 March 2016 % | Fair value at 31 March 2017 £000 | % of total 31 March 2017 % |
|--|------------------------|-------------------------------------|-------------------------------------|-------------------------------------|-------------------------------------|
| Equity securities: | Consumer | 319 | 15.0 | 425 | 15.0 |
| | Manufacturing | 247 | 12.0 | 429 | 15.2 |
| | Energy and utilities | 167 | 8.0 | 210 | 7.4 |
| | Financial institutions | 178 | 8.0 | 197 | 7.0 |
| | Health and care | 139 | 7.0 | 166 | 5.9 |
| | Information technology | 126 | 6.0 | 140 | 4.9 |
| | Other | 120 | 6.0 | 195 | 6.9 |
| Debt securities: | Corporate Bonds | - | 0.0 | - | 0.0 |
| | UK Government | 135 | 6.0 | 284 | 10.0 |
| | Other | 53 | 3.0 | 6 | 0.2 |
| Private equity: | All | 92 | 4.0 | 91 | 3.2 |
| Real property | UK property | 179 | 9.0 | 191 | 6.7 |
| Investment funds and unit trusts: | Equities | - | 0.0 | - | 0.0 |
| | Commodities | 6 | 0.0 | 8 | 0.3 |
| | Bonds | 17 | 1.0 | 42 | 1.5 |
| | Infrastructure | 139 | 7.0 | 253 | 8.9 |
| | Other | 50 | 2.0 | 60 | 2.1 |
| Cash and cash equivalents: | All | 130 | 6.0 | 131 | 4.8 |
| | | 2,097 | 100.0 | 2,828 | 100.0 |

Amounts recognised in the Net Assets Statement

| | LPF Group 31 March 2016 £000 | LPF Group 31 March 2017 £000 |
|-----------------------------------|--|--|
| Fair value of Fund assets | 2,097 | 2,828 |
| Present value of Fund liabilities | (2,277) | (3,513) |
| | (180) | (685) |

Notes to the Accounts

30 Retirement benefits obligation - group (cont)

Movement in the defined benefit obligation during the period

| | LPF Group 2015/16 £000 | LPF Group 2016/17 £000 |
|--|---------------------------------|---------------------------------|
| Brought forward | 2,107 | 2,277 |
| Current service cost | 174 | 172 |
| Interest cost on obligation | 69 | 86 |
| Fund participants contributions | 54 | 76 |
| Benefits paid | - | - |
| Actuarial losses arising from changes in financial assumptions | (378) | 902 |
| Actuarial losses arising from changes in demographic assumptions | - | - |
| Other actuarial losses | 251 | - |
| Balance at year end | 2,277 | 3,513 |

Movement in the fair value of Fund assets during the period

| | LPF Group 2015/16 £000 | LPF Group 2016/17 £000 |
|---|---------------------------------|---------------------------------|
| Brought forward | 1,826 | 2,097 |
| Benefits paid | - | - |
| Interest income on Fund assets | 60 | 80 |
| Contributions by employer | 121 | 156 |
| Contributions by member | 54 | 76 |
| Contributions in respect of unfunded benefits | - | - |
| Unfunded benefits paid | - | - |
| Return on assets excluding amounts included in net interest | 36 | 419 |
| Balance at year end | 2,097 | 2,828 |

Amounts recognised in the Fund Account

| | LPF Group 2015/16 £000 | LPF Group 2016/17 £000 |
|---|---------------------------------|---------------------------------|
| Interest received on Fund assets | (60) | (80) |
| Interest cost on Fund liabilities | 69 | 86 |
| Current service costs | 174 | 172 |
| Transfer of opening retirement benefit obligation on 1 May 2015 | 281 | - |
| Actuarial gains due to re-measurement of the defined benefit obligation | (127) | 902 |
| Return on Fund assets (excluding interest above) | (36) | (419) |
| Net cost recognised in Fund account | 301 | 661 |
| Less - cash flows | (121) | (156) |
| Increase in retirement benefit obligations | 180 | 505 |

Principal actuarial assumptions used in this valuation

| | 31 March 2016 % p.a. | 31 March 2017 % p.a. |
|------------------------------------|-------------------------|-------------------------|
| Inflation / pensions increase rate | 2.2 | 2.4 |
| Salary increase rate | 4.2 | 4.4 |
| Discount rate | 3.6 | 2.7 |

Notes to the Accounts

30 Retirement benefits obligation - group (cont)

The assumptions used by the actuary are the best estimates chosen from a range of possible actuarial assumptions which, due to the timescale covered, may not necessarily be borne out in practice. Best estimate has been interpreted to mean that the proposed assumptions are 'neutral' – there is an equal chance of actual experience being better or worse than the assumptions proposed.

The financial assumptions used for reporting in the financial statements are the responsibility of the employer. These assumptions are largely prescribed at any point and reflect market conditions at the reporting date. Changes in market conditions that result in changes in the net discount rate can have a significant effect on the value of the liabilities reported.

A reduction in the net discount rate will increase the assessed value of liabilities as a higher value is placed on benefits paid in the future. A rise in the net discount rate will have an opposite effect of a similar magnitude. There is also uncertainty around life expectancy of the UK population – the value of current and future pension benefits will depend on how long they are assumed to be in payment.

Life expectancy is based on Fund specific statistical analysis with improvements in line with the CMI 2012 model assuming current rates of improvements have peaked and will converge to a long term rate of 1.25% p.a.

Based on these assumptions, the average future life expectancies at age 65 are summarised below:

| | 31 March 2016 | | 31 March 2017 | |
|--------------------|---------------|------------|---------------|------------|
| | Males | Females | Males | Females |
| Current pensioners | 22.1 years | 23.7 years | 22.1 years | 23.7 years |
| Future pensioners | 24.2 years | 26.3 years | 24.2 years | 26.3 years |

Expected employer contributions to the defined benefit plan for the year ended 31 March 2018 are £157,000, based on a pensionable payroll cost of £764,000.

31 Contractual commitments

Investment commitments

The Fund has commitments relating to outstanding call payments due on unquoted funds held in the private equity, timber, property and infrastructure parts of the portfolio. The amounts 'called' by these funds are irregular in both size and timing, taking place over a number of years from the date of each original commitment. The outstanding commitments at the year end are as follows:

| | 31 March 2016 | 31 March 2017 |
|------------------------------------|---------------|---------------|
| | £000 | £000 |
| Outstanding investment commitments | 160,891 | 235,565 |
| | 160,891 | 235,565 |

Office accommodation - 144 Morrison Street, Edinburgh

The Investment and Pensions Service is committed to making the following future payments.

| | 31 March 2016 | 31 March 2017 |
|--|---------------|---------------|
| | £000 | £000 |
| Within one year | 42 | 115 |
| Between one and five years | 345 | 345 |
| After five years | 992 | 877 |
| | 1,379 | 1,337 |
| Recognised as an expense during the year | 92 | 92 |

The above expense has been allocated across the three Funds, Lothian Pension Fund's share is £84.9k.

Notes to the Accounts

32 Contingent assets and liabilities

Infrastructure co-investment

At 31 March 2017 the Fund had entered into negotiations for an infrastructure co-investments in which it is exposed to the potential risk of investment abort costs. At 31 March 2017, Lothian Pension Fund's exposure is approximately £21.4k.

Contribution refunds

At 31st March 2017, Lothian Pension Fund had £473k in unclaimed refunds due to members.

Employer Cessations

The Fund has, in consultation with external advisors, drawn up a funding agreement to address repayment of the cessation debt. In order to avoid employer default or insolvency, the agreement will allow for repayment over longer terms, and if necessary for repayment of less than the cessation debt. In the latter scenario, an appropriate clause will be included which will allow the Fund to revisit the repayment of the remaining debt at a future date. At 31st March 2017, Lothian Pension Fund had £325k unsecured assets due from ceased employers.

EU Tax claims & income recovery

The Fund, in consultation with external advisers participates in various claims to recover withheld income on its investments. For some of these claims there is a high level of uncertainty on the success of these claims so they are not accrued for in the financial statements. The value of these outstanding claims is approximately £9.8m.

33 Impairment losses

During the year the Fund recognised a decrease in impairment losses in respect of specific benefit over payments for which reimbursement has been requested of £23.6k. This decreased the impairment to £22.8k at the year end.

Lothian Pension Fund

Actuarial Statement for 2016/17

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

Description of Funding Policy

The funding policy is set out in the Administering Authority's Funding Strategy Statement (FSS), dated 16 November 2015. In summary, the key funding principles are as follows:

- To ensure solvency of the Fund;
- to ensure the solvency of each individual employers' share of the Fund based on their expected term of participation in the Fund;
- to minimise the degree of short-term change in employer contribution rates;
- maximise the returns from investments within reasonable and considered risk parameters, and hence minimise the cost to the employer;
- to ensure that sufficient cash is available to meet all liabilities as they fall due for payment;
- to help employers manage their pension liabilities; and
- where practical and cost effective, to make allowance for the different characteristics of different employers and groups of employers.

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

Funding Position as at the last formal funding valuation

The most recent actuarial valuation carried out under Regulation 32 of the Local Government Pension Scheme (Scotland) (Administration) Regulations 2008 was as at 31 March 2014. This valuation revealed that the Fund's assets, which at 31 March 2014 were valued at £4,379 million, were sufficient to meet 91% of the liabilities (i.e. the present value of promised retirement benefits) accrued up to that date. The resulting deficit at the 2014 valuation was £417 million.

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

Principal Actuarial Assumptions and Method used to value the liabilities

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

Method

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

Assumptions

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

Lothian Pension Fund

Actuarial Statement for 2016/17

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

| Financial assumptions | 31 March 2014 | |
|-----------------------------------|---------------|--------|
| | % p.a. | % p.a. |
| | Nominal | Real |
| Discount rate | 5.0% | 2.3% |
| Pay increases* | 5.0% | 2.3% |
| Price inflation/Pension increases | 2.7% | - |

*2% p.a. for 2014/15 and 2015/16, reverting to 5.0% thereafter.

The key demographic assumption was the allowance made for longevity. The life expectancy assumptions are based on the Fund's VitaCurves with improvements in line with the CMI_2012 model, assuming the current rate of improvements has reached a peak and will converge to long term rate of 1.25% p.a.. Based on these assumptions, the average future life expectancies at age 65 are as follows:

| | Males | Females |
|---------------------|------------|------------|
| Current Pensioners | 22.1 years | 23.7 years |
| Future Pensioners * | 24.2 years | 26.3 years |

*Future pensioners are assumed to be at the 2014 valuation aged 45.

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

Experience over the period since April 2014

The Fund's experience has been worse than expected since the last formal valuation (excluding the effect of any membership movements and any potential changes to assumptions at the 2017 valuation). Real bond yields have fallen sharply which places a higher value on liabilities. The effect of this will have been partially offset by strong asset returns. Funding levels are therefore likely to have worsened and deficits increased over the period.

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

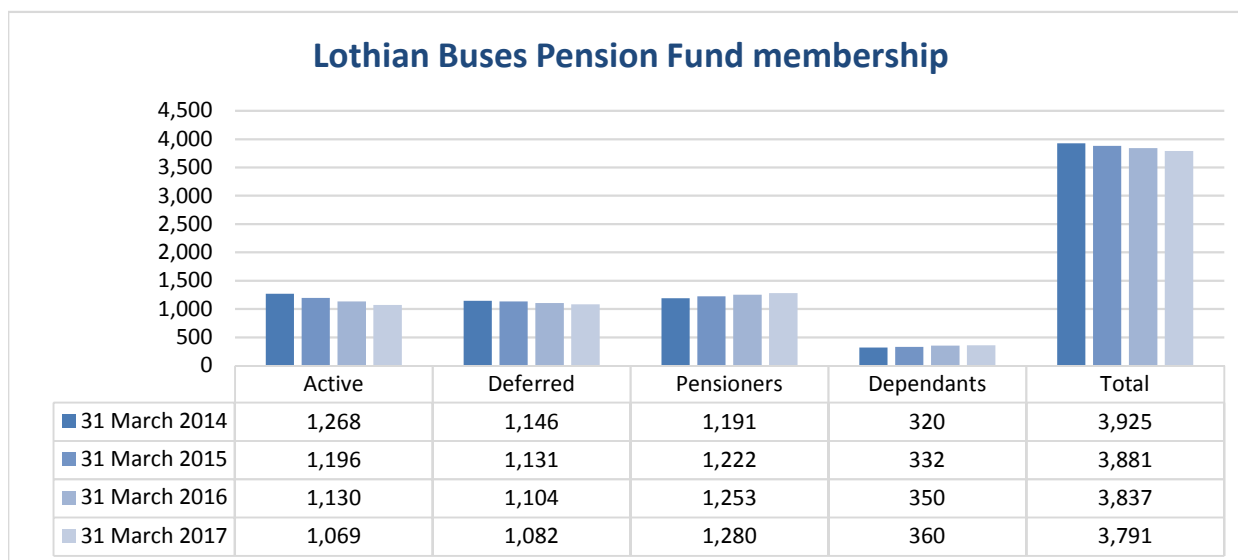
Richard Warden FFA
Fellow of the Institute and Faculty of Actuaries
For and on behalf of Hymans Robertson LLP
20 Waterloo Street
Glasgow
G2 6DB

28 April 2017

List of active employers at 31 March 2017

| Scheduled Bodies | |
|---|--|
| City of Edinburgh Council (The) | Scottish Police Authority |
| East Lothian Council | Scottish Water |
| Edinburgh College | SESTRAN |
| Heriot-Watt University | Visit Scotland |
| Midlothian Council | West Lothian College |
| Scotland's Rural College (SRUC) | West Lothian Council |
| Scottish Fire and Rescue Service | |
| | |
| Admitted Bodies | |
| Amey Services | HWU Students Association |
| Audit Scotland | Improvement Service (The) |
| Barony Housing Association Ltd | Into Work |
| Baxter Storey | ISS UK Ltd |
| Bellrock Property and Facilities Management | Keymoves |
| Canongate Youth Project | LPFE Ltd |
| Capital City Partnership | Melville Housing Association |
| Centre for Moving Image (The) | Mitie PFI |
| CGI UK Ltd | Morrison Facilities Services Ltd |
| Children's Hearing Scotland | Museums Galleries Scotland |
| Children's Hospice Association Scotland | Newbattle Abbey College |
| Citadel Youth Centre | North Edinburgh Dementia Care |
| Compass Chartwell | NSL Ltd |
| Convention of Scottish Local Authorities | Open Door Accommodation Project |
| Dacoll Limited | Penumbra |
| Dean Orphanage and Cauvin's Trust | Pilton Equalities Project |
| Donaldson's Trust | Pilton Youth and Children's Project |
| EDI Group Ltd | Queen Margaret University |
| Edinburgh Business School | Queensferry Churches Care in the Community Project |
| Edinburgh Cyrenians Trust | Royal Edinburgh Military Tattoo |
| Edinburgh Development Group | Royal Society of Edinburgh |
| Edinburgh International Festival Society | Scotland's Learning Partnership |
| Edinburgh Leisure | Scottish Adoption Agency |
| Edinburgh Napier University | Scottish Futures Trust |
| Edinburgh World Heritage Trust | Scottish Legal Complaints Commission |
| ELCAP | Scottish Schools Education Research Centre (SSERC) |
| Enjoy East Lothian | Skanska UK |
| Family & Community Development West Lothian | St Andrew's Children's Society Limited |
| Family Advice and Information Resource | St Columba's Hospice |
| Festival City Theatres Trust | Stepping Out Project |
| First Step | Streetwork UK Ltd |
| Forth and Oban Ltd | University of Edinburgh (Edin College of Art) |
| Four Square (Scotland) | Victim Support Scotland |
| Freespace Housing Association | Waverley Care |
| Granton Information Centre | Weslo Housing Management |
| Handicabs (Lothian) Ltd | West Granton Community Trust |
| Hanover (Scotland) Housing Association | West Lothian Leisure |
| Health in Mind | Wester Hailes Land and Property Trust |
| Homeless Action Scotland | Young Scot Enterprise |
| Homes for Life Housing Partnership | Youthlink Scotland |

Lothian Buses Pension Fund



Investment Strategy

An in-depth review of Lothian Buses Pension Fund's investment strategy was undertaken by the Investment Strategy Panel over the 2015/16 financial year, supported by asset liability modelling from the Fund's investment adviser. In March 2016, the Pensions Committee approved a revised investment strategy to be implemented over the five years from 2016 to 2021.

The revised strategy reduces the Fund's allocation to equities (including private equity) from 55% to 40% by the end of 2021 and increases the allocation to index-linked gilts from 15% to 20% and fixed income assets from 10% to 22% within the same timeframe.

The review highlighted the potential future funding level volatility on the employing company's balance sheet and contributions. It afforded the opportunity to clarify the funding approach for this increasingly mature pension fund (it is closed to new entrants) in the event of the funding level worsening and also at the point when the last active member leaves the Fund. After discussions with the majority shareholder and company, Lothian Buses has agreed to continue paying deficit contributions (if required) after the last active member has left the Fund. With this clarity, the Fund is able to continue to adopt a long-term investment approach.

A significant allocation to equities is retained because they have historically exhibited higher returns than bonds when held over the long term. Implementation of the strategy will include further de-risking within equities and an increasing exposure to index-linked assets and fixed income assets to provide greater downside protection in the event of further reductions in interest rates (a key driver of liability values).

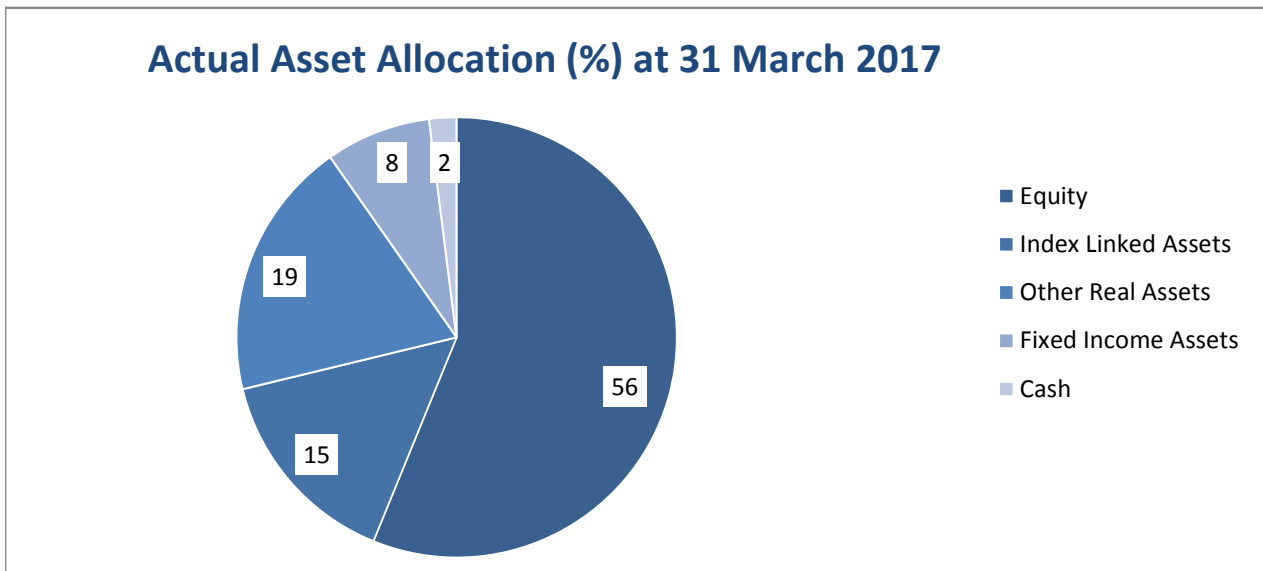
Over the course of 2016/17, the implementation of the investment strategy 2016-21 was initiated. The interim strategy allocation was adjusted over the year with equities reducing from 58.5% to 57%, index-linked gilts increasing from 14% to 15% and other real assets rising from 17.5% to 18%. Further progress will involve the interim strategy allocation and the actual asset allocation changing gradually over time.

In terms of the Fund's actual allocation over the year, equities reduced from 59% to 56%, index-linked assets increased from 12% to 15%, and other real assets and fixed income assets were stable at 19% and 8% respectively. These changes reflected both investment activity and the relative price movements of the various assets.

The investment strategy for 2016-21 is set out in the table below along with the current interim strategy.

| | Strategic Allocation 31/03/2017 % | Long term Strategy 2016 - 2021 % |
|---------------------|---|--|
| Equities | 57.0 | 40.0 |
| Index Linked Assets | 15.0 | 20.0 |
| Other Real Assets | 18.0 | 18.0 |
| Fixed Income Assets | 10.0 | 22.0 |
| Cash | - | - |
| Total | 100.0 | 100.0 |

The investment strategy is now set at the broad asset class level of equities, index-linked assets, other real assets and fixed income assets, the latter two of which had previously been categorised within Alternatives. These broad groupings are the key determinants of investment risk and return. Equities includes listed and unlisted equities; index-linked assets includes index-linked gilts/bonds and gold; other real assets includes property, infrastructure and timber; and fixed income assets includes listed and unlisted debt investments.



Investment performance

The objectives of the Fund are:

- over long-term economic cycles (typically 5 years or more) the achievement of the same return as that generated by the strategic allocation
- over shorter periods, the Fund should perform better than the strategic allocation if markets fall significantly.

The Fund return fell slightly short of the benchmark over the last year, although the absolute return of 23.7% was well above historical averages. Over longer timeframes the Fund has returned more than its benchmark, as shown in the table below. The benchmark returns shown in the table represent the strategic allocations and comprise equity and index-linked gilt indices as well as an inflation-linked index for the other real and fixed income assets.

| Annualised returns to 31 March 2016 (% per year) | 1 year | 5 year | 10 years |
|--|--------|--------|----------|
| Lothian Buses Pension Fund | 23.7 | 13.2 | 9.6 |
| Benchmark | 24.2 | 11.5 | 8.0 |
| Actuarial Valuation Assumptions * | 5.0 | 5.5 | 5.8 |
| Retail Price Index (RPI) | 3.1 | 2.3 | 2.8 |
| Consumer Price Index (CPI) | 2.3 | 1.4 | 2.3 |
| National Average Earnings | 2.4 | 1.9 | 2.0 |

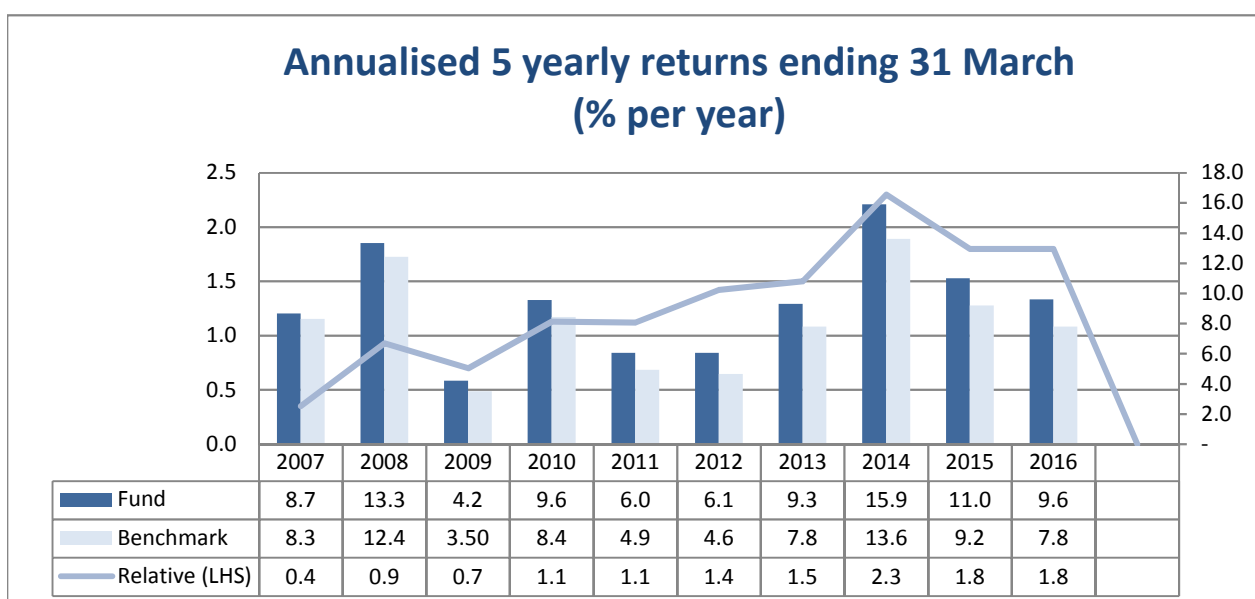
*estimate

The strong absolute return in 2016/17 was largely attributable to the global equity portfolios, one internally managed and one externally managed (by Baillie Gifford), which together rose in value by over 30%. The Fund's index-linked investments were also a significant contributor, driven by the internally-managed assets which rose 26% over the year. The real assets portfolio provided returns of over 6%, with timber and infrastructure assets returning close to 17% and 19% respectively, but offset by a disappointing return from property, which fell over 5% over the period. Fixed income assets returned 10% over the year, led by the corporate bond portfolio managed by Baillie Gifford (+10.2%), though private debt assets partially offset this with a return of 7.6%.

The shortfall in performance (-0.5%) relative to the benchmark over 2016/17 can be largely explained by the Fund's 2% allocation to cash throughout the year. This is a reflection of the fact that risk asset returns (especially equities and index-linked gilts) were so strong. The positive contribution to relative return from fixed income assets (+0.7%), led by the corporate bond portfolio (+0.7%) managed by Baillie Gifford, was offset by small shortfalls from equities (-0.2%), index-linked gilts (-0.1%) and from real assets (-0.4%), driven by weakness in property (-1.2%).

Returns relative to the benchmark over a one year period need to be placed in the context that there are no ideal benchmarks for many of the assets held in the Fund, especially the Alternatives. The Fund's benchmark for real and fixed income assets is inflation plus 3.5% per annum, which makes sense over the long term as the Fund's liabilities are linked to inflation. However, over shorter periods, there is less information content in the relative returns of the Fund because the development of asset prices is much more volatile than that of UK retail or consumer prices. The Investment Strategy Panel assesses the underlying risks of the portfolios that make up the asset allocation to ensure that these are consistent with the long term objectives of the Fund.

The chart below shows the rolling 5 year performance of the Fund against its strategic benchmark over the last 10 years. The Fund has consistently outperformed its benchmark over rolling 5 year periods. Relative returns on a rolling 5 year basis have generally been on an improving trend over the last 10 years, rising from 0.4% pa in 2007 to 1.7% pa in 2016.



Lothian Buses Pension Fund

Fund Account for year ended 31 March 2017

This statement shows a summary of the income and expenditure that the Pension Fund has generated and consumed in delivering the Local Government Pension Scheme. Included is the income generated from employers' and employees' contributions and investment income, as well as the cost of providing benefits and administration of the Fund.

| 2015/16 | | | 2016/17 |
|----------------|--|--------|----------------|
| £000 | | Note | £000 |
| | Income | | |
| 7,538 | Contributions from employer | 3 | 7,731 |
| 2,129 | Contributions from members | | 2,060 |
| - | Transfers from other schemes | | 10 |
| 9,667 | | | 9,801 |
| | Less: expenditure | | |
| 8,087 | Pension payments including increases | | 8,425 |
| 2,101 | Lump sum retirement payments | | 3,277 |
| 530 | Lump sum death benefits | | 295 |
| 2 | Refunds to members leaving service | | 9 |
| 129 | Transfers to other schemes | 4 | 418 |
| 102 | Administrative expenses | 5a | 98 |
| 10,951 | | | 12,522 |
| (1,284) | Net withdrawals from dealing with members | | (2,721) |
| | Returns on investments | | |
| 8,076 | Investment income | 6 | 7,641 |
| 3,532 | Change in market value of investments | 8, 14b | 90,672 |
| (1,677) | Investment management expenses | 5b | (1,880) |
| 9,931 | Net returns on investments | | 96,433 |
| 8,647 | Net increase in the Fund during the year | | 93,712 |
| 385,784 | Net assets of the Fund at 1 April 2016 | | 394,431 |
| 394,431 | Net assets of the Fund at 31 March 2017 | | 488,143 |

Lothian Buses Pension Fund

Net Assets Statement as at 31 March 2017

This statement provides a breakdown of type and value of all net assets at the year end.

| 31 March 2016 £000 | | Note | 31 March 2017 £000 |
|-------------------------------|--|--------------|--------------------------|
| Investment Assets | | | |
| 19,661 | Bonds | 7 | 73,313 |
| 236,417 | Equities | 7 | 273,603 |
| 121,923 | Pooled investment vehicles | 7 | 122,566 |
| - | Derivatives - forward foreign exchange | 9 | - |
| 11,811 | Cash Deposits | | 14,074 |
| 1,291 | Other investment assets | | 1,398 |
| 391,103 | | | 484,954 |
| Investment Liabilities | | | |
| (32) | Derivatives - forward foreign exchange | 9 | - |
| (283) | Other investment assets | | (18) |
| (315) | | | (18) |
| 390,788 | Net investment assets | 8, 10 | 484,936 |
| Current assets | | | |
| 400 | The City of Edinburgh Council | 21 | 385 |
| 2,867 | Cash balances | 15, 21 | 2,440 |
| 828 | Debtors | 18 | 744 |
| 4,095 | | | 3,569 |
| Current liabilities | | | |
| (452) | Creditors | 19 | (362) |
| (452) | | | (362) |
| 3,643 | Net current assets | | 3,207 |
| 394,431 | Net assets of the Fund at 31 March 2017 | | 488,143 |

The unaudited accounts were issued on 28 June 2017 and the audited accounts were authorised for issue on 27 September 2017.

JOHN BURNS FCMA CGMA

Chief Finance Officer, Lothian Pension Fund

27 September 2017

Notes to the net asset statement

The financial statements summarise the transactions of the Fund during the year and its net assets at the year end. They do not take account of the obligations to pay pensions and benefits which fall due after the end of the year. The actuarial position of the Fund, which does take account of such obligations, is discussed in the Actuarial Valuation section of this report and 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.

Notes to the Financial Statements

1 Statement of Accounting Policies

The statement of accounting policies for all three Funds can be found on page 112.

2 Events after the Reporting Date

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

3 Contributions from employer

| By category | 2015/16 £000 | 2016/17 £000 |
|---|-----------------|-----------------|
| Normal (ongoing contributions) | 7,425 | 7,516 |
| Deficit contribution | - | - |
| Strain costs and augmentation contributions | 113 | 215 |
| | 7,538 | 7,731 |

The Lothian Buses Pension Fund is a single employer pension fund for employees of Lothian Buses Limited. The Lothian Buses Fund was set up in 1986 under the Local Government Superannuation (Funds) (Scotland) Regulations 1986 (SSI 115/1986).

The employer contribution rate was 22.9% for the period from 1 April 2016 to 31 December 2016 then 24.1% for the remainder of the financial year.

Where the employer makes certain decisions which result in additional benefits being paid out to a member, or benefits being paid early, this results in a "strain" on the Fund. The resulting pension strain costs are calculated and recharged in full to the employer.

4 Transfers out to other pension schemes

| | 2015/16 £000 | 2016/17 £000 |
|----------------------|-----------------|-----------------|
| Group transfers | - | - |
| Individual transfers | 129 | 418 |
| | 129 | 418 |

Notes to the Financial Statements

5a Administrative expenses

| | 2015/16 £000 | 2016/17 £000 |
|---|-----------------|-----------------|
| Employee Costs | 52 | 55 |
| The City of Edinburgh Council - other support costs | 7 | 6 |
| System costs | 13 | 13 |
| Actuarial fees | 13 | 9 |
| External audit fees | 2 | 2 |
| Legal fees | - | - |
| Printing and postage | 4 | 4 |
| Depreciation | 3 | 3 |
| Office costs | 6 | 5 |
| Sundry costs less sundry income | 2 | 1 |
| | 102 | 98 |

The Investment and Pensions Service of the Council is responsible for administering the three pension Funds. The Service receives an allocation of the overheads of the Council. In turn the Service allocates administration and investment costs to the three pension funds. Costs directly attributable to a specific fund are charged to the relevant Fund, costs that are common to all three funds are allocated on a defined basis.

5b Investment management expenses

| | 2015/16 £000 | 2016/17 £000 |
|---|-----------------|-----------------|
| <u>External management fees -</u> | | |
| invoiced | 704 | 616 |
| deducted from capital (direct investment) | 329 | 694 |
| deducted from capital (indirect investment) | 368 | 325 |
| Securities lending fees | 43 | 20 |
| Transaction costs | 59 | 33 |
| Employee costs | 70 | 82 |
| Custody fees | 34 | 33 |
| Engagement and voting fees | 6 | 6 |
| Performance measurement fees | 17 | 19 |
| Consultancy fees | 12 | 5 |
| System costs | 13 | 18 |
| Legal fees | 3 | 9 |
| The City of Edinburgh Council - other support costs | 9 | 8 |
| Depreciation | 1 | 2 |
| Office costs | 5 | 6 |
| Sundry costs less sundry income | 4 | 4 |
| | 1,677 | 1,880 |

Any costs incurred through the bid-offer spread on some pooled investment vehicles are reflected in the cost of investment acquisitions or in the proceeds of investment sales (see note 8 - Reconciliation of movements in investments and derivatives).

The external investment management fees above include £0.3m in respect of performance-related fees (2015/16 £0.1m).

Notes to the Financial Statements

5b Investment management expenses (cont)

It should be noted that Lothian Buses Pension Fund's disclosure on investment management fees goes further than CIPFA's LGPS Management Cost revised guidance on cost transparency which came into effect on 1st April 2016. Consistent with recent years, the Fund recognises fees deducted from investments not within its direct control (such as fund of fund fees) to give a full picture of its investment management costs. Further details can be found on page 19. This further disclosure highlights an extra £325k in costs (2015/16 £368k)

5c Total management expenses

| | 2015/16 £000 | 2016/17 £000 |
|---------------------------------|-----------------|-----------------|
| Administrative costs | 80 | 78 |
| Investment management expenses* | 1,621 | 1,814 |
| Oversight and governance costs | 78 | 86 |
| | 1,779 | 1,978 |

* as per note 5b, includes £325k (2015/16 £368k) in costs above CIPFA guidance

In accordance with CIPFA, the above analysis looks at the combined administration and investment management expenses in notes 5a and b and splits out the costs to include a third category covering oversight and governance expenditure.

6 Investment income

| | 2015/16 £000 | 2016/17 £000 |
|--|-----------------|-----------------|
| Income from bonds | 92 | 186 |
| Dividends from equities | 6,025 | 7,026 |
| Income from pooled investment vehicles | 1,751 | 452 |
| Interest on cash deposits | 53 | 18 |
| Stock lending and sundries | 214 | 103 |
| | 8,135 | 7,785 |
| Irrecoverable withholding tax | (59) | (144) |
| | 8,076 | 7,641 |

Notes to the Financial Statements

7 Analysis of investments

| | Region | 31 March 2016 £000 | 31 March 2017 £000 |
|---|----------|-----------------------|-----------------------|
| Investment Assets | | | |
| Bonds | | | |
| Public sector fixed interest securities | Overseas | 1,122 | - |
| Public sector index linked gilts quoted | UK | 18,539 | 73,313 |
| | | 19,661 | 73,313 |
| Equities | | | |
| Quoted | UK | 32,849 | 33,935 |
| Quoted | Overseas | 203,568 | 239,668 |
| | | 236,417 | 273,603 |
| Pooled investment vehicles | | | |
| Managed funds - property | UK | 37,492 | 38,146 |
| Managed funds - index linked gilts | UK | 28,326 | - |
| Managed funds - other bonds | UK | 27,221 | 30,100 |
| Timber funds - unquoted | Overseas | 8,023 | 8,361 |
| Infrastructure - unquoted | UK | 4,424 | 26,636 |
| Infrastructure - unquoted | Overseas | 13,583 | 12,607 |
| Private debt funds - unquoted | UK | 1,051 | 2,266 |
| Private debt funds - unquoted | Overseas | 1,803 | 4,450 |
| | | 121,923 | 122,566 |

8 Reconciliation of movement in investments and derivatives

| | Market value at 31 March 2016 £000 | Purchases at cost & derivative payments £000 | Sales & derivative receipts £000 | Change in market value £000 | Market value at 31 March 2017 £000 |
|---|---------------------------------------|---|-------------------------------------|--------------------------------|---------------------------------------|
| Bonds | 19,661 | 87,284 | (49,714) | 16,082 | 73,313 |
| Equities | 236,417 | 15,473 | (41,164) | 62,877 | 273,603 |
| Pooled investment vehicles | 121,923 | 18,969 | (29,504) | 11,178 | 122,566 |
| Derivatives - fwd foreign exchange | (32) | 604 | (265) | (307) | - |
| Derivatives - futures | - | 3 | (692) | 689 | - |
| | 377,969 | 122,333 | (121,339) | 90,519 | 469,482 |
| Other financial assets / (liabilities) | | | | | |
| Cash deposits | 11,811 | | | 69 | 14,074 |
| Broker balances | (73) | | | 84 | (18) |
| Dividend due etc | 1,081 | | | - | 1,398 |
| | 12,819 | | | 153 | 15,454 |
| Net financial assets | 390,788 | | | 90,672 | 484,936 |

The change in market value of investments during the year comprises all increases and decreases in the market value of investments held at any time during the year, including profits and losses realised on sales of investments during the year.

Notes to the Financial Statements

8 Reconciliation of movement in investments and derivatives (cont)

Any costs incurred through the bid-offer spread on some pooled investment vehicles are reflected in the cost of investment acquisitions and in the proceeds from sales and are therefore included in the tables above.

| | Market value at 31 March 2015 £000 | Purchases at cost & derivative payments £000 | Sales & derivative receipts £000 | Change in market value £000 | Market value at 31 March 2016 £000 |
|---|---------------------------------------|---|-------------------------------------|--------------------------------|---------------------------------------|
| Bonds | 13,209 | 10,193 | (4,284) | 543 | 19,661 |
| Equities | 242,863 | 27,541 | (31,081) | (2,906) | 236,417 |
| Pooled investment vehicles | 105,943 | 12,172 | (1,947) | 5,755 | 121,923 |
| Derivatives - fwd foreign exchange | - | 31 | (7) | (56) | (32) |
| | 362,015 | 49,937 | (37,319) | 3,336 | 377,969 |
| Other financial assets / (liabilities) | | | | | |
| Cash deposits | 19,174 | | | 112 | 11,811 |
| Broker balances | (17) | | | 84 | (73) |
| Dividend due etc | 991 | | | - | 1,081 |
| | 20,148 | | | 196 | 12,819 |
| Net financial assets | 382,163 | | | 3,532 | 390,788 |

9 Derivatives - forward foreign exchange

Summary of contracts held at 31 March 2017

| Contract settlement within | Currency bought | Currency sold | Local currency bought 000 | Local currency sold 000 | Asset value £000 | Liability value £000 |
|--|-----------------|---------------|------------------------------|----------------------------|---------------------|-------------------------|
| Up to one month | - | - | - | - | - | - |
| Open forward currency contracts at 31 March 2017 | | | | | - | - |
| Net forward currency contracts at 31 March 2017 | | | | | | - |
| Prior year comparative | | | | | | |
| Open forward currency contracts at 31 March 2016 | | | | | - | (32) |
| Net forward currency contracts at 31 March 2016 | | | | | | (32) |

At the year ended 31 March 2017 the Lothian Buses Pension Fund did not hold any Forward foreign exchange contracts.

Notes to the Financial Statements

10 Investment managers and mandates

| Manager | Mandate | Market value at 31 March 2016 £000 | % of total 31 March 2016 % | Market value at 31 March 2017 £000 | % of total 31 March 2017 % |
|-------------------------------------|-------------------------|--|-------------------------------------|--|-------------------------------------|
| Baillie Gifford | Global equities | 112,761 | 28.9 | 124,570 | 25.7 |
| In-house | Global high dividend | 116,638 | 29.8 | 142,297 | 29.3 |
| In-house | Private equity quoted | 4,659 | 1.2 | 6,287 | 1.3 |
| Total global equities | | 234,058 | 59.9 | 273,154 | 56.3 |
| Baillie Gifford | Index linked gilts | 28,326 | 7.2 | - | 0.0 |
| In-house | Index linked gilts | 19,771 | 5.1 | 73,793 | 15.2 |
| Total inflation linked bonds | | 48,097 | 12.3 | 73,793 | 15.2 |
| Baillie Gifford | Corporate bonds | 27,221 | 7.0 | 30,100 | 6.2 |
| In-house | Secured loans quoted | 4 | 0.0 | - | 0.0 |
| In-house | Secured loans unquoted | 2,855 | 0.7 | 6,716 | 1.4 |
| Total fixed income assets | | 30,080 | 7.7 | 36,816 | 7.6 |
| Standard Life | Property | 37,491 | 9.6 | 38,146 | 7.9 |
| In-house | Infrastructure unquoted | 18,007 | 4.6 | 39,243 | 8.1 |
| In-house | Infrastructure quoted | 6,660 | 1.7 | 3,661 | 0.8 |
| In-house | Timber | 8,022 | 2.1 | 8,361 | 1.7 |
| Total other real assets | | 70,180 | 18.0 | 89,411 | 18.5 |
| In-house | Cash | 8,373 | 2.1 | 11,762 | 2.4 |
| Total cash and sundries | | 8,373 | 2.1 | 11,762 | 2.4 |
| Net financial assets | | 390,788 | 100.0 | 484,936 | 100.0 |

11 Investments representing more than 5% of the net assets of the Fund

| | Market value at 31 March 2016 £000 | % of net assets 31 March 2016 | Market value at 31 March 2017 £000 | % of net assets 31 March 2017 |
|--|--|--|--|--|
| Standard Life Property Fund | 37,491 | 9.5 | 38,146 | 7.9 |
| Baillie Gifford Inv Grade Bond Fund | 27,221 | 6.9 | 30,100 | 6.2 |
| Baillie Gifford Index Linked Gilt Fund | 28,326 | 7.2 | - | 0.0 |

Notes to the Financial Statements

12 Investments representing more than 5% of any investment class

| | Market value at 31 March 2016 £000 | % of asset class 31 March 2016 | Market value at 31 March 2017 £000 | % of asset class 31 March 2017 |
|--|--|---|--|---|
| Bonds | | | | |
| UK Gov 1.125% Index Linked 22/11/37 | 1,213 | 6.2 | 10,490 | 14.3 |
| UK Gov 0.125% Index Linked 22/03/44 | 3,142 | 16.0 | 10,003 | 13.6 |
| UK Gov 1.25% Index Linked 2055 | 2,341 | 11.9 | 8,634 | 11.8 |
| UK Gov 0.125% Index Linked 22/03/68 | 1,981 | 10.1 | 7,624 | 10.4 |
| UK Gov 0.625% Index Linked 22/03/40 | 1,228 | 6.2 | 7,225 | 9.9 |
| UK Gov 0.125% Index Linked 22/03/58 | 1,847 | 9.4 | 6,300 | 8.6 |
| UK Gov 0.25% Index Linked 22/03/52 | 1,133 | 5.8 | 4,203 | 5.7 |
| UK Gov 0.375% Index Linked 22/03/62 | 919 | 4.7 | 3,650 | 5.0 |
| UK Gov 2% Index Linked 26/01/35 | 1,360 | 6.9 | 3,405 | 4.6 |
| Pooled funds | | | | |
| Standard Life Property Fund | 37,491 | 30.8 | 38,146 | 31.0 |
| Baillie Gifford Inv Grade Bond Fund | 27,221 | 22.3 | 30,100 | 24.4 |
| Baillie Gifford Index Linked Gilt Fund | 28,326 | 23.2 | - | 0.0 |

13 Securities lending

During the year Lothian Buses Pension Fund participated in a securities lending arrangement with the Northern Trust Company. As at 31 March 2017, £17.4m (2016 £10.4m) of securities were released to third parties. Collateral valued at 105.24% (2016 110.26%) of the market value of the securities on loan was held at that date.

14 Financial Instruments

14a Classification of financial instruments

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

All financial instruments are marked to market (at fair value) in the Fund's accounting records, hence there is no difference between the carrying value and fair value.

Notes to the Financial Statements

14a Classification of financial instruments

| | 31 March 2016 | | | 31 March 2017 | | |
|-------------------------------|---|-------------------------------|---|---|-------------------------------|---|
| | Designated as fair value through fund account £000 | Loans and receivables £000 | Financial liabilities at amortised cost £000 | Designated as fair value through fund account £000 | Loans and receivables £000 | Financial liabilities at amortised cost £000 |
| Financial assets | | | | | | |
| Investment assets | | | | | | |
| Bonds | 19,661 | - | - | 73,313 | - | - |
| Equities | 236,417 | - | - | 273,603 | - | - |
| Pooled investments | 121,923 | - | - | 122,566 | - | - |
| Cash | - | 11,811 | - | - | 14,074 | - |
| Other balances | - | 1,291 | - | - | 1,398 | - |
| | 378,001 | 13,102 | - | 469,482 | 15,472 | - |
| Other assets | | | | | | |
| City of Edinburgh Council | - | 400 | - | - | 385 | - |
| Cash | - | 2,867 | - | - | 2,440 | - |
| Debtors | - | 828 | - | - | 744 | - |
| | - | 4,095 | - | - | 3,569 | - |
| Assets total | 378,001 | 17,197 | - | 469,482 | 19,041 | - |
| Financial liabilities | | | | | | |
| Investment liabilities | | | | | | |
| Derivative contracts | (32) | - | - | - | - | - |
| Other investment balances | - | - | (283) | - | - | (18) |
| | (32) | - | (283) | - | - | (18) |
| Other liabilities | | | | | | |
| Creditors | - | - | (452) | - | - | (362) |
| Liabilities total | (32) | - | (735) | - | - | (380) |
| Total net assets | 377,969 | 17,197 | (735) | 469,482 | 19,041 | (380) |

| | | |
|-----------------------------------|---------|---------|
| Total net financial assets | 394,431 | 488,143 |
|-----------------------------------|---------|---------|

14b Net gains and losses on financial instruments

| | 2015/16 £000 | 2016/17 £000 |
|---|-----------------|-----------------|
| Designated as fair value through fund account | 3,336 | 90,519 |
| Loans and receivables | 196 | 153 |
| Financial liabilities at amortised cost | - | - |
| Total | 3,532 | 90,672 |

Notes to the Financial Statements

14c Valuation of financial instruments carried at fair value

The valuation of financial instruments has been classified into three levels, according to the quality and reliability of information used to determine fair values.

Level 1

Financial instruments 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 and unit trusts.

Quoted investments are shown at bid prices. The bid value of the investment is based on the bid market quotation of the relevant stock exchange.

Level 2

Financial instruments 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 and where these techniques use inputs that are based significantly on observable market data.

Level 3

Financial instruments 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. Such instruments would include unquoted equity investments, which are valued using various valuation techniques that require significant judgement in determining appropriate assumptions.

The values of the investments in unquoted private debt, infrastructure and timber are based on valuations provided by the general partners to the funds in which the Fund has invested.

These valuations are prepared in accordance with the International Private Equity and Venture Capital Valuation Guidelines or similar guidelines provided by the British Venture Capital Association, which follow the valuation principles of International Financial Reporting Standards (IFRS). The valuations are typically undertaken annually at the end of December. Cash flow adjustments are used to roll forward the valuations to 31 March as appropriate.

Notes to the Financial Statements

14c Valuation of financial instruments carried at fair value (cont)

| | 31 March 2017 | | | |
|---|-----------------|-----------------|-----------------|----------------|
| | Level 1 £000 | Level 2 £000 | Level 3 £000 | Total £000 |
| Investment assets | | | | |
| Designated as fair value through fund account | 341,849 | 73,313 | 54,320 | 469,482 |
| Loans and receivables | 15,472 | - | - | 15,472 |
| Total investments assets | 357,321 | 73,313 | 54,320 | 484,954 |
| Investment liabilities | | | | |
| Designated as fair value through fund account | (18) | - | - | (18) |
| Total investment liabilities | (18) | - | - | (18) |
| Net Investment assets | 357,303 | 73,313 | 54,320 | 484,936 |

| | 31 March 2016 | | | |
|---|-----------------|-----------------|-----------------|----------------|
| | Level 1 £000 | Level 2 £000 | Level 3 £000 | Total £000 |
| Investment assets | | | | |
| Designated as fair value through fund account | 329,457 | 19,661 | 28,883 | 378,001 |
| Loans and receivables | 13,102 | - | - | 13,102 |
| Total investments assets | 342,559 | 19,661 | 28,883 | 391,103 |
| Investment liabilities | | | | |
| Designated as fair value through fund account | (315) | - | - | (315) |
| Total investment liabilities | (315) | - | - | (315) |
| Net Investment assets | 342,244 | 19,661 | 28,883 | 390,788 |

14d Reconciliation of fair value measurements within level 3

| | Market value at 31 March 2016 | Level 3 transfers | | Purchases at cost & derivative payments | Sales & derivative receipts | Unrealised gains / (losses) | Realised gains / (losses) | Market value at 31 March 2017 |
|---------------------------|-------------------------------------|-------------------|----------|--|-----------------------------------|-----------------------------------|---------------------------------|-------------------------------------|
| | | in | out | | | | | |
| Pooled investments | | | | | | | | |
| Infrastructure | 18,007 | - | - | 18,781 | (2,306) | 4,456 | 305 | 39,243 |
| Timber | 8,022 | - | - | - | (889) | 188 | 1,040 | 8,361 |
| Secured loans | 2,854 | - | - | 3,953 | (291) | 3 | 197 | 6,716 |
| | 28,883 | - | - | 22,734 | (3,486) | 4,647 | 1,542 | 54,320 |

Unrealised and realised gains and losses are recognised in the profit and losses on disposal and changes in the market value of investments line of the fund account.

Notes to the Financial Statements

15 Nature and extent of risk arising from financial instruments

Risk and risk management

The Fund's primary aim is to ensure that all members and their dependants receive their benefits when they become payable. The investment strategy aims to maximise the returns from investments within reasonable risk parameters and hence minimise the long-term cost to employers. The Fund achieves this by investing in a diverse range of assets to reduce risk to an acceptable level. In addition, the Fund ensures that sufficient cash is available to meet all liabilities when they are due to be paid.

Responsibility for the Fund's overall investment strategy rests with the Pensions Committee. The Investment Strategy Panel and the internal investment team monitor investment risks on a regular basis. Investment risk management tools are used to identify and analyse risks faced by the Fund's investments.

Consideration of the Fund's investment risk is part of the overall risk management of the pensions operations. Risks are reviewed regularly to reflect changes in activity and market conditions.

Types of investment risk

There are various ways of considering investment risks for pension funds. For the purposes of this note, market risk is the potential for an investor to experience losses from falls in the prices of investments. All financial instruments, including cash deposits, present a risk of loss of capital and risks vary depending on different asset classes.

Market risk also changes over time as economic conditions and investor sentiment change. The Fund considers overall fluctuations in prices arising from a variety of sources: market risk, foreign exchange risk, interest rate risk, credit risk, etc. The different risks may, to some extent, offset each other.

The overall market risk of the Fund depends on the actual mix of assets and encompasses all the different elements of risk.

The Fund manages these risks in a number of ways:

- assessing and establishing acceptable levels of market risk when setting overall investment strategy. Importantly, risk is considered relative to the liabilities of the Fund
- diversification of investments in terms of type of asset, investment styles, investment managers, geographical and industry sectors as well as individual securities
- taking stewardship responsibilities seriously and pursuing constructive engagement with the companies in which we invest
- monitoring market risk and market conditions to ensure risk remains within tolerable levels
- using equity futures contracts from time to time to manage market risk. Options are not used by the Fund.

Notes to the Financial Statements

15 Nature and extent of risk arising from financial instruments (cont)

Sensitivity analysis

Asset prices have a tendency to fluctuate. The degree of such fluctuation is known as “volatility” and it differs by asset class. The table sets out the long-term volatility assumptions used in the Fund’s asset-liability modelling undertaken by the Fund’s investment adviser KPMG:

| Asset type | Potential price movement (+ or -) |
|------------------------------|-----------------------------------|
| Equities - Developed Markets | 20.5% |
| Private Equity | 30.0% |
| Timber and Gold | 18.0% |
| Secured Loans | 8.0% |
| Corporate Bonds | 5.5% |
| Index-Linked Gilts | 10.9% |
| Infrastructure | 18.0% |
| Property | 13.0% |
| Cash | 1.1% |

Volatility is the standard deviation of annual returns. Broadly speaking, in two years out of three, the asset’s change in value (which could be a gain or a loss) is expected to be lower than the volatility figure, but in one year out of three, the change in value is expected to be higher than the volatility figure.

Asset classes do not always move in line with each other. The extent to which assets move together is known as their “correlation”. A lower correlation means that there is less risk of assets losing value at the same time.

The overall Fund benefits from “diversification” because it invests in different asset classes, which don’t all move in line with each other. Consequently, the aggregate risk at the Fund level is less than the total risk from all the individual assets in which the Fund invests. The following table shows the risks at the asset class level and the overall Fund level, with and without allowance for correlation.

| | Value at 31 March 2017 £000 | % of fund % | Potential Change +/- % | Value on increase £000 | Value on decrease £000 |
|-----------------------------------|-----------------------------------|----------------|---------------------------------|------------------------------|------------------------------|
| Equities - Developed Markets | 266,867 | 55.1 | 20.5 | 321,575 | 212,159 |
| Private Equity | 6,287 | 1.3 | 30.0 | 8,173 | 4,401 |
| Timber and Gold | 8,361 | 1.7 | 18.0 | 9,866 | 6,856 |
| Secured Loan | 6,717 | 1.4 | 8.0 | 7,254 | 6,180 |
| Corporate Bonds | 30,100 | 6.2 | 5.5 | 31,764 | 28,436 |
| Index-Linked Gilts | 73,793 | 15.2 | 10.9 | 81,801 | 65,785 |
| Infrastructure | 42,903 | 8.8 | 18.0 | 50,626 | 35,180 |
| Property | 38,146 | 7.9 | 13.0 | 43,105 | 33,187 |
| Cash and forward foreign exchange | 11,762 | 2.4 | 1.1 | 11,892 | 11,632 |
| Total [1] | 484,936 | 100.0 | 16.7 | 566,055 | 403,817 |
| Total [2] | | | 13.9 | 552,240 | 417,632 |
| Total [3] | | | 13.9 | 552,287 | n/a |

[1] No allowance for correlations between assets

[2] Including allowance for correlations between assets

[3] Including allowance for correlation between assets and liabilities.

Notes to the Financial Statements

15 Nature and extent of risk arising from financial instruments (cont)

The value on increase/decrease columns illustrate the monetary effect of the percentage change in the volatility column. The actual annual change in value is expected to be lower than this in two years out of three, but higher in one year out of three.

It can be seen that the risk to the overall Fund assets [2] is lower than the total of the risks to the individual assets.

However, because the purpose of a pension scheme is to make payments to scheme beneficiaries, the true risk of a pension scheme is not measured in absolute terms, but relative to its liabilities [3].

This risk analysis incorporates volatility from market, interest rate, foreign exchange, credit, and all other sources of risk, and, importantly, makes allowance for how these risks may offset each other.

Credit risk

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

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

Cash deposits, derivatives and securities lending are the major areas of credit exposure where credit risk is not reflected in market prices.

Cash deposits

At 31 March 2017, cash deposits represented £16.5m, 3.3% of total net assets. This was held with the following institutions:

| | Moody's Credit Rating at 31 March 2017 | Balances at 31 March 2016 £000 | Balances at 31 March 2017 £000 |
|--|--|-----------------------------------|-----------------------------------|
| Held for investment purposes | | | |
| Northern Trust Global Investment Limited - liquidity funds | Aaa-mf | 2,384 | 3,270 |
| Northern Trust Company - cash deposits | Aa2 | 8,509 | 9,882 |
| The City of Edinburgh Council - treasury management | See below | 918 | 922 |
| Total investment cash | | 11,811 | 14,074 |
| Held for other purposes | | | |
| The City of Edinburgh Council - treasury management | See below | 2,867 | 2,440 |
| Total cash | | 14,678 | 16,514 |

The majority of Sterling cash deposits of the Fund are managed along with those of the administering authority (the City of Edinburgh Council) and other related organisations which are pooled for investment purposes as a treasury cash fund. Management of the cash fund is on a low risk basis, with security of the investments the key consideration.

Notes to the Financial Statements

15 Nature and extent of risk arising from financial instruments (cont)

The Council has in place institutional restrictions on investments and counterparty criteria. These include -

- (a) UK Government and other UK local Authorities with no limit, other public bodies up to £20 million per organisation.
- (b) Money market funds (MMFs) no more than £30 million or 15% with any one Fund.
- (c) Financial Institutions: Banks and Building Societies with multiple criteria based on a range of short and long term credit ratings, as well as any security provided, from maximum of £60 million / 20% of assets under management (AUM) for institutions with the highest criteria to £10 million / 5% of AUM for institutions with the lowest acceptable criteria.

| | Moody's Credit Rating at 31 March 2017 | Balances at 31 March 2016 £000 | Balances at 31 March 2017 £000 |
|---|--|-----------------------------------|-----------------------------------|
| Money market funds | | | |
| Deutsche Bank AG, London | Aaa-mf | 505 | 18 |
| Goldman Sachs | Aaa-mf | 4 | - |
| Bank call accounts | | | |
| Bank of Scotland | A1 | 248 | 336 |
| Royal Bank of Scotland | A3 | 40 | 5 |
| Santander UK | Aa3 | - | 1 |
| Barclays Bank | A1 | 256 | - |
| Svenska Handelsbanken | Aa2 | 261 | 1 |
| UK Pseudo-Sovereign risk instruments | | | |
| Other Local Authorities [1] | Aa1 | 1,717 | 3,001 |
| UK Government Treasury Bills | Aa1 | 754 | - |
| | | 3,785 | 3,362 |

[1] Very few Local Authorities have their own credit rating but they are generally assumed to have a pseudo-sovereign credit rating (which in the UK at 31 March 2017 was 'Aa1').

No breaches of the Council's counterparty criteria occurred during the reporting period and the Fund does not expect any losses from non-performance by any of its counterparties in relation to deposits.

Securities lending

The Fund participates in a securities lending programme as described above. The Fund is potentially exposed to credit risk in the event of the borrower of securities defaults. This risk is mitigated by the contractual commitment that borrowers provide collateral in excess of 100% of the value of the securities borrowed. In addition, Northern Trust has signed an agreement requiring it to make good any losses arising from the lending programme.

Derivatives

The Fund transacts foreign currency derivatives over-the-counter and hence is exposed to credit risk in the event of a counterparty defaulting on the net payment or receipt that remains outstanding. This risk is minimised by the use of counterparties that are recognised financial intermediaries with acceptable credit ratings and by netting agreements. At 31 March 2017, the Fund had no over-the-counter foreign currency derivatives.

Refinancing risk

Refinancing risk is the risk that the Fund will be bound to replenish a significant proportion of its pension fund financial instruments at a time of unfavourable interest rates. The Fund is not bound by any obligation to replenish its investments and hence is not exposed to refinancing risk.

Notes to the Financial Statements

15 Nature and extent of risk arising from financial instruments (cont)

Liquidity risk

Liquidity risk reflects the risk that the Fund will not be able to meet its financial obligations as they fall due. The Fund therefore ensures that there is adequate cash and liquid resources to meet its commitments. Cash flow projections are prepared on a regular basis to understand and manage the timing of the Fund's cash flows.

The majority (estimated to be approximately 89% (2016 93%)) of the Fund's investments could be converted to cash within three months in a normal trading environment.

16 Actuarial statement

The Scheme Actuary has provided a statement describing the funding arrangements of the Fund. This can be found at the end of this section.

17 Actuarial present value of promised retirement benefits

The actuarial value of promised retirement benefits at the accounting date, calculated in line with International Accounting Standard 19 (IAS19) assumptions, is estimated to be £488m (2016 £374m). This figure is used for statutory accounting purposes by Lothian Buses Pension Fund and complies with the requirements of IAS26.

The figure is only prepared for the purposes of IAS26 and has no validity in other circumstances. In particular, it is not relevant for calculations undertaken for funding purposes and setting contributions payable to the Fund.

| Financial assumptions | 31 March 2016 | 31 March 2017 |
|----------------------------------|---------------|---------------|
| | % p.a. | % p.a. |
| Inflation/pensions increase rate | 2.2 | 2.4 |
| Salary increase rate | 4.2 | 4.4 |
| Discount rate | 3.5 | 2.6 |

Longevity assumptions

The life expectancy assumption is based on Fund specific statistical analysis with improvements in line with the CMI 2012 model, assuming that the current rate of improvements has reached a peak and will converge to a long term rate of 1.25% p.a.. Based on these assumptions, the average future life expectancies, in years, at age 65 are summarised below:

| | 31 March 2016 | | 31 March 2017 | |
|--|---------------|------------|---------------|------------|
| | Males | Females | Males | Females |
| Current pensioners | 20.4 years | 22.9 years | 20.4 years | 22.9 years |
| Future pensioners (assumed to be currently 45) | 23.5 years | 25.9 years | 23.5 years | 25.9 years |

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 for post-April 2009 service.

Notes to the Financial Statements

18 Debtors

| | 2015/16 £000 | 2016/17 £000 |
|------------------------------|-----------------|-----------------|
| Contributions due - employer | 576 | 581 |
| Contributions due - members | 158 | 153 |
| Sundry debtors | 94 | 10 |
| | 828 | 744 |

Analysis of debtors

| | 31 March 2016 £000 | 31 March 2017 £000 |
|--------------------------------|-----------------------|-----------------------|
| Administering Authority | 1 | 1 |
| Lothian Buses Limited | 818 | 733 |
| Other entities and individuals | 9 | 10 |
| | 828 | 744 |

19 Creditors

| | 31 March 2016 £000 | 31 March 2017 £000 |
|--|-----------------------|-----------------------|
| Benefits payable | 275 | 201 |
| Miscellaneous creditors and accrued expenses | 177 | 161 |
| | 452 | 362 |

Analysis of creditors

| | 31 March 2016 £000 | 31 March 2017 £000 |
|--------------------------------|-----------------------|-----------------------|
| Other entities and individuals | 452 | 362 |
| | 452 | 362 |

20 Additional Voluntary Contributions

Active members of the Lothian Buses Pension Fund have the option to pay additional voluntary contributions (AVCs). These AVCs are invested separately from the main funds, securing additional benefits on a money purchase basis for those members that have elected to contribute. The investment of the AVCs is managed by Standard Life and Prudential.

In accordance with regulation 4 (2) (b) of the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010, AVCs are not included in the pension fund financial statements.

| Total contributions during year | 2015/16 £000 | 2016/17 £000 |
|---------------------------------|-----------------|-----------------|
| Standard Life | 6 | 8 |
| Prudential | 61 | 70 |
| | 67 | 78 |

| Total value at year end | 31 March 2016 £000 | 31 March 2017 £000 |
|-------------------------|-----------------------|-----------------------|
| Standard Life | 170 | 155 |
| Prudential | 315 | 294 |
| | 485 | 449 |

Notes to the Financial Statements

21 Related party transactions

The City of Edinburgh Council

The Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund are administered by the City of Edinburgh Council. Consequently there is a strong relationship between the Council and the Pension Funds.

The Investment and Pensions Service of the Council is responsible for administering the three Pension Funds. The Service receives an allocation of the overheads of the Council, based on the amount of central services consumed. In turn, the Service allocates its costs to the three Pension Funds. Costs directly attributable to a specific Fund are charged to the relevant Fund; costs that are common to all three Funds are allocated on a defined basis.

Transactions between the Council and the Fund are managed via a holding account. Each month the Fund is paid a cash sum leaving a working balance in the account to cover the month's pension payroll costs and other expected costs.

| | 31 March 2016 £000 | 31 March 2017 £000 |
|-------------------------------------|-----------------------|-----------------------|
| Year end balance of holding account | 400 | 385 |
| | 400 | 385 |

Part of the Fund's cash holdings are invested on the money markets by the treasury management operations of the Council, through a service level agreement. During the year to 31 March 2017, the fund had an average investment balance of £3.0m (2016 £9.5m). Interest earned was £12.1k (2016 £12.2k).

| Year end balance on treasury management account | 31 March 2016 £000 | 31 March 2017 £000 |
|---|-----------------------|-----------------------|
| Held for investment purposes | 918 | 922 |
| Held for other purposes | 2,867 | 2,440 |
| | 3,785 | 3,362 |

Scheme employer - Lothian Buses Limited

Lothian Buses Limited are (by definition) a related party to the scheme. The employer contributions to the Fund can be found in note 3 (page 70) of the notes to the Financial Statements.

Governance

As at 31 March 2017, all members of the Pensions Committee, with the exception of Councillor Bill Cook and Richard Lamont, and all members of the Pensions Board, were members of the Lothian Pension Fund or Lothian Buses Pension Fund, with one member of the Pensions Board in receipt of pension benefits from Lothian Pension Fund.

Each member of the Pensions Committee and Pension Board is required to declare any financial and non-financial interests they have in the items of business for consideration at each meeting, identifying the relevant agenda item and the nature of their interest.

Notes to the Financial Statements

21 Related party transactions (cont)

With effect from 1 May 2015, all the employees listed below, with the exception of the Executive Director of Resources, were employed by LPFE Limited. These employees and their financial relationship with the Fund (expressed as cash-equivalent transfer values or CETV) are set out below:

| Name | Position held | Accrued CETV as | Accrued CETV as |
|------------------|---|---------------------|---------------------|
| | | at 31 March 2016 | at 31 March 2017 |
| | | £000 | £000 |
| Hugh Dunn* | Acting Executive Director of Resources, City of Edinburgh Council | 755 | 1,251 |
| Clare Scott* | Chief Executive Officer, Lothian Pension Fund | 175 | 221 |
| Bruce Miller | Chief Investment Officer, Lothian Pension Fund | 185 | 267 |
| Struan Fairbairn | Chief Risk Officer, Lothian Pension Fund | 30 | 46 |
| John Burns | Chief Finance Officer, Lothian Pension Fund | 474 | 538 |
| Esmond Hamilton | Financial Controller, Lothian Pension Fund | 161 | 200 |

* Also disclosed in the financial statements of the City of Edinburgh Council.

Total compensation paid in relation to key management personnel employed by LPFE Limited during the period was as follows:

| | 31 March 2016 | 31 March 2017 |
|---|---------------|---------------|
| | £000 | £000 |
| Short-term employee benefits | 318 | 380 |
| Post-employment benefits - employer pension contributions | 65 | 78 |

Key management personnel employed by LPFE, had accrued pensions totalling £81,825 (1 April 2016: £68,004) and lump sums totalling £100,185 (1 April 2016: £68,004) at the end of the period.

Staff are either employed by City of Edinburgh Council or LPFE Limited, and their costs reimbursed by the Pension Funds. The Councillors, who are members of the Pensions Committee, are also remunerated by City of Edinburgh Council.

22 Contractual commitments

The Fund has commitments relating to outstanding call payments due on unquoted funds invested in private debt, timber and infrastructure. The amounts 'called' by these funds are irregular in both size and timing, taking place over a period of years from the date of each original commitment. The outstanding commitments at the year end are as follows:

| | 31 March 2016 | 31 March 2017 |
|------------------------------------|---------------|---------------|
| | £000 | £000 |
| Outstanding investment commitments | 6,722 | 12,462 |
| | 6,722 | 12,462 |

Notes to the Financial Statements

23 Contingent assets and liabilities

At 31 March 2017 the Fund had entered into negotiations for an infrastructure co-investments in which it is exposed to the potential risk of investment abort costs. Lothian Buses Pension Fund's exposure to this is approximately £1.6k.

There were no contingent assets at year end.

24 Impairment losses

No impairment losses have been identified during the year.

Lothian Buses Pension Fund

Actuarial Statement for 2016/17

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

Description of Funding Policy

The funding policy is set out in the Administering Authority's Funding Strategy Statement (FSS), dated 16 November 2015. In summary, the key funding principles are as follows:

- To ensure solvency of the Fund;
- To minimise the degree of short-term change in employer contribution rates;
- Reduce risk of the investment strategy over time;
- To ensure that sufficient cash is available to meet all liabilities as they fall due for payment

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

Funding Position as at the last formal funding valuation

The most recent actuarial valuation carried out under Regulation 32 of the Local Government Pension Scheme (Scotland) (Administration) Regulations 2008 was as at 31 March 2014. This valuation revealed that the Fund's assets, which at 31 March 2014 were valued at £337 million, were sufficient to meet 117% of the liabilities (i.e. the present value of promised retirement benefits) accrued up to that date. The resulting surplus at the 2014 valuation was £48 million.

On the more prudent gilts basis, the Fund's assets as at 31 March 2014 were sufficient to meet 88% of the liabilities accrued to that date. The resulting deficit at the 2014 valuation, on the gilts basis, was £45 million.

The employer contributions for the period 1 April 2015 to 31 March 2018 were set in accordance with the Fund's funding policy as set out in its Funding Strategy Statement.

Principal Actuarial Assumptions and Method used to value the liabilities

Full details of the methods and assumptions used are described in the valuation report dated 31 March 2014.

Method

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

Assumptions

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

Lothian Buses Pension Fund

Actuarial Statement for 2016/17

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

| Financial assumptions | 31 March 2014 | |
|-----------------------------------|---------------|--------|
| | % p.a. | % p.a. |
| | Nominal | Real |
| Discount rate | 5.0% | 2.3% |
| Pay increases* | 5.0% | 2.3% |
| Price inflation/Pension increases | 2.7% | - |

*2% p.a. for 2014/15 and 2015/16, reverting to 5.0% thereafter.

The key demographic assumption was the allowance made for longevity. The life expectancy assumptions are based on the Fund's VitaCurves with improvements in line with the CMI_2012 model, assuming the current rate of improvements has reached a peak and will converge to long term rate of 1.25% p.a.. Based on these assumptions, the average future life expectancies at age 65 are as follows:

| | Males | Females |
|---------------------|------------|------------|
| Current Pensioners | 20.4 years | 22.6 years |
| Future Pensioners * | 23.5 years | 25.9 years |

*Future pensioners are assumed to be at the 2014 valuation aged 45.

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

Experience over the period since April 2014

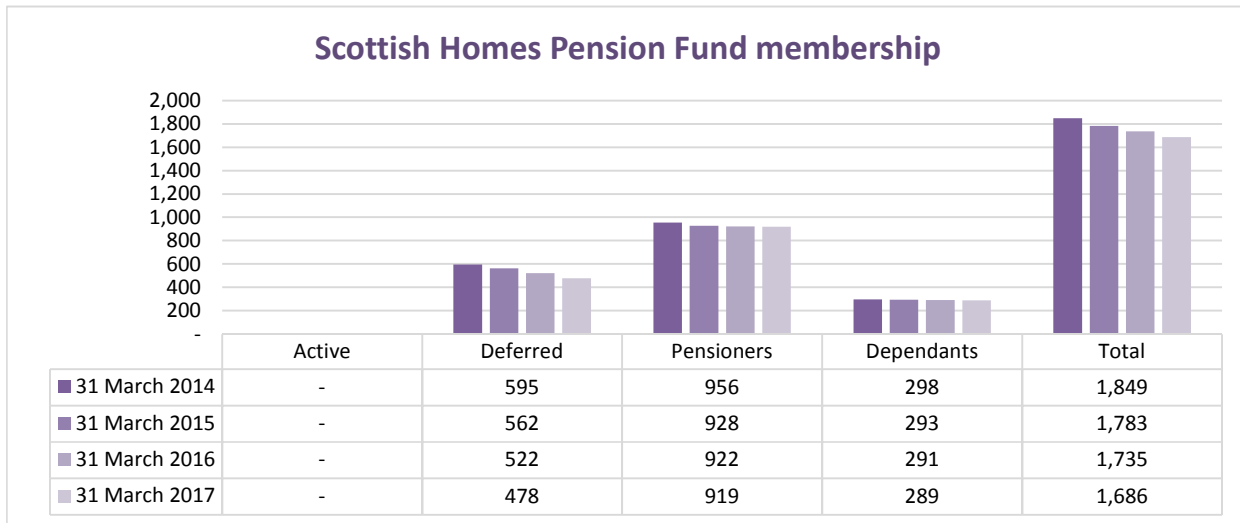
The Fund's experience has been worse than expected since the last formal valuation (excluding the effect of any membership movements and any potential changes to assumptions at the 2017 valuation). Real bond yields have fallen sharply which places a higher value on liabilities. The effect of this will have been partially offset by strong asset returns. The funding level is therefore likely to have worsened over the period.

The next actuarial valuation will be carried out as at 31 March 2017 with the results signed off within 12 months. The Funding Strategy Statement will also be reviewed at that time.

Richard Warden FFA
Fellow of the Institute and Faculty of Actuaries
For and on behalf of Hymans Robertson LLP
20 Waterloo Street
Glasgow
G2 6DB

28 April 2017

Scottish Homes Pension Fund



Investment strategy

The funding agreement with the Scottish Government and the investment strategy are designed to reduce investment risk as the Fund is closed to new members and the liabilities will mature over time. Both allow for acceleration in the sale of equities and property and purchase of bonds if the actual funding level improves to the target funding level. The 2014 Actuarial Valuation showed that the actual funding level (88.8%) was below the target funding level (91.5%).

Following the results of the 2014 Actuarial Valuation, the Pensions Committee approved a revised investment strategy for Scottish Homes Pension Fund in December of that year, with a reducing equity allocation, and corresponding increases in the bond allocation dependent on the funding level. The target funding levels from 2014 to 2026 are shown in the table below along with the corresponding target equity allocations.

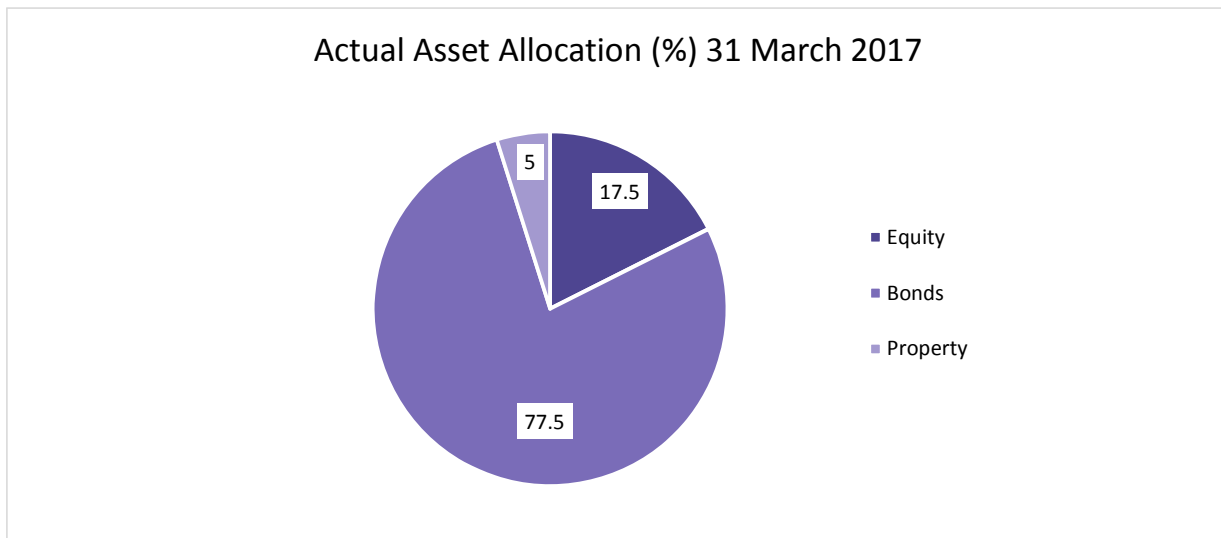
| Year [1] | Target Funding Level | Target Equity Allocation |
|----------|----------------------|--------------------------|
| | % | % |
| 2014 | 91.5 | 30 |
| 2017 | 93.0 | 25 |
| 2020 | 94.5 | 20 |
| 2023 | 95.5 | 15 |
| 2026 | 96.5 | 10 |

[1] The Scottish Government guarantee agreement sets out the increasing target funding levels every 3 years until 2044.

Over 2016/17, the actual funding level fluctuated above and below the target funding level reflecting movements in market interest rates and fund asset prices. Action was taken to vary the equity allocation between 30% and 17.5% over the year, consistent with the funding approach. The strategic asset allocation at the end of the 2016 and 2017 financial years are shown below.

| | Strategic Allocation | Strategic Allocation |
|--------------|----------------------|----------------------|
| | 31 March 2016 | 31 March 2017 |
| | % | % |
| Equities | 30.0 | 17.5 |
| Bonds | 65.0 | 77.5 |
| Property | 5.0 | 5.0 |
| Cash | - | - |
| Total | 100.0 | 100.0 |

During 2016/17, the equity allocation was reduced on four occasions from 30% to 17.5%. These changes were made to take advantage of movements in financial markets, which caused the funding level to trend higher over the course of the year. The actual allocations at 31 March 2017 are shown in the pie chart below.



Due to the requirement to divest on a regular basis, an analysis of a cash flow based strategy was undertaken which looked at alternative asset portfolios to demonstrate the effect on future cash flows for the Fund. As a result, the Fund implemented changes within the current funding approach to enhance income generation and to improve matching of cash flows from bond investments with the expected timing of pension payments. Management of the equity and bond portfolios was brought in-house.

These changes followed on from a review of the investment strategy during 2015/16 and further work undertaken in relation to the proposals to the Scottish Government to change and update its funding agreement. The Scottish Government has agreed to consider alternatives to the existing funding approach. The current bond-focused investment strategy provides income yield of less than 2%, and so the Fund is required to sell assets on a regular basis to pay pensions. The latest work concluded that a less prescriptive investment and funding strategy would allow a higher-yielding investment strategy and a more flexible approach to setting contributions. Further development of the alternative funding strategies will be taken forward in 2017/18 as part of the 2017 actuarial valuation.

Investment performance

The objectives of the Fund are:

- over long-term economic cycles (typically 5 years or more), the achievement of the same return as that generated by the strategic allocation;
- over shorter periods, the Fund should perform better than the strategic allocation if markets fall significantly.

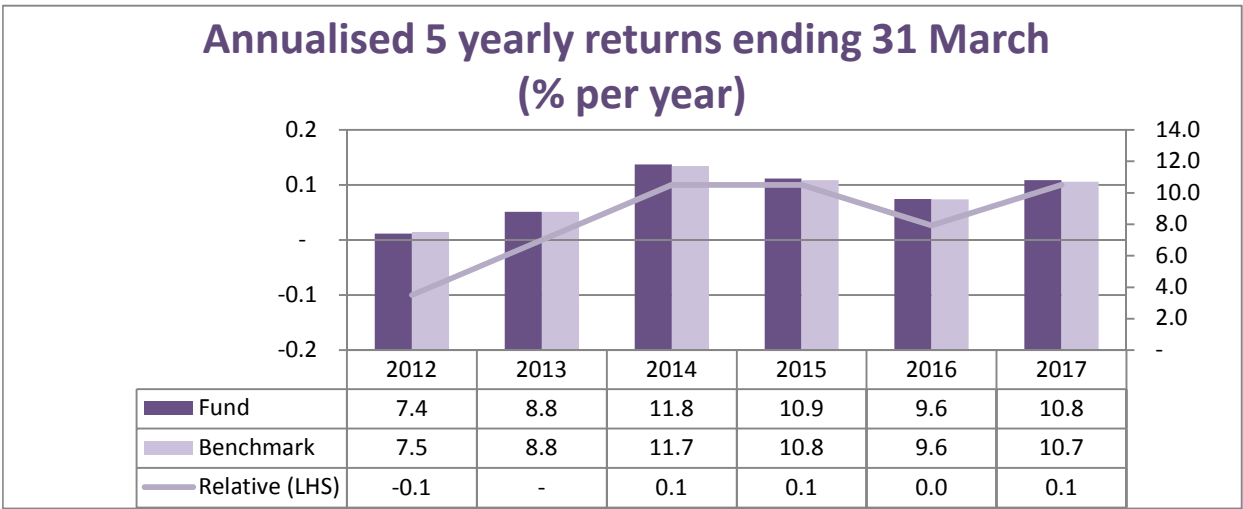
The Fund's annualised performance over the year and longer-term periods is shown in the table below. The Fund has performed broadly in line with its benchmark over all time periods.

| Annualised returns to 31 March 2017 (% per year) | 1 year | 5 years | 10 years |
|---|--------|---------|----------|
| Scottish Homes Pension Fund | 18.9 | 10.8 | 9.1 |
| Benchmark | 18.7 | 10.7 | 9.1 |
| Actuarial Valuation Assumptions * | 3.4 | 3.8 | 4.1 |
| Retail Price Index (RPI) | 3.1 | 2.3 | 2.8 |
| Consumer Price Index (CPI) | 2.3 | 1.4 | 2.3 |
| National Average Earnings | 2.4 | 1.9 | 2.0 |

* estimated

The absolute performance of Scottish Homes Pension Fund over the 12-month period was 18.9% and 5 year performance was 10.8% per annum. Over 2016/17, all asset classes generated healthy positive returns of 22.7%, 14.5%, and 6.2% from equities, bonds and property, respectively. While equities and bonds performed in line with their benchmarks, property outperformed during the

property, respectively. While equities and bonds performed in line with their benchmarks, property outperformed during the period. The Fund's risk has been marginally lower than that of the benchmark over the last year and 5 years. Since inception in July 2005, the Fund has returned +9.3% per annum, in line with its benchmark but well ahead of broad measures of inflation and national average earnings.



Scottish Homes Pension Fund

Fund Account for year ended 31 March 2017

This statement shows a summary of the income and expenditure that the Pension Fund has generated and consumed in delivering the Local Government Pension Scheme. Included is the income generated from the Scottish Government's contributions and investment income, as well as the cost of providing benefits and administration of the Fund.

| 2015/16 | | | 2016/17 |
|----------------|--|---------------|----------------|
| £000 | | Note | £000 |
| | Income | | |
| 675 | Contributions from the Scottish Government | 3 | 675 |
| - | Transfers from other schemes | | - |
| 675 | | | 675 |
| | Less: expenditure | | |
| 6,890 | Pension payments including increases | | 6,789 |
| 472 | Lump sum retirement payments | | 563 |
| 7 | Lump sum death benefits | | - |
| 290 | Transfers to other schemes | 4 | 120 |
| 53 | Administrative expenses | 5b | 68 |
| 7,712 | | | 7,540 |
| (7,037) | Net withdrawals from dealing with members | | (6,865) |
| | Returns on investments | | |
| 799 | Investment income | 6 | 877 |
| 1,962 | Change in market value of investments | 7, 10b | 26,569 |
| (169) | Investment management expenses | 5c | (212) |
| 2,592 | Net returns on investments | | 27,234 |
| (4,445) | Net increase/(decrease) in the Fund during the year | | 20,369 |
| 154,720 | Net assets of the Fund at 1 April 2016 | | 150,275 |
| 150,275 | Net assets of the Fund at 31 March 2017 | 10 | 170,644 |

Scottish Homes Pension Fund

Net Assets Statement as at 31 March 2017

This statement provides a breakdown of type and value of all net assets at the year end.

| 31 March 2016 £000 | Note | 31 March 2017 £000 |
|-------------------------------|--|--------------------------|
| Investment Assets | | |
| 59,749 | Bonds | 127,970 |
| - | Equities - UK | 4,450 |
| - | - Overseas | 23,771 |
| 88,661 | <u>Pooled investment vehicles</u> | 7,998 |
| 7,788 | - UK managed fund - Property | 7,998 |
| 44,928 | - UK managed fund - Equity | - |
| 35,945 | - UK managed fund - Gilts | - |
| 11 | Cash Deposits | 3,602 |
| 177 | Other investment assets | 459 |
| 148,598 | | 168,250 |
| Investment Liabilities | | |
| - | Other investment assets | - |
| - | | - |
| 148,598 | Net investment assets | 168,250 |
| | 8 | |
| Current assets | | |
| 95 | The City of Edinburgh Council | 146 |
| 1,610 | Cash balances | 2,232 |
| 22 | Debtors | 31 |
| 1,727 | | 2,409 |
| Current liabilities | | |
| (50) | Creditors | (15) |
| (50) | | (15) |
| 1,677 | Net current assets | 2,394 |
| 150,275 | Net assets of the Fund at 31 March 2017 | 170,644 |
| | 10 | |

The unaudited accounts were issued on 28 June 2017 and the audited accounts were authorised for issue on 27 September 2017.

JOHN BURNS FCMA CGMA

Chief Finance Officer, Lothian Pension Fund

27 September 2017

Note to the net asset statement

The financial statements summarise the transactions of the Fund during the year and its net assets at the year end. They do not take account of the obligations to pay pensions and benefits which fall due after the end of the year. The actuarial position of the Fund, which does take account of such obligations, is discussed in the Actuarial Valuation section of this report and 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.

Notes to the Financial Statements

1 Statement of Accounting Policies

The statement of accounting policies for all Funds can be found on page 112.

2 Events after the Reporting Date

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

3 Contributions from the Scottish Government

| | 2015/16 £000 | 2016/17 £000 |
|-------------------------|-----------------|-----------------|
| Deficit funding | 575 | 575 |
| Administration expenses | 100 | 100 |
| | 675 | 675 |

The Scottish Homes Pension Fund is a single employer pension fund for former employees of Scottish Homes. The Scottish Homes Pension Fund was set up under (Scottish) Statutory Instrument 315/2005, when Scottish Homes became Communities Scotland, an agency of the Scottish Government.

Following the actuarial valuation at 31 March 2014, deficit funding of £575,000 per year is being paid by the Scottish Government over the period April 2015 to March 2018. In addition, the Scottish Government agreed to pay £100,000 every year towards the cost of ongoing administration.

Where the Scottish Government makes certain decisions which result in additional benefits being paid out to a member, or benefits being paid early, this results in a "strain" on the Fund. The resulting pension strain costs are calculated and recharged in full.

The Fund consists of only deferred and pensioner members, hence no employee contributions were paid during the year.

4 Transfers out to other pension schemes

| | 2015/16 £000 | 2016/17 £000 |
|----------------------|-----------------|-----------------|
| Group transfers | - | - |
| Individual transfers | 290 | 120 |
| | 290 | 120 |

5a Total Management expenses

| | 2015/16 £000 | 2016/17 £000 |
|--------------------------------|-----------------|-----------------|
| Administrative costs | 38 | 38 |
| Investment management expenses | 149 | 149 |
| Oversight and governance costs | 35 | 93 |
| | 222 | 280 |

This analysis of costs for the Scottish Homes Pension Fund has been prepared in accordance with CIPFA guidance. The analysis looks at the combined administration and investment management expenses in note 5b and c and splits out the costs to include a third heading covering oversight and governance expenditure.

Notes to the Financial Statements

5b Administrative expenses

| | 2015/16 £000 | 2016/17 £000 |
|---|-----------------|-----------------|
| Employee Costs | 23 | 26 |
| The City of Edinburgh Council - other support costs | 3 | 3 |
| System costs | 7 | 7 |
| Actuarial fees | 12 | 24 |
| External audit fees | 1 | 1 |
| Printing and postage | 2 | 2 |
| Depreciation | 1 | 1 |
| Office costs | 2 | 3 |
| Sundry costs less sundry income | 2 | 1 |
| | 53 | 68 |

The Investment and Pensions Service of the Council is responsible for administering the three Pension Funds. The Service receives an allocation of the overheads of the Council. In turn the Service apportioned administration and investment costs to the three pension funds. Costs directly attributable to a specific fund are charged to the relevant Fund, costs that are common to all three funds are apportioned on a defined basis.

5c Investment management expenses

| | 2015/16 £000 | 2016/17 £000 |
|---|-----------------|-----------------|
| External management fees - invoiced | 52 | 50 |
| External management fees - deducted from capital (direct) | 52 | 55 |
| External management fees - deducted from capital (indirect) | - | - |
| Transaction costs | 1 | 40 |
| Employee costs | 25 | 29 |
| Custody fees | 17 | 14 |
| Engagement and voting fees | 2 | 2 |
| Performance measurement fees | 5 | 5 |
| Consultancy fees | 2 | 2 |
| System costs | 5 | 6 |
| Legal fees | - | 3 |
| The City of Edinburgh Council - other support costs | 3 | 3 |
| Office costs | 2 | 2 |
| Sundry costs less sundry income | 3 | 1 |
| | 169 | 212 |

Any indirect costs incurred through the bid-offer spread on some pooled investment vehicles are reflected in the cost of investment acquisitions or in the proceeds of investment sales (see note 7a - Reconciliation of movements in investments).

The Fund has not incurred any performance-related investment management fees in 2016/17 or 2015/16.

Notes to the Financial Statements

| 6 Investment income | 2015/16 | 2016/17 |
|---|---------|---------|
| | £000 | £000 |
| Income from fixed interest securities | 512 | 536 |
| Dividends from Equities | - | 62 |
| Income from pooled investments - property | 277 | 265 |
| Interest on cash deposits and sundries | 10 | 16 |
| | 799 | 879 |
| Irrecoverable withholding tax | - | (2) |
| | 799 | 877 |

| 7 Reconciliation of movement in investments | Market value at 31 March 2016 | Purchases at cost | Sales & proceeds | Change in market value | Market value at 31 March 2017 |
|---|-------------------------------|-------------------|------------------|------------------------|-------------------------------|
| | £000 | £000 | £000 | £000 | £000 |
| Bonds | 59,749 | 97,017 | (37,319) | 8,523 | 127,970 |
| Equities | - | 28,285 | - | (64) | 28,221 |
| Pooled investment vehicles | 88,661 | 9,569 | (108,262) | 18,030 | 7,998 |
| | 148,410 | 134,871 | (145,581) | 26,489 | 164,189 |
| Other financial assets / (liabilities) | | | | | |
| Cash deposits | 11 | | | 80 | 3,602 |
| Dividend due etc | 177 | | | - | 459 |
| | 188 | | | 80 | 4,061 |
| Net financial assets | 148,598 | | | 26,569 | 168,250 |

The change in market value of investments during the year comprises all increases and decreases in the market value of investments held at any time during the year, including profits and losses realised on sales of investments during the year.

Any indirect costs incurred through the bid-offer spread on some pooled investment vehicles are reflected in the cost of investment acquisitions and in the proceeds from sales and are therefore included in the tables above.

| | Market value at 31 March 2015 | Purchases at cost | Sales & proceeds | Change in market value | Market value at 31 March 2016 |
|---|-------------------------------|-------------------|------------------|------------------------|-------------------------------|
| | £000 | £000 | £000 | £000 | £000 |
| Bonds | 54,147 | 5,698 | - | (96) | 59,749 |
| Pooled investment vehicles | 97,503 | 13,987 | (24,887) | 2,058 | 88,661 |
| | 151,650 | 19,685 | (24,887) | 1,962 | 148,410 |
| Other financial assets / (liabilities) | | | | | |
| Cash deposits | 244 | | | - | 11 |
| Dividend due etc | 173 | | | - | 177 |
| | 417 | | | - | 188 |
| Net financial assets | 152,067 | | | 1,962 | 148,598 |

Notes to the Financial Statements

8 Investment managers and mandates

| Manager | Mandate | Market value at 31 March 2016 £000 | % of total 31 March 2016 % | Market value at 31 March 2017 £000 | % of total 31 March 2017 % |
|--|-----------------------------|--|-------------------------------------|--|-------------------------------------|
| State Street | UK equities | 10,060 | 6.8 | - | - |
| Total UK equities | | 10,060 | 6.8 | - | - |
| State Street | N American equities | 13,752 | 9.2 | - | - |
| State Street | European (ex UK) equities | 8,994 | 6.1 | - | - |
| State Street | Pacific (ex Japan) equities | 3,617 | 2.4 | - | - |
| State Street | Japanese equities | 4,834 | 3.3 | - | - |
| State Street | Emerging markets equities | 3,672 | 2.5 | - | - |
| Total regional overseas equities | | 34,869 | 23.5 | - | - |
| In-house | High Div Equity | - | - | 29,037 | 17.3 |
| Total global equities | | - | - | 29,037 | 17.3 |
| In-house | UK Index linked gilts | 59,937 | 40.3 | 128,477 | 76.4 |
| State Street | UK Fixed interest gilts | 19,777 | 13.3 | - | - |
| State Street | UK Index linked gilts | 16,167 | 10.9 | - | - |
| Total fixed interest and inflation linked bonds | | 95,881 | 64.5 | 128,477 | 76.4 |
| Schroders | Property | 7,788 | 5.2 | 7,998 | 4.8 |
| Total property | | 7,788 | 5.2 | 7,998 | 4.8 |
| In-house | Cash | - | - | 2,738 | 1.5 |
| Total cash | | - | - | 2,738 | 1.5 |
| Net financial assets | | 148,598 | 100.0 | 168,250 | 100.0 |

Notes to the Financial Statements

9a Investments representing more than 5% of the net assets of the Fund

| | Market value at 31 March 2016 £000 | % of total 31 March 2016 % | Market value at 31 March 2017 £000 | % of total 31 March 2017 % |
|--|--|-------------------------------------|--|-------------------------------------|
| UK Gov 1.25% Index Linked 22/11/27 | - | - | 11,905 | 7.0 |
| UK Gov 4.125% Index Linked 22/11/17 | - | - | 10,955 | 6.4 |
| UK Gov 2.5% Index Linked 17/07/24 | - | - | 10,637 | 6.2 |
| UK Gov 2.5% Index Linked 16/04/20 | - | - | 10,538 | 6.2 |
| UK Gov 1.875% Index Linked 22/11/22 | - | - | 10,517 | 6.2 |
| UK Gov 1.125% Index Linked 22/11/27 | 26,386 | 17.4 | 9,003 | 5.3 |
| State Street UK Index Linked Gilts Over 15 Years | 16,167 | 10.8 | - | - |
| State Street UK Conventional Gilts Over 15 Years | 19,777 | 13.2 | - | - |
| UK Gov 1.25% Index Linked 22/11/32 | 16,380 | 10.9 | 7,614 | 4.5 |
| State Street MPF North America Equity Index | 13,752 | 9.2 | - | - |
| UK Gov 1.125% Index Linked 22/11/37 | 11,321 | 7.5 | 7,800 | 4.6 |
| State Street MPF UK Equity Index | 10,060 | 6.7 | - | - |
| State Street MPF Europe ex-UK Equity Index | 8,994 | 6.0 | - | - |
| Schroders UK Real Estate Income Units | 7,788 | 5.2 | 7,998 | 4.7 |

9b Investments representing more than 5% of asset class

| | Market value at 31 March 2016 £000 | % of total 31 March 2016 % | Market value at 31 March 2017 £000 | % of total 31 March 2017 % |
|--|--|-------------------------------------|--|-------------------------------------|
| Bonds | | | | |
| UK Gov 1.25% Index Linked 22/11/27 | - | - | 11,905 | 9.3 |
| UK Gov 4.125% Index Linked 22/11/17 | - | - | 10,955 | 8.6 |
| UK Gov 2.5% Index Linked 17/07/24 | - | - | 10,637 | 8.3 |
| UK Gov 2.5% Index Linked 16/04/20 | - | - | 10,538 | 8.2 |
| UK Gov 1.875% Index Linked 22/11/22 | - | - | 10,517 | 8.2 |
| UK Gov 1.125% Index Linked 22/11/27 | 26,386 | 44.2 | 9,003 | 7.0 |
| UK Gov 1.125% Index Linked 22/11/37 | 11,321 | 18.9 | 7,800 | 6.1 |
| UK Gov 1.25% Index Linked 22/11/32 | 16,380 | 27.4 | 7,614 | 5.9 |
| UK Gov 0.75% Index Linked 22/03/34 | 3,472 | 5.8 | 3,315 | 2.6 |
| Pooled funds | | | | |
| Schroders UK Real Estate Income Units | 7,788 | 8.8 | 7,998 | 100.0 |
| State Street UK Index Linked Gilts Over 15 Years | 16,167 | 15.5 | - | - |
| State Street UK Conventional Gilts Over 15 Years | 19,777 | 22.3 | - | - |
| State Street MPF North America Equity Index | 13,752 | 15.5 | - | - |
| State Street MPF UK Equity Index | 10,060 | 11.3 | - | - |
| State Street MPF Europe ex-UK Equity Index | 8,994 | 10.1 | - | - |
| State Street MPF Japan | 4,834 | 5.5 | - | - |

Notes to the Financial Statements

10 Financial Instruments

10a Classification of financial instruments

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

All financial instruments are marked to market (at fair value) in the Fund's accounting records hence there is no difference between the carrying value and fair value.

| | 31 March 2016 | | | 31 March 2017 | | |
|------------------------------|---|-------------------------------|---|---|-------------------------------|---|
| | Designated as fair value through fund account £000 | Loans and receivables £000 | Financial liabilities at amortised cost £000 | Designated as fair value through fund account £000 | Loans and receivables £000 | Financial liabilities at amortised cost £000 |
| Financial assets | | | | | | |
| Investment assets | | | | | | |
| Bonds | 59,749 | - | - | 127,970 | - | - |
| Equities | - | - | - | 28,221 | - | - |
| Pooled investments | 88,661 | - | - | 7,998 | - | - |
| Cash | - | 11 | - | - | 3,602 | - |
| Other balances | - | 177 | - | - | 459 | - |
| | 148,410 | 188 | - | 164,189 | 4,061 | - |
| Other assets | | | | | | |
| City of Edinburgh Council | - | 95 | - | - | 146 | - |
| Cash | - | 1,610 | - | - | 2,232 | - |
| Debtors | - | 22 | - | - | 31 | - |
| | - | 1,727 | - | - | 2,409 | - |
| Assets total | 148,410 | 1,915 | - | 164,189 | 6,470 | - |
| Financial liabilities | | | | | | |
| Other liabilities | | | | | | |
| Creditors | - | - | (50) | - | - | (15) |
| Liabilities total | - | - | (50) | - | - | (15) |
| Total net assets | 148,410 | 1,915 | (50) | 164,189 | 6,470 | (15) |

| | | | |
|--|---------|--|---------|
| Total net financial instruments | 150,275 | | 170,644 |
|--|---------|--|---------|

10b Net gains and losses on financial instruments

| | 2015/16 £000 | 2016/17 £000 |
|---|-----------------|-----------------|
| Designated as fair value through fund account | 1,962 | 26,569 |
| Loans and receivables | - | - |
| Financial liabilities at amortised cost | - | - |
| Total | 1,962 | 26,569 |

Notes to the Financial Statements

10c Valuation of financial instruments carried at fair value

The valuation of financial instruments has been classified into three levels, according to the quality and reliability of information used to determine fair values.

Level 1

Financial instruments 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 and unit trusts.

Quoted investments are shown at bid prices. The bid value of the investment is based on the bid market quotation of the relevant stock exchange.

Level 2

Financial instruments 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 and where these techniques use inputs that are based significantly on observable market data.

Level 3

Financial instruments 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. Such instruments would include unquoted equity investments, which are valued using various valuation techniques that require significant judgement in determining appropriate assumptions.

The values of the investments in unquoted private equity, infrastructure, timber and real estate are based on valuations provided by the general partners to the funds in which the Fund has invested.

These valuations are prepared in accordance with the International Private Equity and Venture Capital Valuation Guidelines or similar guidelines provided by the British Venture Capital Association, which follow the valuation principles of International Financial Reporting Standards (IFRS). The valuations are typically undertaken annually at the end of December. Cash flow adjustments are used to roll forward the valuations to 31 March as appropriate.

| | 31 March 2017 | | | |
|---|-----------------|-----------------|-----------------|----------------|
| | Level 1 £000 | Level 2 £000 | Level 3 £000 | Total £000 |
| Investment assets | | | | |
| Designated as fair value through fund account | 36,219 | 127,970 | - | 164,189 |
| Loans and receivables | 4,061 | - | - | 4,061 |
| Total investment assets | 40,280 | 127,970 | - | 168,250 |
| Investment liabilities | | | | |
| Designated as fair value through fund account | - | - | - | - |
| Total investment liabilities | - | - | - | - |
| Net investment assets | 40,280 | 127,970 | - | 168,250 |

Notes to the Financial Statements

10c Valuation of financial instruments carried at fair value (cont)

| | 31 March 2016 | | | |
|---|-----------------|-----------------|-----------------|----------------|
| | Level 1 £000 | Level 2 £000 | Level 3 £000 | Total £000 |
| Financial assets | | | | |
| Designated as fair value through fund account | 88,661 | 59,749 | - | 148,410 |
| Loans and receivables | 188 | - | - | 188 |
| Total financial assets | 88,849 | 59,749 | - | 148,598 |
| Financial liabilities | | | | |
| Designated as fair value through fund account | - | - | - | - |
| Total financial liabilities | - | - | - | - |
| Net financial assets | 88,849 | 59,749 | - | 148,598 |

11 Nature and extent of risk arising from financial instruments

Risk and risk management

The Fund's primary aim is to ensure that all members and their dependants receive their benefits when they become payable. The investment strategy aims to maximise the returns from investments within reasonable risk parameters and hence minimise the long-term cost to employer. The Fund achieves this by investing in a diverse range of assets to reduce risk to an acceptable level. In addition, the Fund ensures that sufficient cash is available to meet all liabilities when they are due to be paid

Responsibility for the Fund's overall investment strategy rests with the Pensions Committee. The Investment Strategy Panel and the internal investment team monitor investment risks on a regular basis. Investment risk management tools are used to identify and analyse risks faced by the Fund's investments.

Types of investment risk

There are various ways of considering investment risks for pension funds. For the purposes of this note, market risk is the potential for an investor to experience losses from falls in the prices of investments. All financial instruments, including cash deposits, present a risk of loss of capital and risks vary depending on different asset classes.

Market risk also changes over time as economic conditions and investor sentiment change. The Fund considers overall fluctuations in prices arising from a variety of sources: market risk, foreign exchange risk, interest rate risk, credit risk, etc. The different risks may, to some extent, offset each other. The overall market risk of the Fund depends on the actual mix of assets and encompasses all the different elements of risk.

The Fund manages these risks in a number of ways:

- assessing and establishing acceptable levels of market risk when setting overall investment strategy. Importantly, risk is considered relative to the liabilities of the Fund
- diversification of investments in terms of type of asset, investment styles, investment managers, geographical and industry sectors as well as individual securities
- taking stewardship responsibilities seriously and pursuing constructive engagement with the companies in which we invest
- monitoring market risk and market conditions to ensure risk remains within tolerable levels.

Notes to the Financial Statements

11 Nature and extent of risk arising from financial instruments (cont)

Sensitivity analysis

Asset prices have a tendency to fluctuate. The degree of such fluctuation is known as “volatility” and it differs by asset class. The table sets out the long-term volatility assumptions used by the Fund’s investment adviser KPMG:

| Asset type | Potential price movement (+ or -) |
|------------------------------|-----------------------------------|
| Equities - Developed Markets | 20.5% |
| Index-Linked Gilts | 10.9% |
| Property | 13.0% |
| Cash | 1.1% |

Volatility is the standard deviation of annual returns. Broadly speaking, in two years out of three, the asset’s change in value (which could be a gain or a loss) is expected to be lower than the volatility figure, but in one year out of three, the change in value is expected to be higher than the volatility figure.

Asset classes don’t always move in line with each other. The extent to which assets move together is known as their "correlation". A lower correlation means that there is less risk of assets losing value at the same time. The overall Fund benefits from "diversification" because it invests in numerous different asset classes, which don’t all move in line with each other. Consequently, the aggregate risk at the Fund level is less than the total risk from all the individual assets in which the Fund invests.

The following table shows the risks at the asset class level and the overall Fund level.

| | Value at 31 March 2017 £000 | % of fund % | Potential Change +/- % | Value on increase £000 | Value on decrease £000 |
|------------------------------|-----------------------------------|----------------|---------------------------------|------------------------------|------------------------------|
| Equities - Developed Markets | 29,037 | 17.3 | 20.5 | 34,990 | 23,084 |
| Index-Linked Gilts | 128,476 | 76.4 | 10.9 | 142,418 | 114,534 |
| Property | 7,998 | 4.8 | 13.0 | 9,038 | 6,958 |
| Cash | 2,739 | 1.5 | 1.1 | 2,769 | 2,709 |
| Total [1] | 168,250 | 100.0 | 12.5 | 189,214 | 147,286 |
| Total [2] | | | 9.5 | 184,192 | 152,308 |
| Total [3] | | | 8.6 | 182,767 | n/a |

[1] No allowance for correlations between assets

[2] Including allowance for correlations between assets

[3] Including allowance for correlation between assets and liabilities.

The value on increase/decrease columns illustrate the monetary effect of the percentage change in the volatility column. The actual annual change in value is expected to be lower than this in two years out of three, but higher in one year out of three.

It can be seen that the risk to the overall Fund assets [2] is lower than the total of the risks to the individual assets [1].

Notes to the Financial Statements

11 Nature and extent of risk arising from financial instruments (cont)

However, because the purpose of a pension scheme is to make payments to scheme beneficiaries, the true risk of a pension scheme is not measured in absolute terms, but relative to its liabilities [3]. The risk is lower than the absolute asset risk, due to the impact of correlation with the discount rate used to value the liabilities.

This risk analysis incorporates volatility from market, interest rate, foreign exchange, credit, and all other sources of risk, and, importantly, makes allowance for how these risks may offset each other.

Credit risk

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

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

Cash deposits are the major areas of credit exposure where credit risk is not reflected in market prices.

Cash deposits

At 31 March 2017, cash deposits represented £5.8m, 3.4% of total net assets. This was held with the following institutions:

| | Moody's Credit Rating at 31 March 2017 | Balances at 31 March 2016 £000 | Balances at 31 March 2017 £000 |
|---|--|-----------------------------------|-----------------------------------|
| Held for investment purposes | | | |
| Northern Trust Company - cash deposits | A2 | 11 | 3,602 |
| Held for other purposes | | | |
| The City of Edinburgh Council - treasury management | See below | 1,610 | 2,232 |
| Total cash | | 1,621 | 5,834 |

The majority of Sterling cash deposits of the Fund are managed along with those of the administering authority (the City of Edinburgh Council) and other related organisations which are pooled for investment purposes as a treasury cash fund. Management of the cash fund is on a low risk basis, with security of the investments the key consideration. The Council has in place counterparty criteria.

The Council has in place institutional restrictions on investments and counterparty criteria. These include -

- (a) UK Government and other UK local Authorities with no limit, other public bodies up to £20 million per organisation.
- (b) Money market funds (MMFs) no more than £30 million or 15% with any one Fund.
- (c) Financial Institutions: Banks and Building Societies with multiple criteria based on a range of short and long term credit ratings, as well as any security provided, from maximum of £60 million / 20% of assets under management (AUM) for institutions with the highest criteria to £10 million / 5% of AUM for institutions with the lowest acceptable criteria.

Notes to the Financial Statements

11 Nature and extent of risk arising from financial instruments (cont)

| | Moody's Credit Rating at 31 March 2017 | Balances at 31 March 2016 £000 | Balances at 31 March 2017 £000 |
|---|--|-----------------------------------|-----------------------------------|
| Money market funds | | | |
| Deutsche Bank AG, London | Aaa-mf | 215 | 12 |
| Goldman Sachs | Aaa-mf | 2 | - |
| Bank call accounts | | | |
| Bank of Scotland | A1 | 105 | 223 |
| Royal Bank of Scotland | A3 | 17 | 3 |
| Santander UK | Aa3 | - | 1 |
| Barclays Bank | A1 | 109 | - |
| Svenska Handelsbanken | Aa2 | 111 | - |
| UK Pseudo-Sovereign risk instruments | | | |
| Other Local Authorities [1] | Aa1 | 730 | 1,993 |
| UK Government Treasury Bills | Aa1 | 321 | - |
| | | 1,610 | 2,232 |

[1] Very few Local Authorities have their own credit rating but they are generally assumed to have a pseudo-sovereign credit rating (which in the UK at 31 March 2017 was 'Aa1').

No breaches of the Council's counterparty criteria occurred during the reporting period and the Fund does not expect any losses from non-performance by any of its counterparties in relation to deposits.

Refinancing risk

Refinancing risk is the risk that the Fund will be bound to replenish a significant proportion of its pension fund financial instruments at a time of unfavourable interest rates. The Fund is not bound by any obligation to replenish its investments and hence is not exposed to refinancing risk.

Liquidity risk

Liquidity risk reflects the risk that the Fund will not be able to meet its financial obligations as they fall due. The Fund therefore ensures that there is adequate cash and liquid resources to meet its commitments. Cash flow projections are prepared on a regular basis to understand and manage the timing of the Fund's cash flows.

All of the Fund's investments could be converted to cash within three months in a normal trading environment.

12 Actuarial statement

The Scheme Actuary has provided a statement describing the funding arrangements of the Fund. This can be found at the end of this section.

13 Actuarial present value of promised retirement benefits

The actuarial value of promised retirement benefits at the accounting date, calculated in line with International Accounting Standard 19 (IAS19) assumptions, is estimated to be £145m (2016 £130m). This figure is used for statutory accounting purposes by Scottish Homes Pension Fund and complies with the requirements of IAS26. The assumptions underlying the figure match those adopted for the Administering Authority's FRS17/IAS19 reports at each year end.

Notes to the Financial Statements

13 Actuarial present value of promised retirement benefits (cont)

The figure is only prepared for the purposes of IAS26 and has no validity in other circumstances. In particular, it is not relevant for calculations undertaken for funding purposes and setting contributions payable to the Fund.

| | 31 March 2016 % p.a. | 31 March 2017 % p.a. |
|----------------------------------|-------------------------|-------------------------|
| Inflation/pensions increase rate | 2.2% | 2.4% |
| Discount rate | 3.5% | 2.6% |

Longevity assumptions

The life expectancy assumption is based on Fund specific statistical analysis with improvements in line with the CMI 2012 model, assuming that the current rate of improvements has reached a peak and will converge to a long term rate of 1.25% p.a.. Based on these assumptions, the average future life expectancies, in years, at age 65 are summarised below:

| | 31 March 2016 | | 31 March 2017 | |
|--|---------------|------------|---------------|------------|
| | Males | Females | Males | Females |
| Current pensioners | 24.5 years | 25.4 years | 24.5 years | 25.4 years |
| Future pensioners (assumed to be currently 45) | 26.8 years | 28.6 years | 26.8 years | 28.6 years |

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 for post-April 2009 service.

14 Debtors

| | 31 March 2016 £000 | 31 March 2017 £000 |
|----------------|-----------------------|-----------------------|
| Sundry debtors | 22 | 31 |
| | 22 | 31 |

Analysis of debtors

| | 31 March 2016 £000 | 31 March 2017 £000 |
|--------------------------------|-----------------------|-----------------------|
| Administering Authority | 1 | 1 |
| Other entities and individuals | 21 | 30 |
| | 22 | 31 |

15 Creditors

| | 31 March 2016 £000 | 31 March 2017 £000 |
|--|-----------------------|-----------------------|
| Benefits payable | 8 | - |
| Miscellaneous creditors and accrued expenses | 42 | 15 |
| | 50 | 15 |

Analysis of creditors

| | 31 March 2016 £000 | 31 March 2017 £000 |
|--------------------------------|-----------------------|-----------------------|
| Other entities and individuals | 50 | 15 |
| | 50 | 15 |

Notes to the Financial Statements

16 Related party transactions

The City of Edinburgh Council

The Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund are administered by the City of Edinburgh Council. Consequently there is a strong relationship between the Council and the Pension Funds.

The Investment and Pensions Service of the Council is responsible for administering the three Pension Funds. The Service receives an allocation of the overheads of the Council, based on the amount of central services consumed. In turn, the Service allocates its costs to the three Pension Funds. Costs directly attributable to a specific Fund are charged to the relevant Fund; costs that are common to all three Funds are allocated on a defined basis.

Transactions between the Council and the Fund are managed via a holding account. Each month the Fund pays a cash sum to the Council leaving a working balance in the account.

| | 31 March 2016 £000 | 31 March 2017 £000 |
|-------------------------------------|-----------------------|-----------------------|
| Year end balance of holding account | 95 | 146 |
| | 95 | 146 |

Part of the Fund's cash holdings are invested on the money markets by the treasury management operations of the Council, through a service level agreement. During the year to 31 March 2017, the fund had an average investment balance of £2.1m (2016 £2.2m). Interest earned was £8k (2016 £10.5k).

| | 31 March 2016 £000 | 31 March 2017 £000 |
|--|-----------------------|-----------------------|
| Year end balance on treasury management account | | |
| Held for investment purposes | - | - |
| Held for other purposes | 1,610 | 2,232 |
| | 1,610 | 2,232 |

Scheme Guarantor

As the scheme guarantor (by definition) a related party to the scheme. The Scottish Government's contributions to the Fund can be found in note 3 (page 96) of the notes to the Financial Statements.

Governance

As at 31 March 2017, all members of the Pensions Committee, with the exception of Councillor Bill Cook and Richard Lamont, and all members of the Pensions Board, were members of the Lothian Pension Fund or Lothian Buses Pension Fund, with one member of the Pensions Board in receipt of pension benefits from Lothian Pension Fund.

Each member of the Pensions Committee and Pensions Board is required to declare any financial and non-financial interests they have in the items of business for consideration at each meeting, identifying the relevant agenda item and the nature of their interest.

With effect from 1 May 2015, all the employees listed below, with the exception of the Executive Director of Resources, were employed by LPFE Limited. These employees and their financial relationship with the Fund (expressed as cash-equivalent transfer values or CETV) are set out below:

Notes to the Financial Statements

16 Related party transactions (cont)

| Name | Position held | Accrued CETV as at 31 March 2016 | Accrued CETV as at 31 March 2017 |
|------------------|---|----------------------------------|----------------------------------|
| | | £000 | £000 |
| Hugh Dunn* | Acting Executive Director of Resources, City of Edinburgh Council | 755 | 1,251 |
| Clare Scott* | Chief Executive, Lothian Pension Fund | 175 | 221 |
| Bruce Miller | Chief Investment Officer, Lothian Pension Fund | 185 | 267 |
| Struan Fairbairn | Chief Risk Officer, Lothian Pension Fund | 30 | 46 |
| John Burns | Chief Finance Officer, Lothian Pension Fund | 474 | 538 |
| Esmond Hamilton | Financial Controller, Lothian Pension Fund | 161 | 200 |

* Also disclosed in the financial statements of the City of Edinburgh Council.

Total compensation paid in relation to key management personnel employed by LPFE Limited during the period was as follows:

| | 31 March 2016 | 31 March 2017 |
|---|---------------|---------------|
| | £000 | £000 |
| Short-term employee benefits | 318 | 380 |
| Post-employment benefits - employer pension contributions | 65 | 78 |

Key management personnel employed by LPFE, had accrued pensions totalling £81,825 (1 April 2016: £68,004) and lump sums totalling £100,185 (1 April 2016: £68,004) at the end of the period.

Staff are either employed by City of Edinburgh Council or LPFE Limited, and their costs reimbursed by the Pension Funds. The Councillors, who are members of the Pensions Committee are also remunerated by City of Edinburgh Council.

17 Contingent assets/liabilities and contractual commitments

There were no contingent liabilities or contractual commitments at the year end.

18 Impairment losses

No impairment losses have been identified during the year.

Scottish Homes Pension Fund

Actuarial Statement for 2016/17

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

Description of Funding Policy

The administering authority's Funding Strategy Statement, dated 16 November 2015, states that a bespoke funding strategy has been adopted for the Fund.

The strategy aims for the Fund to be 100% solvent by 2044 using a discount rate based on government bonds. It includes target funding levels at each actuarial valuation. Contributions from the Scottish Government are determined by reference to the target funding levels. The deficit recovery period is 8 years.

The Funding strategy is designed to reduce investment risk as the Fund is closed to new members and the liabilities will mature over the time, with a reducing allocation to equities over time reflecting the requirements of the Scottish Government to lock away any surpluses that may occur over time by accelerating the transfer into bonds.

Funding Position as at the last formal funding valuation

The most recent actuarial valuation carried out under Regulation 32 of the Local Government Pension Scheme (Scotland) (Administration) Regulations 2008 was as at 31 March 2014. This valuation revealed that the Fund's assets, which at 31 March 2014 were valued at £136 million, were sufficient to meet 89% of the liabilities (i.e. the present value of promised retirement benefits) accrued up to that date. The resulting deficit at the 2014 valuation was £17 million.

The Guarantor's contributions for the period 1 April 2015 to 31 March 2018 were set in accordance with the Fund's funding policy as set out in its Financial Strategy Statement.

Principal Actuarial Assumptions and Method used to value the liabilities

Full details of the methods and assumptions used are described in the valuation report dated 4 December 2014.

Method

The liabilities were assessed using an accrued benefits method which takes into account pensionable membership up to the valuation date.

Assumptions

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

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

| Assumption | Description |
|---|--|
| Price Inflation (CPI) (deferreds and pensioners) | Bank of England implied (RPI) curve less 0.8% p.a. |
| Discount rate (deferreds and pensioners) | Bank of England nominal yield curve |

Scottish Homes Pension Fund

Actuarial Statement for 2016/17

The key demographic assumption was the allowance made for longevity. The life expectancy assumptions are based on the Fund's VitaCurves with improvements in line with the CMI_2012 model, assuming the current rate of improvements has reached a peak and will converge to long term rate of 1.25% p.a.. Based on these assumptions, the average future life expectancies at age 65 are as follows:

| | Males | Females |
|---------------------|------------|------------|
| Current Pensioners | 24.5 years | 25.4 years |
| Future Pensioners * | 26.8 years | 28.6 years |

*Future pensioners are assumed to be aged 45 at the 2014 valuation

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

Experience over the period since April 2014

The administering authority monitors the funding position on a regular basis as part of its risk management programme. The funding level at 31 March 2017 is estimated to be 96%, an increase of 7% since the formal funding valuation at 31 March 2014.

The next actuarial valuation will be carried out as at 31 March 2017 with the results signed off within 12 months. The Funding Strategy Statement will also be reviewed at that time.

Richard Warden FFA
Fellow of the Institute and Faculty of Actuaries
For and on behalf of Hymans Robertson LLP
20 Waterloo Street
Glasgow
G2 6DB

28 April 2017

Statement of Accounting Policies and General Notes

1 Basis of preparation

The Financial Statements have been prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2016/17 which is based upon International Financial Reporting Standards (IFRS), as amended for the UK public sector.

The Financial Statements summarise the transactions of the Funds for the 2016/17 financial year and report on the net assets available to pay pension benefits as at 31 March 2017. The Financial Statements do not take account of obligations to pay pensions and benefits which fall due after the end of the financial year. The actuarial present values of promised retirement benefits, valued on an International Accounting Standard (IAS) 19 basis, are disclosed in the Notes to the Financial Statements.

2 Summary of significant accounting policies

General

a) Basis of consolidation

Commencing with the year ended 31 March 2016, Consolidated Financial Statements have been prepared for Lothian Pension Fund. The Financial Statements of Lothian Buses Pension Fund and Scottish Homes Pension Fund continue to be prepared on a single entity basis.

The Consolidated Financial Statements for Lothian Pension Fund are prepared by combining the Financial Statements of the Fund (the parent entity) and its controlled entities (LPFE Limited and LPFI Limited) as defined in accounting standard IAS27 - Consolidated and Separate Financial Statements. Consistent accounting policies are employed in the preparation and presentation of the Consolidated Financial Statements. All inter-entity balances and transactions between entities, including any unrealised profits or losses, have been eliminated on consolidation.

As LPFE Limited commenced trading on 1 May 2015, the prior year comparative figures consist only of the results of Lothian Pension Fund. Further details of the consolidation are provided in the Notes to the Financial Statements of Lothian Pension Fund.

LPFE Limited and LPFI Limited are wholly owned by the City of Edinburgh Council in its capacity as administering authority for the Local Government Pension Scheme in the Lothian area. The purpose of LPFE Limited is to provide staff services in respect of investment and general management of the Funds. LPFI Limited's purpose is to provide FCA regulated services to the Funds and other Local Government Pension Scheme funds in Scotland and Northern Ireland. It is considered appropriate to consolidate the Financial Statements of the two companies with those of Lothian Pension Fund.

Fund account - revenue recognition

b) Contribution income

Normal contributions, both from the members and from employers, are accounted for on an accruals basis at the rate certified by the Scheme Actuary in the payroll period to which they relate.

Similarly, employer deficit funding contributions are accounted for on the due date on which they are payable as certified by the Scheme Actuary.

Employers' pensions strain contributions are accounted for in the period in which the liability arises. Any amount due but unpaid will be classed as a current financial asset. Amounts not due until future years are classed as long-term financial assets.

c) 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 Funds during the financial year and are calculated in accordance with the Local Government Pension Scheme Regulations.

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

Transfers in from members wishing to use the proceeds of their additional voluntary contributions to purchase scheme benefits are accounted for on a receipts basis and are included in transfers in.

Bulk (group) transfers are accounted for on an accruals basis in accordance with the terms of the transfer agreement.

d) Investment income

i) Interest income

Interest income is recognised in the Funds accounts as it accrues, using the effective interest rate of the financial instrument as at the date of acquisition or origination. Income includes the amortisation of any discount or premium, transaction costs or other differences between the initial carrying amount of the instrument and its amount at maturity calculated on an effective interest rate basis.

ii) Dividend income

Dividend income is recognised on the date the shares are quoted ex-dividend. Any amount not received by the end of the reporting period is disclosed in the Net Assets Statement as a current financial asset.

iii) Distributions from pooled funds

Distributions from pooled funds are recognised at 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.

iv) Income from unquoted private equity and infrastructure investments

Income from the above sources is recognised when it is notified by the manager. Distributions are split into capital and income elements with the latter being included under investment income in the Fund Account.

v) Property related income

Property-related income consists primarily of rental income. Rental income from operating leases on properties owned by Lothian Pension Fund is recognised on a straight-line basis over the term of the lease. Any lease incentives granted are recognised as an integral part of the total rental income, over the term of the lease.

Rental income is reported gross with the operational costs of the properties included in investment management expenses.

Contingent rents based on the future amount of a factor that changes other than with the passage of time, such as turnover rents, are only recognised when contractually due.

vi) Movement in the net market value of investments

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

Fund Account - expense items

e) 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.

f) Taxation

i) Pension Funds

The Local Government Pension Scheme 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 investments sold. Income from overseas investments suffers withholding tax in the country of origin, unless exemption is permitted. Irrecoverable tax is accounted for as a fund expense as it arises.

ii) Controlled entities - LPFE Limited and LPFI Limited

The Companies are mutual traders and are therefore not liable to corporation tax on any surpluses generated from services provided in respect of the Funds. The tax charges for the period are based on any profit for the period from non-mutual trade, adjusted for any non-assessable or disallowed items. They are calculated using tax rates that have been enacted or are substantively enacted by the period end date.

Deferred tax is accounted for using the balance sheet liability method in respect of temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the Financial Statements. No deferred tax will be recognised from the initial recognition of an asset or liability, excluding a business combination, where there is no effect on accounting or taxable profit or loss.

Deferred tax is calculated at the tax rates that are expected to apply to the period when the asset is realised or liability is settled. Deferred tax is credited in the income statement except where it relates to items that may be credited directly to equity, in which case the deferred tax is adjusted directly against equity.

Deferred tax assets are recognised to the extent that it is probable that future profits will be available against which deductible temporary differences can be utilised.

The amount of benefit brought to account or which may be realised in the future is based on the assumption that no adverse change will occur in income taxation legislation and the anticipation that the economic entity will derive sufficient future assessable income to enable the benefit to be realised and comply with the conditions of deductibility imposed by the law.

g) Administrative expenses

All administrative expenses are accounted for on an accruals basis. The Investment and Pensions Division of the Council is responsible for administering the three Funds. The Division's costs include charges from LPFE Limited and LPFI Limited for services rendered. The Division receives an allocation of the overheads of the Council, this is based on the amount of central services consumed. In turn, the Division allocates its costs to the three Funds.

Costs directly attributable to a specific fund are charged to the relevant Fund. Investment management costs that are common to all three Funds are allocated in proportion to the value of the Funds as at the end of the year. Other administration costs are allocated in proportion to the number of members in each of the Funds at the end of the year.

h) Investment management expenses

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

Fees of the external investment managers and custodian are agreed in the respective mandates governing their appointments. Broadly, these are based on the market value of the investments under their management and therefore increase or reduce as the value of these investments change. For some investment managers, an element of their fee is performance related. The amount of any performance related fees paid is disclosed in the note to the accounts on investment management expenses provided for each Fund.

The cost of administering the Local Government Pension Scheme in the UK has come under increasing scrutiny in recent years. As a result, it has been decided to recognise investment management costs that are deducted from the value of an investment and recognised this as a cost in the Fund Account rather than as a reduction in the change in market value of investments. Investment transaction costs that are added to an investment purchase price or deducted from the proceeds of a sale are also recognised as a cost in the Fund Account rather than as a reduction in the change in market value of investments.

h) Investment management expenses (cont'd)

In June 2016, CIPFA revised and updated its guidance "Accounting for Local Government Pension Scheme Management Costs". Whilst the underlying principle of transparency of investment costs remains unchanged, there has been a degree of relaxation to full cost disclosure. Specifically, for complex "fund of funds" structures, the new guidance states that "Investment costs incurred by a separate legal entity, or in respect of investment decisions over which the pension fund has no control, should not be included in the (Pension) Fund Account.....If pension funds wish to provide information about the total cost of "fund of fund" investments, this should be included as part of the Investments section in the Annual Report". The impact of this is that investment management costs deducted from any underlying fund in a "fund of funds" investment would not be included in the costs disclosed in the Fund Account. As this would significantly under-report investment management costs the decision has been made not to adopt this element of the CIPFA guidance. However, this type of cost is separately identified as "external management fees - deducted from capital (indirect)" in the notes on investment management expenses.

Any indirect costs incurred through the bid-offer spread on some pooled investment vehicles are not treated as an expense. Such costs are accounted for as part of the acquisition costs or sale proceeds.

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

The costs of the in-house investment management team are charged to the Funds. The basis of allocation is as described in section g.

Securities lending revenue is reported gross and their fees are disclosed in investment management expenses.

i) Operating lease

Lease payments under an operating lease are recognised as an expense on a straight-line basis over the term of the lease. In accordance with SIC 15, lease incentives are recognised as a reduction in the lease expense over the term of the lease on a straight-line basis.

Net Assets Statement

j) 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 fund becomes party to the contractual acquisition of the asset. From this date, any gains or losses arising from changes in the fair value of asset are recognised by the fund.

The values of investments as shown in the Net Assets Statement have been determined at fair value in accordance with the requirements of the Code and IFRS13. For the purposes of disclosing levels of fair value hierarchy, the Funds has adopted the classification guidelines recommended in Practical Guidance on Investment Disclosures (PRAG/Investment Association, 2016).

The basis of the valuation of each class of investment assets 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 which represent the highest and best price available at the reporting date.

| Description of asset | Valuation hierarchy | Basis of valuation | Observable and unobservable inputs | Key sensitivity affecting the valuations provided |
|--------------------------------------|---------------------|---|------------------------------------|---|
| Market quoted investments - Equities | Level 1 | Closing bid value on published exchanges | Not required | Not required |
| Exchange traded pooled investments | Level 1 | Closing bid value on published exchanges | Not required | Not required |
| Future derivative contracts | Level 1 | Determined using exchange prices at the reporting date. Amounts due from or owed to the broker are the amounts outstanding in respect of the initial margin and variation margin. | Not required | Not required |

| Description of asset | Valuation hierarchy | Basis of valuation | Observable and unobservable inputs | Key sensitivity affecting the valuations provided |
|--|---------------------|---|---|---|
| Forward foreign exchange derivatives | Level 1 | Based on market forward exchange rates at the year-end date and determined as the gain or loss that would arise if the outstanding contract were matched at the year-end with an equal and opposite contract. | Not required | Not required |
| Government bonds - fixed interest / index linked gilts | Level 2 | Recorded at net market value based on their current yields. | Evaluated price feeds | Not required |
| Unquoted Pooled investments - unitised | Level 2 | Closing bid price where bid offer prices are published. Closing single price where single price published. | NAV-based pricing set on a forward pricing basis | Not required |
| Freehold and leasehold properties | Level 3 | Valued at fair value at the year-end using the investment method of valuation by John Finley FRICS of independent valuers, Carrott-Jones LLP in accordance with RICS Valuation Standards (9th Edition) | Existing lease terms and rentals. Independent market research. Nature of tenancies. Covenant strength for existing tenants. Assumed vacancy levels. Estimated rental growth. Discount rate. | Significant changes in rental growth, vacancy levels or the discount rate could affect valuations as could more general changes to market price |
| Unquoted Pooled investments – Private Equity, Infrastructure, Timber, Private Secured Loans & Property | Level 3 | Comparable valuation of similar companies in accordance with International Private Equity and Venture Capital Guidelines (2012) | EBITDA multiple Revenue multiple. Discount for lack of marketability. Control premium. | Valuations could be affected by material events occurring between the date of the financial statements provided and the Funds' own reporting date, by changes to expected cashflows, and by any differences between audited and unaudited accounts. |

Sensitivity of assets valued at level 3

Having analysed historical data and current market trends, and consulted with independent investment advisers, the Funds have determined that the valuation methods described above are likely to be accurate to within the following ranges, and has set out below the consequent potential impact on the closing value of investments held at 31 March 2017.

| Lothian Pension Fund | Assessed Valuation range (+ or -) | Value at 31 March 2017 | Value on increase | Value on decrease |
|-----------------------|-----------------------------------|------------------------|-------------------|-------------------|
| Unquoted | | £m | £m | £m |
| Private Equity | 30% | 129.3 | 168.1 | 90.5 |
| Infrastructure | 18% | 663.2 | 782.4 | 543.8 |
| Timber | 18% | 132.5 | 156.4 | 108.2 |
| Private Secured Loans | 8% | 89.2 | 96.3 | 82.1 |
| Property | 13% | 389.7 | 440.4 | 339.0 |
| | | 1,403.9 | 1,643.6 | 1,163.6 |

| Lothian Buses Pension Fund | Assessed Valuation range (+ or -) | Value at 31 March 2017 | Value on increase | Value on decrease |
|----------------------------|-----------------------------------|------------------------|-------------------|-------------------|
| Unquoted | | £m | £m | £m |
| Infrastructure | 18% | 39.2 | 46.3 | 32.1 |
| Timber | 18% | 8.4 | 9.9 | 6.9 |
| Private Secured Loans | 8% | 6.7 | 7.2 | 6.2 |
| | | 54.3 | 63.4 | 45.2 |

Scottish Homes Pension Fund has no assets valued at Level 3.

k) Foreign currency transactions and balances

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

l) 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.

m) Financial liabilities

The Funds recognise financial liabilities at fair value as at the reporting date. A financial liability is recognised in the Net Assets Statement on the date the Funds becomes party to the liability. From this date, any gains or losses arising from changes in the fair value of the liability are recognised.

n) Actuarial present value of promised retirement benefits

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

As permitted under IAS26, the Funds have opted to disclose the actuarial present value of promised retirement benefits by way of a note to the Net Assets Statements.

o) Additional voluntary contributions

The Lothian Pension Fund and Lothian Buses Pension Fund provide an additional voluntary contributions (AVC) scheme for their members, the assets of which are invested separately from those of the Funds. The Funds have appointed Standard Life and Prudential as their AVC providers. AVCs are paid to the AVC providers 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.

In accordance with regulation 5(2)(b) of the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 1998, AVCs are not included in pension fund financial statements. Details of contributions paid and the total value of funds invested are disclosed by way of note.

p) Contingent assets and contingent liabilities

A contingent liability arises where an event has taken place prior to the year-end giving rise to a possible financial obligation whose existence will only be confirmed or otherwise by the occurrence of future events. Contingent liabilities can also arise in circumstances where a provision would be made, except that it is not possible at the balance sheet date to measure the value of the financial obligation reliably.

A contingent asset arises where an event has taken place giving rise to a possible asset whose existence will only be confirmed or otherwise by the occurrence of future events.

Contingent assets and liabilities are not recognised in the Net Assets Statement but are disclosed by way of narrative in the notes.

q) Employee benefits

i) Investment and Pensions service division

Staff working on the administration of the Funds that are employed by the City of Edinburgh Council are eligible to join Lothian Pension Fund. As these people are employees of the Council, it's the Council that accounts for the benefits of the defined benefits scheme under IAS19. The Council recharges employment costs to the Funds, including employer contributions to Lothian Pension Fund.

ii) Controlled entity - LPFE Limited

The employees of LPFE Limited are eligible to participate in Lothian Pension Fund.

In the Consolidated Financial Statements the current service cost for the period is charged to the Fund Account. The assets of Lothian Pension Fund are held separately from those of the Company. The Company has fully adopted the accounting principles as required by IAS19 – Employee Benefits.

The liability recognised in the Net Asset Statement in respect of the defined benefit pension plan is the present value of the defined benefit obligation at the end of the reporting period less the fair value of plan assets, together with adjustments for unrecognised past-service costs. The defined benefit obligation is calculated annually by the Scheme Actuary using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that are denominated in a currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension obligations.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to the Fund Account in the period in which they arise.

Past-service costs are recognised immediately in the Fund Account, unless the changes to the pension plan are conditional on the employees remaining in service for a specified period of time (the vesting period). In this case, the past-service costs are amortised on a straight-line basis over the vesting period.

3 Accounting Standards that have been issued but not yet adopted

The Code requires the disclosure of information relating to the impact of an accounting change that will be required by a new standard that has been issued but not yet adopted. This applies to the adoption of the following new or amended standards within the 2017/18 Code:

- IAS 12, Income Taxes
- IAS 39, Financial Instruments: Recognition and Measurement
- IFRS 7, Financial Instruments: Disclosures
- IFRS 9, Financial Instruments
- IFRS 15, Revenue from Contracts with Customers
- IFRS 16, Leases

The amendments are generally minor or principally providing clarification. Overall, these new or amended standards are not expected to have a significant impact on the financial statements.

4 Critical judgements in applying accounting policies

Unquoted private equity and infrastructure investments

It is important to recognise the highly subjective nature of determining the fair value of private equity and infrastructure investments. They are inherently based on forward-looking estimates and judgements involving many factors. These valuations are prepared in accordance with the International Private Equity and Venture Capital Valuation Guidelines or similar guidelines provided by the British Venture Capital Association, which follow the valuation principles of IFRS.

For the Lothian Pension Fund, the value of unquoted private equity, infrastructure, timber and secured loan investments at 31 March 2017 was £1,014.2m (2016 £716.2m).

For the Lothian Buses Pension Fund, the value of unquoted private equity, infrastructure and timber investments at 31 March 2017 was £54.3m (2016 £26.0m).

Actuarial present value of promised retirement benefits

Each Fund is required to disclose the estimated actuarial present value of promised retirement benefits as at the end of the financial year. These estimates are prepared by the Funds' Actuary. These values are calculated in line with International Accounting Standard 19 (IAS19) assumptions and comply with the requirements of IAS26. However, the results are subject to significant variances based on changes to the underlying assumptions.

The figures are only prepared for the purposes of IAS26 and has no validity in other circumstances. In particular, it is not relevant for calculations undertaken for funding purposes and setting contributions payable to the Funds.

5 Assumptions made about the future and other major sources of estimation uncertainty

The Financial Statements contain estimated figures that are based on assumptions made by the Council; private equity and infrastructure managers; other providers of valuation information; and the Scheme Actuary about the future or that are otherwise uncertain. Estimates are made taking into account historical experience, current trends and other relevant factors. However, because amounts cannot be determined with certainty, actual results could be materially different from the assumptions and estimates.

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

a) Actuarial present value of promised retirement benefits

Uncertainties

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 the Funds assets. The Funds' Actuary advises on the assumptions to be applied and prepares the estimates.

Effect if actual results differ from assumptions - Lothian Pension Fund

The effects on the net pension liability of changes in individual assumptions can be illustrated as follows:

| Change in assumptions - year ended 31 March 2017 | Approx % increase in liabilities % | Approx monetary amount £m |
|--|---------------------------------------|------------------------------|
| 0.5% decrease in discount rate | 11 | 913 |
| 1 year increase in member life expectancy | 4 | 320 |
| 0.5% increase in salary increase rate | 4 | 320 |
| 0.5% increase in pensions increase rate | 7 | 565 |

Effect if actual results differ from assumptions - Lothian Buses Pension Fund

The effects on the net pension liability of changes in individual assumptions can be illustrated as follows:

| Change in assumptions - year ended 31 March 2017 | Approx % increase in liabilities % | Approx monetary amount £m |
|---|---|--|
| 0.5% decrease in discount rate | 11 | 54 |
| 1 year increase in member life expectancy | 4 | 18 |
| 0.5% increase in salary increase rate | 4 | 18 |
| 0.5% increase in pensions increase rate | 7 | 34 |

Effect if actual results differ from assumptions - Scottish Homes Pension Fund

The effects on the net pension liability of changes in individual assumptions can be illustrated as follows:

| Change in assumptions - year ended 31 March 2017 | Approx % increase in liabilities % | Approx monetary amount £m |
|---|---|--|
| 0.5% decrease in discount rate | 6 | 9 |
| 1 year increase in member life expectancy | 4 | 6 |
| 0.5% increase in pensions increase rate | 6 | 9 |

b) Valuation of unquoted private equity and infrastructure investments

Uncertainties

These investments are not publicly listed and therefore there is a degree of estimation involved in their valuation, see 2j above for more details on the valuation methodology.

Effect if actual results differ from assumptions

There is a risk that these investments may be under or overstated in the accounts at any point in time. The actual financial return of this type of investment is only known with certainty when they reach the end of their lifecycles and the final distributions are made to investors. A sensitivity analysis can be found in note 2j above.

c) Quantifying the cost of investment fees deducted from capital

Uncertainties

Section 2 h) describes the accounting policy for investment management expenses in relation to expenses deducted from the capital value of investments. Quantification of these costs involves asking the relevant managers for information and only some of this information can be independently verified. In cases where the charges relate to an investment as a whole, an estimate needs to be made of the costs applicable to the holding owned by the relevant Fund.

Effect if actual results differ from assumptions

There is a risk that the cost of investment fees deducted from capital may be under or overstated. However, as the costs are included in the Fund Account by adjusting the change in market value of investments, any inaccuracy in the cost estimate will not change the reported net change in the Fund for the year.

Statement of responsibilities for the Statement of Accounts

The responsibilities of the Administering Authority

The Administering Authority's responsibilities require it to:

- Make arrangements for the proper administration of the financial affairs of the Funds in its charge and to secure that one of its officers has the responsibility for the administration of those affairs. The Head of Finance serves as the Section 95 Officer for all the Council's accounting arrangements, including those of Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund. For the Funds, this Section 95 responsibility has been delegated to the Chief Finance Officer, Lothian Pension Fund.
- Manage its affairs to secure economic, efficient and effective use of its resources and 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)
- Approve the Annual Accounts for signature.

HUGH DUNN

Head of Finance of the City of Edinburgh Council

27 September 2017

The responsibilities of the Chief Finance Officer, Lothian Pension Fund

The Chief Finance Officer, Lothian Pension Fund, is responsible for the preparation of the Funds' Financial Statements which, in terms of the CIPFA / LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2016/17 (the Code of Practice), is required to present a true and fair view of the financial position of the Funds at the accounting date and their income and expenditure for the year (ended 31 March 2017).

In preparing this statement of accounts, the Chief Finance Officer, Lothian Pension Fund, has:

- Selected suitable accounting policies and then applied them consistently
- Made judgements and estimates that were reasonable and prudent
- Complied with the Code of Practice.

The Chief Finance Officer, Lothian Pension Fund, has also:

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

The Statement of Accounts presents a true and fair view of the financial position of the Funds as at 31 March 2017, and their income and expenditure for the year ended 31 March 2017.

JOHN BURNS, FCMA CGMA

Chief Finance Officer, Lothian Pension Fund

27 September 2017

Independent auditor's report to the members of City of Edinburgh Council as administering authority for Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund and the Accounts Commission

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

Report on the audit of the financial statements

Opinion on financial statements

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

In our opinion the accompanying financial statements:

- give a true and fair view in accordance with applicable law and the 2016/17 Code of the financial transactions of the funds during the year ended 31 March 2017 and of the amount and disposition at that date of their assets and liabilities;
- have been properly prepared in accordance with IFRSs as adopted by the European Union, as interpreted and adapted by the 2016/17 Code; and
- have been prepared in accordance with the requirements of the Local Government (Scotland) Act 1973, The Local Authority Accounts (Scotland) Regulations 2014, and the Local Government in Scotland Act 2003.

Basis of opinion

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

Responsibilities of the Chief Finance Officer for the financial statements

As explained more fully in the Statement of Responsibilities, the Chief Finance Officer 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 Chief Finance Officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibilities for the audit of the financial statements

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable legal requirements and ISAs (UK&I) as required by the Code of Audit Practice approved by the Accounts Commission. Those standards require us to comply with the Financial Reporting Council's Ethical Standards for Auditors. An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance

that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the circumstances of the funds and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Chief Finance Officer; and the overall presentation of the financial statements.

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

Other information in the annual accounts

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

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

Report on other requirements

Opinions on other prescribed matters

We are required by the Accounts Commission to express an opinion on the following matters.

In our opinion, 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.

Nick Bennett, (for and on behalf of Scott-Moncrieff)
Exchange Place 3
Semple Street
Edinburgh EH3 8BL

27 September 2017

Annual Governance Statement

Roles and responsibilities

The City of Edinburgh Council (the “Council”) has statutory responsibility for the administration of the Local Government Pension Scheme (LGPS) in the Lothian area of Scotland. This responsibility is for three separate Funds: Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund (the “Funds”).

The main functions of the Administering Authority are administration of scheme benefits and the investment of the assets of the Funds. These functions are conducted in accordance with the Local Government Pension Scheme (Scotland) Regulations which are statutory instruments made under the Superannuation Act 1972.

The role of Administering Authority is carried out via:

- The Pensions Committee and the Pensions Audit Sub-Committee
- The Pension Board
- The Investment and Pensions Division of the Resources Directorate of the Council
- Investment Strategy Panel
- LPFE Limited and LPFI Limited, wholly owned subsidiaries of the Council in its capacity as Administering Authority of Lothian Pension Fund.

Further details on the above arrangements can be found in the Governance section of the Management Commentary towards the front of this document.

Scope of responsibility

As the Administering Authority of the Funds, the City of Edinburgh Council is responsible for ensuring that its business, including that of the Funds, is conducted in accordance with the law and appropriate standards, and that monies are safeguarded, properly accounted for, and used economically, efficiently and effectively. The Council also has a statutory duty under the Local Government in Scotland Act 2003, to make arrangements to secure best value, which is defined as continuous improvement in the way its functions are carried out.

In discharging these overall responsibilities, elected members and senior officers are responsible for implementing effective arrangements for governing the Council’s affairs, and facilitating the effective exercise of its functions, including arrangements for the management of risk. The Pensions Committee has delegated responsibility for additional arrangements specific to the Funds.

To this end, the Council has adopted a Local Code of Corporate Governance that is consistent with the principles of the Chartered Institute of Public Finance and Accountancy (CIPFA) and Society of Local Authority Chief Executives (SOLACE) framework ‘Delivering Good Governance in Local Government’. This statement explains how the City of Edinburgh Council delivers good governance and reviews the effectiveness of those arrangements.

This statement explains how the Council has complied with the Local Code of Corporate Governance and how it meets the CIPFA Code of Practice on Local Authority Accounting in the United Kingdom.

The governance framework

The Funds operate within the wider governance framework of the Council to which is added arrangements specific to the Funds themselves. The governance framework comprises the systems, processes, cultures and values by which the Funds are directed and controlled. It also describes the way the Funds engage with and accounts to its stakeholders. It enables the Funds to monitor the achievement of their objectives and consider whether those objectives have led to the delivery of appropriate, cost-effective services. The framework also applies to any subsidiary companies including LPFE Limited and LPFI Limited which are members of the Council’s Group.

The Council's Local Code of Corporate Governance is supported by evidence of compliance which is regularly reviewed and considered by the Governance, Risk & Best Value Committee. The rest of the Group observes the principles of the code.

The Council has implemented arrangements for monitoring each element of the framework and providing evidence of compliance. The Council's Governance and Democratic Services Manager reviewed the arrangements and is satisfied that the Code continues to be adequate and effective. Internal Audit has also reviewed the annual assurance questionnaire process in relation to Arms-Length Companies and has found that this provides the Chief Executive with a level of assurance on the adequacy of the governance arrangements. The Council's Corporate governance framework meets the principles of effective governance.

The Funds place reliance upon the internal financial controls within the Council's financial systems and the monitoring in place to ensure the effectiveness of these controls. The relevant key elements of the Council's corporate governance framework, with specific additional reference as appropriate to the arrangements for the Funds, are set out below:

Elements of the governance framework specific to the Funds include:

- Identifying the objectives of the Funds in the Funding Strategy Statement, Statement of Investment Principles and Service Plan.
- With effect from April 2015 the Pensions Regulator is responsible for setting standards of governance and administration for the Local Government Pension Scheme. The Funds have taken steps to fully integrate compliance with these standards within the overall governance framework operated by the Funds.
- A systematic approach to monitoring service performance by the Pensions Committee, Pensions Audit Sub-Committee, senior officers and stakeholders, including the Pension Board and Independent Professional Observer.
- A structured programme to ensure that Pensions Committee members have the required standard of knowledge and understanding of Local Government Pension Scheme matters.
- Operating within clearly established investment guidelines defined by the Local Government Pension Scheme Investment Regulations and the Funds' Statement of Investment Principles.
- Compliance with the CIPFA Principles for Investment Decision Making and Disclosure in the Local Government Pension Scheme.
- With the exception of managed funds, unlisted investments and property, all investments are held under custody by a global custodian. The Funds benefit from the custodian's extensive internal control framework.
- Benchmarking of services in terms of standards and cost against other pension funds.
- LPFE Limited and LPFI Limited operating within their respective constitutional documentation and the relevant companies regulations.
- LPFI Limited operating within the relevant governance policies and procedures to ensure compliance with the Financial Conduct Authority regulations.

Elements of the governance framework of the Council that are relevant to the Funds include:

- The Council's key corporate vision and priorities are set out and published in the City of Edinburgh Council Business Plan 2016-2020.
- A performance management framework, incorporating internal and public performance reporting, which focuses on continuous improvement of our services, applying reliable improvement methods to ensure that services are consistently well designed based on the best evidence are delivered on a right first time basis.
- The Council is embedding a culture of commercial excellence to ensure that our services always deliver Best Value. Focused work is underway to further improve standards in buying practices and processes across the Council.

Elements of the governance framework of the Council that are relevant to the Funds include (cont'd):

- The submission of reports, findings and recommendations from the external auditor, other inspectorates and internal audit, to the Corporate Leadership Group, Governance, Risk and Best Value Committee and Council, and to the Pensions Committee and Pensions Audit Sub-Committee for all matters affecting the Funds, where appropriate, supports effective scrutiny and service improvement activities.
- The roles and responsibilities of Elected Members and Officers are defined in Procedural Standing Orders, Committee Terms of Reference and Delegated Functions, Contract Standing Orders, Scheme of Delegation to Officers, the Member/officer protocol and Financial Regulations. These are subject to annual review.
- The Chief Executive has overall responsibility to Council, for all aspects of operational management and overall responsibility for ensuring the continued development and improvement of systems and processes concerned with ensuring appropriate direction, accountability and control.
- The Section 95 Officer has overall responsibility for ensuring appropriate advice is given to the Council and Group on all financial matters, keeping proper financial records of accounts and maintaining an effective system of internal financial control. For the Funds, the Section 95 officer responsibility has sub-delegated to the Chief Finance Officer, Lothian Pension Fund.
- The Chief Internal Auditor has overall responsibility to review, appraise and report to management and the Governance, Risk and Best Value Committee, and for Fund matters to the Pensions Committee and Pensions Audit Sub-Committee, on the adequacy of the Council's internal control and corporate governance arrangements and on risks relating to approved policies, programmes and projects.
- The Council's Governance and Democratic Services Manager, reporting to the Head of Strategy and Insight, has responsibility for advising the Council on corporate governance arrangements.
- The Governance, Risk and Best Value Committee, and for Fund matters, the Pensions Committee and Pensions Audit Sub-Committee, provides the Council with independent assurance of the adequacy of the governance and risk management frameworks and internal control environment. Also providing independent scrutiny of financial and non-financial performance, approving and monitoring the progress of the Internal Audit risk based plan, and monitoring performance of the internal audit service.
- The risk management policy and framework set out the responsibilities of elected members, Governance, Risk and Best Value Committee, and for pension fund matters, the Pensions Committee and Pensions Audit Sub-Committee, management and staff for the identification and management of risks to corporate and service related priorities;
- The Service Area Risk Register, Resources Senior Management Team Risk Register and Council Risk Register all identify risks and proposed treatment and actions. These registers are regularly reviewed, updated and reported to the Corporate Leadership Group, which reviews Council-wide risk and reports to the Governance, Risk and Best Value Committee for scrutiny and challenge. For fund matters, the Pensions Committee and Pensions Audit Sub-Committee are responsible for scrutiny and challenge.
- Resilience and business continuity plans are in place for all essential Council services. These set out arrangements for continuing to deliver essential services in the event of an emergency or other disruption.
- Senior management and Heads of Service have formal objectives, with performance reviewed by the appropriate chief officer. Officers have personal work objectives, and receive feedback on their performance through the Council-wide performance review and development process.
- An Elected Members remuneration and expenses scheme is in place and is consistent with the Scottish Government's 'Councillors Remuneration: allowances and expenses – Guidance'. Information on the amounts and composition of elected members salaries, allowances and expenses is published on the Council's website.
- The Council's Governance and Democratic Services Manager ensures that induction training on roles and responsibilities, and ongoing development opportunities, are provided for Elected Members. For the Pension Funds, a policy on Committee and Board member training has been adopted.

Elements of the governance framework of the Council that are relevant to the Pension Funds include (cont'd):

- Mandatory training for councillors newly appointed to the Pensions Committee is programmed within the Induction and Training programme for Elected Members following the 2017 Local Government Election. This focuses on Governance, Investment management and strategy and how the Pension Scheme works. Committee members will also be reminded of the requirement to undertake a minimum of 21 hours of training per financial year to fulfil their role on the Pension Committee.
- Codes of Conduct, that set out the standards of behaviour expected from Elected Members and officers, are in place.
- The Employee Code of Conduct, Anti Bribery Policy and Policy on Fraud Prevention set out the responsibilities of officers and Elected Members in relation to fraud and corruption, and are reinforced by the Councillors' Code of Conduct, the Code of Ethical Standards and the Financial Regulations.
- The Whistleblowing policy provides a process for disclosure in the public interest about the Council and its activities by officers, Elected Members and others.
- A Register of Members' Interests and Registers of Officers' interests are maintained and available for public inspection.
- The directors of LPFE Limited and LPFI Limited have obligations to report to the Council/Pensions Committee being the sole shareholder. In addition, the Board and staff of LPFI Limited are each individually regulated by the Financial Conduct Authority and so bound by the associated Principles and Standards of governance best practice.

A significant element of the governance framework is the system of internal controls, which is based on an ongoing process to identify and prioritise risks to the achievement of the Council's objectives, including those relevant to the Pension Funds. Following the establishment of the wholly-owned subsidiary companies, LPFE Limited and LPFI Limited, the Council continues to have appropriate assurance processes and procedures in relation to the responsible officers involved in the administration of the Funds.

Review of Effectiveness

The Local Code of Governance details the Council's arrangements for monitoring each element of the framework and providing evidence of compliance. The Council's Governance and Democratic Services Manager has reviewed the effectiveness of the Code.

The Chief Internal Auditor has also provided an assurance statement on the effectiveness of the system of internal control. The opinion in the assurance statement states: "Internal Audit have not identified any fundamental weaknesses in the framework of governance, risk management and control at the Funds. We consider the Funds' framework to be operating at the higher end of the 'generally adequate but with enhancements required' category."

In compliance with standard accounting practice, the then Acting Executive Director of Resources has provided the Chief Executive with a statement of the effectiveness of the Group's internal financial control system for the year ended 31st March 2017. It is the then Acting Executive Director of Resources' opinion that "reasonable assurance can be placed upon the adequacy and effectiveness of the Group's systems of internal control".

The Chief Finance Officer of Lothian Pension Fund has provided a statement of the effectiveness of the internal financial control system for the year ended 31st March 2017 for the Funds. It is the Chief Finance Officer's opinion "that reasonable assurance can be placed upon the adequacy and effectiveness of the system of internal control for the Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund."

Certification

It is our opinion, in light of the foregoing, that reasonable assurance can be placed upon the adequacy and effectiveness of the systems of governance that operate within the Group in its administration of the Funds. We consider the governance and internal control environment operating during the financial year from 1 April 2016 to 31 March 2017 to provide reasonable and objective assurance that any significant risks impacting on the Group and its ability to achieve its objectives in properly administering the Funds have and will continue to be identified and actions have and will be taken to avoid or mitigate the impact of any such risks.

Where areas for improvement have been identified and action plans agreed, we will ensure that they are treated as priority and progress towards implementation is reviewed through the governance structures and processes established for the Group and summarised herein. We will continue to review and enhance, as necessary, our governance arrangements.

ANDREW KERR
Chief Executive
of the City of Edinburgh Council
27 September 2017

HUGH DUNN
Head of Finance
of the City of Edinburgh Council
27 September 2017

CLARE SCOTT
Chief Executive Officer
of Lothian Pension Fund
27 September 2017

Governance Compliance Statement

The Regulations that govern the management of Local Government Pension Scheme in Scotland require that a Governance Compliance Statement is published. This statement sets out the extent to which governance arrangements comply with best practice.

The statement below describes arrangements at 31 March 2017 and since the introduction of new governance arrangements on 1 April 2015.

| Principle | | Full Compliance | 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 | <p>The City of Edinburgh Council acts as administering authority and delegates all pension scheme matters to a committee of seven members (Pensions Committee) made up as follows:</p> <ul style="list-style-type: none"> - Five City of Edinburgh elected members - Two external members, one drawn from the membership of the Funds and one drawn from the employers that participate in the Funds. |
| | 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 | <p>The Pensions Committee includes two external places for pension fund stakeholders i.e. one each from the employer and member representatives.</p> <p>Fund members and employers are also represented within the Funds' Pension Board. Membership includes five employer representatives and five member representatives.</p> <p>All members of the Pension Board are invited to attend the meeting of the Pensions Committee and receive the relevant papers prior to those meetings.</p> <p>Two members of the Pension Board attend the Pensions Audit Sub Committee.</p> |
| | That where a secondary committee or board has been established, the structure ensures effective communication across both levels. | Yes | <p>The Pensions Audit Sub-Committee, consisting of three members of the Pensions Committee, report to the Pensions Committee on their findings and recommendations. Two members of the Pension Board attend the Pensions Audit Sub-Committee in a non-voting capacity. The Pension Board attends the Pensions Committee meetings and takes part in training events.</p> <p>Implementation of investment strategy is delegated to the Executive Director of Resources, who takes advice from the Investment Strategy Panel. The Panel meets quarterly and reports to the Pensions Committee annually.</p> <p>The Investment Strategy Panel consists of the Executive Director of Resources, Chief Executive of the Lothian Pension Fund, Chief Finance Officer, Chief Investment Officer and three experienced external industry advisers.</p> <p>The Pensions Committee receives annual updates from LPFE Limited and LPFI Limited.</p> |

| Principle | | Full Compliance | Comments |
|-----------------------------------|---|-----------------|---|
| Representation | That all key stakeholders are afforded the opportunity to be represented within the main or secondary committee structure. These include employing authorities (including non-scheme employers, e.g. admitted bodies) and scheme members (including deferred and pensioner scheme members). | Yes | <p>The Pension Board consists of a mix of representatives:</p> <ul style="list-style-type: none"> - Five employer representatives from non-administering authority employers; - Five member representatives appointed by the Trade Unions in accordance with the approach required under Scottish statute. |
| | Where appropriate, independent professional observers, and expert advisers (on an ad-hoc basis). | Yes | <p>An Independent Professional Observer was appointed in March 2013 to help Committee scrutinise advice.</p> <p>Three external investment advisers sit on the Investment Strategy Panel.</p> <p>A separate specialist Pensions Audit Sub-Committee consisting of three members (including at least two elected members from the City of Edinburgh Council) undertake the audit scrutiny of the funds.</p> <p>A non-executive director was appointed to the board of LPFI Limited on 7 February 2017.</p> |
| | That where lay members sit on a main or secondary committee, they are treated equally in terms of access to papers and meetings, training and are given full opportunity to contribute to the decision making process, with or without voting rights. | Yes | <p>The Pension Board attends the Pensions Committee meetings to help ensure that the operation of the pension funds is in accordance with the applicable law and regulation. The Pension Board takes part in all Committee training events.</p> <p>The Pensions Committee takes account of the views of the Pension Board when making decisions.</p> |
| Selection and Role of Lay Members | That committee or board members are made fully aware of the status, role and function that they are required to perform on either a main or secondary committee. | Yes | <p>A comprehensive training programme including induction is in place. Members of the Pensions Committee and Pension Board are expected to attend no less than three days of training (21 hours) per year.</p> <p>The non-elected members confirm that they have read, signed and will abide by a Code of Conduct (specifically tailored for the Committee and Board) prior to their appointment to the Pensions Committee and Pension Board. The elected members are required to read, sign and abide by the Councillors' Code of Conduct.</p> |
| | 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 | <p>The declaration of members' interests is a standard item on the agenda for meetings of the Pensions Committee, Pensions Audit Sub-Committee and Pension Board.</p> <p>A Code of Conduct also applies to all members of the Pensions Committee and the Pension Board.</p> |

| | | | |
|-------------------------------------|---|----------------|---|
| 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 | Five of the seven places of the Pensions Committee are held by elected members of the City of Edinburgh Council, which is required to retain a 2/3 majority in line with the Local Government (Scotland) Act 1973. The Nomination and Appointments Policy of the Funds, available on the Funds' website, clearly documents how employer and member representatives will be elected to the Pensions Committee and Pension Board. |
| Training / Facility Time / Expenses | a) 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 Training and Attendance Policy is in place covering training requirements and reimbursement of expenses. The policy is available on the Funds' website www.lpf.org.uk . Board members and staff working for LPFI Limited also attend separate training for the purposes of their knowledge, understanding and compliance with Financial Conduct Authority regulations. |
| | b) 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. | Yes | The Training and Attendance Policy applies to both the Pensions Committee and the Pension Board. Advisers have their own professional development obligations. |
| | c) That the administering authority considers the adoption of annual training plans for committee and board members and maintains a log of all such training. | Yes | Each Pensions Committee and Pension Board member is expected to attend no less than three days training per year (21 hours) per year. Attendance at meetings and training is monitored and reported. |
| Meetings frequency | a) That an administering authority's main committee or committees meet at least quarterly. | Yes | The Pensions Committee meets at least four times a year. |
| | b) That an administering authority's secondary committee or panel meet at least twice a year and is synchronised with the dates when the main committees sits. | Yes | The Pensions Audit Sub-Committee is held before the Pensions Committee at least three times a year with further meetings held if necessary. The Investment Strategy Panel meets quarterly or more frequently as required. The Pension Board attends all the Pensions Committee meetings and separately meets in advance of each such meetings. Further meetings are held if necessary. |
| | c) That an administering authority who 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. | Not applicable | |

| | | | |
|-----------|--|-----|--|
| Access | That subject to any rules in the council's constitution, all members of main and secondary committees or boards have equal access to committee papers, documents and advice that falls to be considered at meetings of the main committee. | Yes | Committee papers and minutes are publicly available on the Council's website and all Committee and Pension Board members have equal access. Members of the Pensions Committee and Pension Board have equal access to the Independent Professional Observer who holds surgeries ahead of Committee meetings. |
| Scope | That administering authorities have taken steps to bring wider scheme issues within the scope of their governance arrangements. | Yes | The Pensions Committee deals with all matters relating to both the administration and investment of the Funds. A separate specialist Pensions Audit Sub-Committee consisting of three members (including at least two elected members from the City of Edinburgh Council) undertake the audit scrutiny of the Funds. The Convener of the Pensions Committee is also a member of the Scottish LGPS Scheme Advisory Board which considers matters on a national level. |
| 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 | Governance documents, policies and details of Pension Board membership are on the Funds' website. The Funds also communicates regularly with employers and scheme members. |

ANDREW KERR
Chief Executive
of the City of Edinburgh Council
27 September 2017

HUGH DUNN
Head of Finance
of the City of Edinburgh Council
27 September 2017

CLARE SCOTT
Chief Executive Officer
of the Lothian Pension Fund
27 September 2017

Additional information

Key documents online

You can find further information on what we do and how we do it, on our website at www.lpf.org.uk.

- Actuarial Valuation reports
- Pension Board constitution
- Annual Report and Accounts
- Statement of Investment Principles
- Pension Administration Strategy
- Communications strategy
- Funding Strategy Statement
- Service Plan
- Training and attendance policy

Fund advisers

| | |
|--|--|
| Actuaries: | Hymans Robertson LLP |
| Auditor: | Nick Bennett, Scott Moncrieff |
| Bankers: | Royal Bank of Scotland |
| Investment consultancy: | KPMG LLP, Gordon Bagot and Scott Jamieson |
| Investment custodians: | The Northern Trust Company |
| Investment managers: | Details can be found in the notes to the accounts. |
| Additional Voluntary Contributions (AVC) managers: | Standard Life and Prudential |
| Property valuations: | CB Richard Ellis Limited |
| Solicitors: | Dedicated in-house resource |

Comments and suggestions

We appreciate your comments and suggestions on this report. Please let us know which sections you found useful and if you have any suggestions for items to be included in the future. Please email your comments to pensions@lpf.org.uk.

Accessibility

You can get this document on tape, in Braille, large print and various computer formats if you ask us. Please contact the Interpretation and Translation Service (ITS) on 0131 242 8181 and quote reference number 00819. The ITS can also give information on community language translations.

Contact details

If you would like further information about Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Home Pension Fund, please contact us.

Email: pensions@lpf.org.uk
Telephone: 0131 529 4638
Web: www.lpf.org.uk
Fax: 0131 529 6229

Address: Lothian Pension Fund, Atria One, 144 Morrison Street, Edinburgh EH3 8EX



Lothian Pension Fund
Atria One
144 Morrison Street
Edinburgh
EH3 8EX



LPFE Limited

Financial Statements

For the year ended 31 March 2017

Registered number SC497543

LPFE LIMITED

Financial statements

For the year ended 31 March 2017

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LPFE LIMITED

Company information

Board of Directors:

Chairman

Hugh Dunn

Executive Directors

Clare Scott
Alasdair Rankin
Katy Miller

Company Secretaries:

D.W Company Services Limited
Struan Fairbairn

Registered office

4th Floor Saltire Court
20 Castle Terrace
Edinburgh
Lothian
EH1 2EN

Bankers:

The Royal Bank of Scotland plc
Barclays Bank plc

Auditor:

Scott-Moncrieff
Chartered Accountants
Exchange Place 3
Semple Street
Edinburgh
EH3 8BL

LPFE LIMITED

Directors' report

For the year ended 31 March 2017

The directors present their report and audited financial statements for the year ending 31 March 2017.

Principal Activity

The principal activity of the company is the provision of seconded staff to the City of Edinburgh Council and LPFI Limited in support of the administration of the Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund (the "Funds") and, separately, to Falkirk Council in its capacity as the administering authority of the Falkirk Council Pension Fund. All these pension funds are part of the Local Government Pension Scheme in Scotland.

Results, Dividends and Mutual Trading Surplus

The profit for the year after tax was £6,275 (2016 - £60,454 loss) and after allowing for items included under "Other comprehensive income" a loss of £396,275 (2016 - £142,454). The directors do not recommend payment of a dividend.

The company's aim is to make a modest trading surplus before adjustments required under IFRS. After allowing for an addition to costs of £2,464 (2016 - £26,697) in respect of accrued holiday pay and £22,000 (2016 - £62,000) for adjustments to pension costs under IAS19, the underlying trading profit is £30,739 (2016 - £28,243). The additional costs recognised under "Other comprehensive income" amounting to £402,550 (2016 - £82,000) all relate to further adjustments required by IAS19 and the related deferred tax.

Under the mutual trading agreement with the City of Edinburgh Council (acting in its capacity as the administering authority of the Lothian Pension Fund), the company is required to consider if any of profit arising from the mutual trade can be returned to the Council. Although there was an underlying trading profit of £30,739 (2016 - £28,243), Company Law requires that only "distributable profits" are available for distribution. The company's auditor has confirmed that the various adjustments required under IFRS must be taken into account when determining if profits are distributable. As a result, there are no distributable profits available for return to the Council (acting in its capacity as the administering authority of the Lothian Pension Fund) in respect of the period.

Business Review

The company is wholly owned by the City of Edinburgh Council (acting in its capacity as the administering authority of the Lothian Pension Fund) and has entered into a shareholder agreement with the Council to appropriately address certain governance matters. The company also has a loan facility provided by the City of Edinburgh Council (acting in its capacity as the administering authority of the Lothian Pension Fund) for the purpose of the provision of short term working capital.

Staffing services are provided to the City of Edinburgh Council for the purposes of administering the Funds under an intra-group resourcing agreement. The agreement also provides for the running costs of the company to be covered as part of a service charge and anticipates the provision of staffing services to LPFI Limited, also wholly owned by the City of Edinburgh Council (acting in its capacity as the administering authority of the Lothian Pension Fund).

The company has entered into appropriate admission arrangements with the City of Edinburgh Council (acting in its capacity as the administering authority of the Lothian Pension Fund) to enable the employees of the company to be members of the Lothian Pension Fund and in relation to the company's obligations as an employer in that fund.

HMRC has agreed that any profits arising as a result from trade between the company and the City of Edinburgh Council will be covered by the "Mutual Trading" rules and so not subject to Corporation Tax.

The company also has a secondment agreement with the Falkirk Council to provide investment staff to assist with certain aspects of the administration of the Falkirk Council Pension Fund as part of a mutually beneficial collaboration between those LGPS funds.

LPFE LIMITED

Directors' report (continued)

For the year ended 31 March 2017

Future Prospects

The company's future prospects are primarily linked to the needs of the City of Edinburgh Council in its administration of the Funds. The company is securely funded by the City of Edinburgh Council (acting in its capacity as the administering authority of the Lothian Pension Fund) which means that it is able to adapt to any future staffing requirements.

At its meeting on 20 March 2017, Pensions Committee agreed that the remaining pension fund staff, employed by the City of Edinburgh Council, should be transferred to LPFE Limited subject to the appropriate consultation with staff and trades unions and any legal and risk analysis being concluded to the Executive Director of Resources' satisfaction.

Directors

The directors who served during the period were:

| | |
|-----------------|-----------------------------|
| Hugh Dunn | |
| Clare Scott | |
| Alasdair Rankin | |
| Martin Glover | (resigned 19 August 2016) |
| Katy Miller | (appointed 25 October 2016) |

Statement of directors' responsibilities

The directors are responsible for preparing the financial statements in accordance with applicable laws and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have prepared the financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of its results for that period. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable IFRSs as adopted by the European Union have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

LPFE LIMITED

Directors' report (continued)

For the year ended 31 March 2017

Disclosure of information to auditor

As far as each of the directors at the time the report is approved are aware:

- a) there is no relevant information of which the company's auditor is unaware, and
- b) the directors have taken all steps that they ought to have taken to make themselves aware of any relevant audit information and to establish that the auditor is aware of the information

Auditor

The auditor, Scott-Moncrieff, is deemed to be reappointed under Section 487 (2) of the Companies Act 2006.

Small company provisions

This report has been prepared in accordance with the special provisions for small companies under Part 15 of the Companies Act 2006.

This report was approved by the board and signed on its behalf by:

Date: 2017

Hugh Dunn
Chairman

LPFE LIMITED

Independent auditor's report to the members of LPFE Limited

For the year ended 31 March 2017

We have audited the financial statements of LPFE Limited for the year ended 31 March 2017 which comprise the Statement of Profit or Loss and Other Comprehensive Income, Statement of Financial Position, Statement of Changes in Equity, Statement of Cash Flows and related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and, as regards the financial statements, as applied in accordance with the provisions of the Companies Act 2006.

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective Responsibilities of the Directors and the Auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 3, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

Scope of the Audit on the Financial Statements

A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate.

Opinion on Financial Statements

In our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 March 2017 and of its results for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on Other Matter(s) Prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements and the Directors' Report has been prepared in accordance with applicable legal requirements.

In light of the knowledge and understanding of the company and its environment obtained during the course of our audit, we have not identified any material misstatements in the Directors' Report.

LPFE LIMITED

Independent auditor's report to the members of LPFE Limited (continued)

For the year ended 31 March 2017

Matters on Which We Are Required to Report by Exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the company, or returns adequate for our audit have not been received from branches not visited by us; or
- the company financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit; or
- the directors were not entitled to prepare the financial statements in accordance with the small companies regime and take advantage of the small companies' exemption in preparing the directors' report; or
- the directors were not entitled to take advantage of the small companies exemption from the requirement to prepare a strategic report.

Nick Bennett, Senior Statutory Auditor
For and on behalf of Scott-Moncrieff, Statutory Auditor
Chartered Accountants
Exchange Place 3
Semple Street
Edinburgh
EH3 8BL

Date:2017

LPFE LIMITED

Statement of Profit or Loss and Other Comprehensive Income

For the year ended 31 March 2017

| | Note | 2017 £ | 2016 £ |
|--|-------------|-------------------|-------------------|
| Continuing Operations | | | |
| Revenue | 1e | 1,189,855 | 904,074 |
| Gross profit | | <u>1,189,855</u> | <u>904,074</u> |
| Administrative expenses | | (1,176,881) | (959,895) |
| Profit/(loss) from operations | 2 | 12,974 | (55,821) |
| Finance costs | 3 | (6,720) | (9,968) |
| Profit/(loss) before tax | | <u>6,254</u> | <u>(65,789)</u> |
| Corporation tax credit | 4 | 21 | 5,335 |
| Profit/(loss) for the year | | <u>6,275</u> | <u>(60,454)</u> |
| Other comprehensive income: | | | |
| Those that are not recyclable net of tax: | | | |
| Recognition of opening retirement benefit obligation | 15 | - | (281,000) |
| Actuarial (losses)/gains on retirement benefit obligation period | 15 | (483,000) | 163,000 |
| Deferred tax charge thereon | 10 | 80,450 | 36,000 |
| Total comprehensive loss for the year | | <u>(396,275)</u> | <u>(142,454)</u> |

The accompanying notes on pages 11 to 26 form part of these financial statements

LPFE LIMITED

Statement of Financial Position

As at 31 March 2017

| | Note | As at 31 March 2017 £ | As at 31 March 2016 £ |
|--|-------------|--|--|
| Non-current assets | | | |
| Deferred tax asset | 10 | 116,450 | 36,000 |
| Total non-current assets | | 116,450 | 36,000 |
| Current assets | | | |
| Trade and other receivables | 7 | 166,801 | 129,681 |
| Cash and cash equivalents | 8 | 13,381 | 5,065 |
| Total current assets | | 180,182 | 134,746 |
| Total assets | | 296,632 | 170,746 |
| Equity and Liabilities | | | |
| Equity attributable to equity holders of the parent | | | |
| Share capital | 11 | 1 | 1 |
| Retained earnings | 12 | (538,729) | (142,454) |
| | | (538,728) | (142,453) |
| Liabilities | | | |
| Non-current liabilities | | | |
| Retirement benefits obligation | 15 | 685,000 | 180,000 |
| Total non-current liabilities | | 685,000 | 180,000 |
| Current liabilities | | | |
| Trade and other payables | 9 | 150,360 | 133,199 |
| Total current liabilities | | 150,360 | 133,199 |
| Total liabilities | | 835,360 | 313,199 |
| Total equity and liabilities | | 296,632 | 170,746 |

The financial statements were authorised for issue by the Board of Directors on 2017 and were signed on its behalf by:

.....
Director

Registered number SC497543

The accompanying notes on pages 11 to 26 form part of these financial statements

LPFE Limited
Statement of Changes in Equity
As at 31 March 2017

| | Note | Share Capital £ | Retained Earnings £ | Total £ |
|--|------|-----------------------|---------------------------|------------------|
| Comprehensive income | | | | |
| Loss for the year | | - | (60,454) | (60,454) |
| Other comprehensive income | | | | |
| Share capital issued | 11 | 1 | - | 1 |
| Recognition of opening retirement benefit obligation | 15 | - | (281,000) | (281,000) |
| Actuarial gains on retirement benefit obligation in period | 15 | - | 163,000 | 163,000 |
| Deferred tax on retirement benefit obligation | 10 | - | 36,000 | 36,000 |
| Balance at 31 March 2016 | | <u>1</u> | <u>(142,454)</u> | <u>(142,453)</u> |

| | Note | Share Capital £ | Retained Earnings £ | Total £ |
|---|------|-----------------------|---------------------------|------------------|
| Balance at 1 April 2016 | | 1 | (142,454) | (142,453) |
| Comprehensive income | | | | |
| Profit for the year | | - | 6,275 | 6,275 |
| Other comprehensive income | | | | |
| Actuarial losses on retirement benefit obligation in year | 15 | - | (483,000) | (483,000) |
| Deferred tax on retirement benefit obligation | 10 | - | 80,450 | 80,450 |
| Balance at 31 March 2017 | | <u>1</u> | <u>(538,729)</u> | <u>(538,728)</u> |

The accompanying notes on pages 11 to 26 form part of these financial statements

LPFE LIMITED
Statement of Cash Flows

For the year ended 31 March 2017

| | 2017 | 2016 |
|---|-------------|-------------|
| | £ | £ |
| Cash flow from operating activities | | |
| Profit for the period | 6,275 | (60,454) |
| Adjustments for: | | |
| Defined benefit pension – current service cost | 172,000 | 174,000 |
| Defined benefit pension – employer contribution | (156,000) | (121,000) |
| Defined benefit pension – finance costs | 6,000 | 9,000 |
| Other finance costs | 720 | 968 |
| Changes in assets and liabilities: | | |
| (Increase)/decrease in receivables and other financial assets | (19,008) | (123,524) |
| Increase/(decrease) in payables | 17,342 | 133,005 |
| | <hr/> | <hr/> |
| Cash flows from operations | 27,329 | 11,995 |
| Interest paid | (901) | (774) |
| | <hr/> | <hr/> |
| Net cash flows from operating activities | 26,428 | 11,221 |
| | <hr/> | <hr/> |
| Cash flow from investing activities | - | - |
| | <hr/> | <hr/> |
| Net cash flows from investing activities | - | - |
| | <hr/> | <hr/> |
| Cash flow from financing activities | | |
| Share capital issued | | 1 |
| Movement in loan facility | (18,112) | (6,157) |
| | <hr/> | <hr/> |
| Net cash flows from financing activities | (18,112) | (6,156) |
| | <hr/> | <hr/> |
| Net increase in cash and cash equivalents | 8,316 | 5,065 |
| Cash and cash equivalents at beginning of year | 5,065 | - |
| | <hr/> | <hr/> |
| Cash and cash equivalents at end of year | 13,381 | 5,065 |
| | <hr/> <hr/> | <hr/> <hr/> |
| Cash at bank and in hand | 13,381 | 5,065 |
| | <hr/> <hr/> | <hr/> <hr/> |

The accompanying notes on pages 11 to 26 form part of these financial statements

LPFE LIMITED

Notes to the Financial Statements

For the year ended 31 March 2017

1. Statement of significant accounting policies

The financial statements of LPFE Limited have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union (IFRSs as adopted by the EU), IFRIC Interpretations and the Companies Act 2006 applicable to companies reporting under IFRS.

Adoption of new and revised standards

The Company has adopted the following new and amended IFRSs as of 1 April 2016.

- IAS1, Presentation of Financial Statements
- IAS19, Employee Benefits
- IFRS7, Financial Instruments: Disclosures

None of these have materially impacted the financial statements of the company.

Guidance in issue but not in force

IAS 8 requires disclosure of guidance in issue but not in force. The minimum disclosure relates to guidance issued by 31 March 2017, and with potential effect.

| International Accounting Standards and Interpretations | Effective for annual periods beginning on or after |
|---|---|
| IAS 7, Statement of Cash Flows* | 1 January 2017 |
| IAS 12, Income Taxes* | 1 January 2017 |
| IAS 39, Financial Instruments: Recognition and Measurement | 1 January 2018 |
| IFRS 7, Financial Instruments: Disclosures | 1 January 2018 |
| IFRS 9, Financial Instruments | 1 January 2018 |
| IFRS 15, Revenue from Contracts With Customers | 1 January 2018 |
| IFRS 16, Leases* | 1 January 2019 |

*Not yet adopted for use in the European Union

The directors have reviewed the requirements of the new standards and interpretations listed above and they are not expected to have a material impact on the company's financial statements in the period of initial application.

Basis of preparation

The financial statements are presented in Sterling (£) as that is the company's functional currency and the currency in which the majority of the company's accounting policies.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the company's accounting policies.

The following significant accounting policies, which are consistent with the previous period unless otherwise stated, have been adopted in the preparation of this report:

LPFE LIMITED

Notes to the Financial Statements (continued)

For the year ended 31 March 2017

1. Statement of significant accounting policies (continued)

a. Going concern

The directors are of the opinion that the company has adequate resources to enable it to undertake its planned activities for a period of at least one year from the date that the financial statements are approved.

b. Current and deferred income tax

The company is a mutual trader and is therefore not liable to corporation tax on surpluses generated from mutual trade. The tax charge for the period is based on the profit for the year from non-mutual trade, adjusted for any non-assessable or disallowed items. It is calculated using tax rates that have been enacted or are substantively enacted by the balance sheet date.

Deferred tax is accounted for using the balance sheet liability method in respect of temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. No deferred income tax will be recognised from the initial recognition of an asset or liability, excluding a business combination, where there is no effect on accounting or taxable profit or loss.

Deferred tax is calculated at the tax rates that are expected to apply to the period when the asset is realised or liability is settled. Deferred tax is credited in the income statement except where it relates to items that may be credited directly to equity, in which case the deferred tax is adjusted directly against equity.

Deferred income tax assets are recognised to the extent that it is probable that future profits will be available against which deductible temporary differences can be utilised.

The amount of benefit brought to account or which may be realised in the future is based on the assumption that no adverse change will occur in income taxation legislation and the anticipation that the economic entity will derive sufficient future assessable income to enable the benefit to be realised and comply with the conditions of deductibility imposed by the law.

c. Impairment

The carrying value of all assets are reviewed for impairment at each reporting date, with the recoverable amount being estimated when events or changes in circumstances indicate that the carrying value may be impaired.

The recoverable amount of all assets is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which it belongs, unless the asset's value in use can be estimated to be close to its fair value.

An impairment exists when the carrying value of the asset or cash-generating units exceeds its estimated recoverable amount. The asset or cash-generating unit is then written down to its recoverable amount.

LPFE LIMITED

Notes to the Financial Statements (continued)

For the year ended 31 December 2017

1. Statement of significant accounting policies (continued)

d. Cash and cash equivalents

For the purposes of the statement of cash flows, cash includes cash on hand and at call deposits with banks or financial institutions, investments in money market instruments maturing within less than two months and is net of bank overdrafts.

e. Revenue

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Company and the revenue can be reliably measured, regardless of when the payment is being made. Revenue is measured at the fair value of the consideration received or receivable, taking into account contractually defined terms of payment and excluding taxes or duty.

Revenue is derived wholly from the provision of seconded staff in the United Kingdom. Revenue is recognised upon the delivery of the service to the customer.

All revenue is stated net of the amount of value added tax (VAT).

f. Value added tax

Revenues, expenses and assets are recognised net of the amount of value added tax (VAT), except:

- i. Where the amount of VAT incurred is not recoverable from the taxation authority, it is recognised as part of the cost of acquisition of an asset or as part of an item of expense; or
- ii. For receivables and payables, which are recognised inclusive of VAT.

The net amount of VAT recoverable from, or payable to, the taxation authority is included as part of receivables or payables.

Cash flows are included in the statement of cash flows on a gross basis. The VAT component of cash flows arising from investing and financing activities which is recoverable from, or payable to, the taxation authority is classified as operating cash flows.

g. Share capital

Ordinary shares are classified as equity.

LPFE LIMITED

Notes to the Financial Statements (continued)

For the year ended 31 March 2017

1. Statement of significant accounting policies (continued)

h. Employee benefits

The company contributes to a defined benefits scheme operated on behalf of its employees.

The employees of LPFE Limited participate in the Lothian Pension Fund, which is part of the Local Government Pension Scheme in Scotland and is administered by the City of Edinburgh Council.

The current service cost for the period is charged to the Statement of Profit or Loss and Other Comprehensive Income. The assets of the scheme are held separately from those of the company in independently administered funds. The company has fully adopted the accounting principles as required by International Accounting Standard 19 – Employee Benefits.

The liability recognised in the balance sheet in respect of defined benefit pension plan is the present value of the defined benefit obligation at the end of the reporting period less the fair value of plan assets, together with adjustments for unrecognised past-service costs. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that are denominated in a currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension obligations.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to equity through other comprehensive income in the period in which they arise.

Past-service costs are recognised immediately in income, unless the changes to the pension plan are conditional on the employees remaining in service for a specified period of time (the vesting period). In this case, the past-service costs are amortised on a straight-line basis over the vesting period.

i. Financial instruments

Financial assets and financial liabilities are recognised when the company has become party to the contractual provisions of the instrument.

Trade receivables

Trade receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. A provision for impairment of trade receivables is established when there is objective evidence that the Company will not be able to collect all amounts due according to the original terms of receivables. The amount of the provision is recognised in the statement of comprehensive income.

Trade payables

Trade payables are initially recognised at fair value and subsequently at amortised cost using the effective interest method.

Financial liabilities

Financial liabilities are classified according to the substance of the contractual arrangements entered into.

An instrument will be classified as a financial liability when there is a contractual obligation to deliver cash or another financial asset to another enterprise.

LPFE LIMITED

Notes to the Financial Statements (continued)

For the year ended 31 March 2017

1. Statement of significant accounting policies (continued)

i. Financial instruments (continued)

Loans

All interest bearing loans and other borrowings are initially recorded at fair value, which represents the fair value of the consideration received, net of any issue costs associated with other borrowings. Interest bearing bank loans and overdrafts are recorded at the proceeds received, net of direct issue costs.

Finance charges, including premiums payable on settlement or redemption, are accounted for on an amortised cost basis to the statement of comprehensive income using the effective interest method, being recognised in the statement of comprehensive income over the term of such instruments at a constant rate on the carrying amount of the instrument to the extent that they are not settled in the year in which they arise.

Borrowings are classified as current liabilities unless the Company has an unconditional right to defer settlement of the liability for at least 12 months after the reporting date.

j. Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to offset the recognised amount and there is an intention to settle on a net basis or realise the asset and settle the liability simultaneously.

k. Critical accounting estimates and judgements

The directors evaluate estimates and judgements incorporated into the financial report based on historical knowledge and best available current information. Estimates assume a reasonable expectation of future events and are based on current trends and economic data, obtained both externally and within the company.

Key estimates – defined benefit pension obligation

IAS 19, Employee Benefits requires that certain assumptions are made in order to determine the amount to be recorded for retirement benefit obligations and pension plan assets. These are mainly actuarial assumptions such as expected inflation rates, long-term increase in health care costs, employee turnover, expected return on plan assets and discount rates. Substantial changes in the assumed development of any one of these variables may significantly change the Group's retirement benefit obligation and pension assets (see note 15 for further details).

LPFE LIMITED

Notes to the Financial Statements (continued)

For the year ended 31 March 2017

2. Profit/(loss) from operations

| | 2017 | 2016 |
|--|-------------------|-------------------|
| | £ | £ |
| Profit/(loss) from operations has been determined after deducting: | | |
| Auditors' remuneration: | | |
| Audit services | 4,800 | 4,750 |
| Non-Audit services | 3,798 | 2,250 |
| | <u> </u> | <u> </u> |

3. Finance costs

| | 2017 | 2016 |
|---|-------------------|-------------------|
| | £ | £ |
| Loan interest payable to group entities (note 14) | 720 | 968 |
| Pension interest costs (note 15) | 6,000 | 9,000 |
| | <u> </u> | <u> </u> |
| | <u>6,720</u> | <u>9,968</u> |

4. Corporation tax credit

| | 2017 | 2016 |
|-----------------------------|-------------------|-------------------|
| | £ | £ |
| Current tax: | | |
| Corporation tax credit | (21) | (5,335) |
| | <u> </u> | <u> </u> |
| Tax on profits for the year | <u>(21)</u> | <u>(5,335)</u> |

Corporation tax credit is calculated at 20% of the assessable profits for the year.

The credit for the year can be reconciled to the loss per the income statement as follows:

| | 2017 | 2016 |
|---|-------------------|-------------------|
| | £'000 | £'000 |
| Profit/(loss) for the year before taxation | 6,254 | (65,789) |
| | <u> </u> | <u> </u> |
| Profit/(loss) for the year at the effective rate of corporation tax of 20% (2016 – 20%) | 1,251 | (13,158) |
| Effects of: | | |
| Mutual trade adjustment | (1,753) | 6,406 |
| Expenses not deductible for tax purposes | 438 | 1,466 |
| Trading losses carried forward | 42 | - |
| Other adjustments | 1 | (49) |
| | <u> </u> | <u> </u> |
| Current tax credit | <u>(21)</u> | <u>(5,335)</u> |

LPFE LIMITED

Notes to the Financial Statements (continued)

For the year ended 31 December 2017

5. Employee benefits expense

The average number of persons employed by the company (including directors) during the year was 11 (2016: 11).

The aggregate payroll costs were as follows:

| | 2017 | 2016 |
|---|------------------|----------------|
| | £ | £ |
| Wages and salaries | 849,767 | 675,817 |
| Social security costs | 104,078 | 67,389 |
| Defined benefit pension obligation - current service cost | 172,000 | 174,000 |
| | <u>1,125,845</u> | <u>917,206</u> |

6. Directors' remuneration

One director received emoluments from the company during the period. The director's emoluments for the period were as follows:

| | 2017 | 2016 |
|--------------------------------|----------------|---------------|
| | £ | £ |
| Aggregate emoluments | 92,000 | 78,384 |
| Employer pension contributions | 18,860 | 16,068 |
| | <u>110,860</u> | <u>94,452</u> |

The director had an accrued pension of £16,799 (2016: £13,919) and a lump sum of £11,843 (2016: £10,973) at the end of the year.

All other directors are employed by the City of Edinburgh Council.

7. Trade and other receivables

| | 2017 | 2016 |
|---------------------------------|----------------|----------------|
| | £ | £ |
| Trade receivables | 29,433 | 27,295 |
| Amounts due from group entities | 137,354 | 102,366 |
| Prepayments and accrued income | 14 | 20 |
| | <u>166,801</u> | <u>129,681</u> |

The directors consider the fair value of receivables to be in line with carrying values.

8. Cash and cash equivalents

| | 2017 | 2016 |
|--------------------------|---------------|--------------|
| | £ | £ |
| Cash at bank and in hand | <u>13,381</u> | <u>5,065</u> |

LPFE LIMITED

Notes to the Financial Statements (continued)

For the year ended 31 December 2017

9. Current liabilities

| | 2017 | 2016 |
|---------------------------------|-------------|-------------|
| | £ | £ |
| Trade payables | 3,109 | 308 |
| Accruals and deferred income | 39,813 | 36,581 |
| Social security and other taxes | 107,425 | 96,116 |
| Amounts due to group entities | 13 | 194 |
| | 150,360 | 133,199 |
| | 150,360 | 133,199 |

10. Deferred tax

| | 2017 | 2016 |
|---|-------------|-------------|
| | £ | £ |
| At 31 March 2016 | 36,000 | - |
| Charge for the year to other comprehensive income | 80,450 | 36,000 |
| | 116,450 | 36,000 |
| | 116,450 | 36,000 |
| The elements of deferred tax are as follows: | | |
| Defined benefit pension scheme liability | 116,450 | 36,000 |
| | 116,450 | 36,000 |
| | 116,450 | 36,000 |

11. Share Capital

| | 2017 | 2016 |
|---|-------------|-------------|
| | £ | £ |
| <i>Allotted, called up and fully paid</i> | | |
| Ordinary shares of £1 each | 1 | 1 |
| | 1 | 1 |
| | 1 | 1 |

LPFE LIMITED

Notes to the Financial Statements (continued)

For the year ended 31 March 2017

12. Reserves

| | Retained Earnings £ |
|---|------------------------------------|
| Loss for the period | (60,454) |
| Transfer of opening retirement benefit obligation | (281,000) |
| Actuarial gains on retirement benefit obligation | 163,000 |
| Deferred tax on retirement benefit obligation | 36,000 |
| | <hr/> |
| At 31 March 2016 | (142,454) |
| Profit for the year | 6,275 |
| Actuarial loss on pension plan | (483,000) |
| Deferred tax on retirement benefit obligation | 80,450 |
| | <hr/> |
| At 31 March 2017 | <u>(538,729)</u> |

13. Controlling interest

The City of Edinburgh Council (acting in its capacity as the administering authority of the Lothian Pension Fund) owns all the issued share capital of the company. The company itself has been established to support the administration of the Lothian Pension Fund. Administering authorities are required to prepare separate financial statements for the Local Government Pension Scheme funds that they administer and so it is considered appropriate to consolidate the company's individual financial statement into Lothian Pension Fund's consolidated financial statements.

Group accounts are available to the public from the following address:

Account Dept.
Lothian Pension Fund
Atria One
144 Morrison Street
Edinburgh
EH3 8EX

LPFE LIMITED

Notes to the Financial Statements (continued)

For the year ended 31 March 2017

14. Related party transactions

| | 2017 | 2016 |
|--|-------------|-------------|
| | £ | £ |
| Lothian Pension Fund (pension fund administered by City of Edinburgh Council) | | |
| Sale of services during the period | 1,073,448 | 819,720 |
| Receivables at the period end | 104,803 | 90,874 |
| Loan facility balance receivable at the period end | 24,269 | 6,157 |
| Interest payable during the period | 720 | 968 |
| Interest payable but still accruing at the period end | 13 | 194 |
| Lothian Buses Limited (company under common control) | | |
| Balance receivable for group tax losses surrendered | 1,321 | 5,335 |
| LPFI Limited (company under common control) | | |
| Sale of services during the period | 6,940 | - |
| Receivables at the period end | 6,940 | - |
| Balance receivable for group tax losses surrendered | 21 | - |

The company has a loan facility agreement with Lothian Pension Fund for the purpose of the provision of short term working capital. The current agreement covers the period to 1 May 2020 and provides that interest is payable at 2% above the Royal Bank of Scotland base lending rate on the daily balance. In order to minimise the amount of interest payable, the company returns any cash not immediately required and this can result in short periods when the company has returned more cash than has been drawn. On such days the loan interest is negative, reducing the amount of interest payable.

Total compensation paid in relation to key management personnel during the period was as follows:

| | 2017 | 2016 |
|---|-------------|-------------|
| | £ | £ |
| Short-term employee benefits | 380,321 | 318,192 |
| Post-employment benefits - employer pension contributions | 77,616 | 65,228 |
| | 457,937 | 383,420 |
| | 457,937 | 383,420 |

Key management personnel had accrued pensions totalling £81,825 (2016: £68,004) and lump sums totalling £100,185 (2016: £92,156) at the end of the period.

All other key management personnel are employed by the City of Edinburgh Council.

LPFE LIMITED

Notes to the Financial Statements (continued)

For the year ended 31 March 2017

15. Retirement benefits obligation

The Lothian Pension Fund, which is administered by the City of Edinburgh Council, is part of the Local Government Pension Scheme in Scotland. This is a pension scheme providing benefits based on final pensionable pay, contributions being charged to the profit or loss so to spread the cost of pensions over employees' working lives. The contributions are determined by a qualified actuary.

The valuation of the pension fund is carried out triennially. The most recent actuarial valuations of plan assets and the present value of the defined benefit obligation were carried out at 31 December 2014 by Hymans Robertson LLP. The present value of the defined benefit obligation, and related current service cost and past service cost, were measured using the Projected Unit Credit Method.

Scheme assets

The group's share of the fair value of the scheme's assets which are not intended to be realised in the short term and may be subject to significant change before they are realised, were comprised as follows:

| | % | 2017 £'000 | % | 2016 £'000 |
|--|-------------|---------------|-------------|---------------|
| Equity Securities: | | | | |
| Consumer | 15% | 425 | 15% | 319 |
| Manufacturing | 15% | 429 | 12% | 247 |
| Energy and Utilities | 7% | 210 | 8% | 167 |
| Financial Institutions | 7% | 197 | 8% | 178 |
| Health and Care | 6% | 166 | 7% | 139 |
| Information Technology | 5% | 140 | 6% | 126 |
| Other | 7% | 195 | 6% | 120 |
| Debt Securities: | | | | |
| Corporate Bonds (investment grade) | 0% | 0 | 0% | 0 |
| UK Government | 10% | 284 | 6% | 135 |
| Other | 0% | 6 | 3% | 53 |
| Private Equity: | | | | |
| All | 3% | 91 | 4% | 92 |
| Real Estate | | | | |
| UK Property | 7% | 191 | 9% | 179 |
| Investment Funds and Unit Trusts: | | | | |
| Equities | 0% | 0 | 0% | 0 |
| Commodities | 0% | 8 | 0% | 6 |
| Bonds | 1% | 42 | 1% | 17 |
| Infrastructure | 9% | 253 | 7% | 139 |
| Other | 2% | 60 | 2% | 50 |
| Cash and Cash Equivalents: | | | | |
| All | 5% | 131 | 6% | 130 |
| | <u>100%</u> | <u>2,828</u> | <u>100%</u> | <u>2,097</u> |

LPFE LIMITED

Notes to the Financial Statements (continued)

For the year ended 31 December 2017

15. Retirement benefits obligation (continued)

| | | |
|--|--------------|--------------|
| The amounts recognised in the statement of financial position are determined as follows: | 2017 | 2016 |
| | £'000 | £'000 |
| Fair value of plan assets | 2,828 | 2,097 |
| Present value of scheme liabilities | (3,513) | (2,277) |
| | <hr/> | <hr/> |
| Net pension liability | (685) | (180) |
| | <hr/> <hr/> | <hr/> <hr/> |

The movement in the defined benefit obligation over the year is as follows:

| | | |
|--|--------------|--------------|
| | 2017 | 2016 |
| | £'000 | £'000 |
| Brought forward | 2,277 | 2,107 |
| Current service cost | 172 | 174 |
| Interest cost on obligation | 86 | 69 |
| Plan participants contributions | 76 | 54 |
| Benefits paid | 0 | 0 |
| Actuarial losses arising from changes in financial assumptions | 902 | (378) |
| Actuarial losses arising from changes in demographic assumptions | 0 | 0 |
| Other actuarial (gains) | 0 | 251 |
| | <hr/> | <hr/> |
| Balance at year end | 3,513 | 2,277 |
| | <hr/> <hr/> | <hr/> <hr/> |

The movement in the fair value of plan assets of the year is as follows:

| | | |
|---|--------------|--------------|
| | 2017 | 2016 |
| | £'000 | £'000 |
| Brought forward | 2,097 | 1,826 |
| Benefits paid | 0 | 0 |
| Interest income on plan assets | 80 | 60 |
| Contributions by employer | 156 | 121 |
| Contributions by member | 76 | 54 |
| Return on assets excluding amounts included in net interest | 419 | 36 |
| | <hr/> | <hr/> |
| Balance at year end | 2,828 | 2,097 |
| | <hr/> <hr/> | <hr/> <hr/> |

LPFE LIMITED

Notes to the Financial Statements (continued)

For the year ended 31 March 2017

15. Retirement benefits obligation (continued)

The amounts recognised in the Statement of Profit or Loss are as follows:

| | 2017 | 2016 |
|---|--------------|--------------|
| | £'000 | £'000 |
| Interest received on pension scheme assets | (80) | (60) |
| Interest cost on pension scheme liabilities | 86 | 69 |
| | <hr/> | <hr/> |
| Finance (income)/cost | 6 | 9 |
| Current service cost | 172 | 174 |
| | <hr/> | <hr/> |
| | 178 | 183 |
| | <hr/> <hr/> | <hr/> <hr/> |

Amounts recognised in other comprehensive income:

| | 2017 | 2016 |
|---|--------------|--------------|
| | £'000 | £'000 |
| Transfer of opening retirement benefit obligation on 1 May 2015 | - | (281) |
| Actuarial (losses) in the defined benefit obligation | (902) | 127 |
| Actuarial gains in the fair value of defined benefit assets | 419 | 36 |
| | <hr/> | <hr/> |
| | (483) | (118) |
| | <hr/> <hr/> | <hr/> <hr/> |

The principal actuarial assumptions used in this valuation were:

| | 2017 | 2016 |
|---------------------------------|-------------|-------------|
| Inflation/pension increase rate | 2.4% | 2.2% |
| Salary increase rate | 4.4% | 4.2% |
| Discount rate | 2.7% | 3.6% |

The assumptions used by the actuary are the best estimates chosen from a range of possible actuarial assumptions which, due to the timescale covered, may not necessarily be borne out in practice. Best estimate has been interpreted to mean that the proposed assumptions are 'neutral' – there is an equal chance of actual experience being better or worse than the assumptions proposed.

The financial assumptions used for reporting in the financial statements are the responsibility of the employer. These assumptions are largely prescribed at any point and reflect market conditions at the reporting date. Changes in market conditions that result in changes in the net discount rate can have significant effect on the value of the liabilities reported.

A reduction in the net discount rate will increase the assessed value of liabilities as a higher value is placed on benefits paid in the future. A rise in the net discount rate will have the opposite effect of a similar magnitude. There is also uncertainty around life expectancy of the UK population – the value of current and future pension benefits will depend on how long they are assumed to be in payment.

LPFE LIMITED

Notes to the Financial Statements (continued)

For the year ended 31 March 2017

15. Retirement benefits obligation (continued)

The sensitivity of the overall pension liability to changes in the weighted principal assumptions is:

| Change in assumption | Approximate % increase to employer liability | | Approximate increase to employer liability (£'000) | |
|--|--|------|--|------|
| | 2017 | 2016 | 2017 | 2016 |
| 0.5% decrease in real discount rate | 14% | 14% | 508 | 319 |
| 0.5% increase in the salary increase rate | 7% | 7% | 237 | 156 |
| 0.5% increase in the pension increase rate | 7% | 7% | 252 | 155 |

Mortality rates:

Life expectancy is based on the Fund's Vita Curves with improvements in line with the CMI 2012 model assuming current rates of improvements have peaked and will converge at to a long term rate of 1.25% p.a.

Based on these assumptions, the average future life expectancy at age 65 are summarised below:

| | Male | Female |
|--------------------|------|--------|
| Current pensioners | 22.1 | 23.7 |
| Future pensioners | 24.2 | 26.3 |

Expected employer contributions to the benefit plans for the year ended 31 March 2018 are £157,000, based on a pensionable payroll cost of £764,000.

16. Financial Risk Management

The company's financial instruments consist mainly of deposits with banks and accounts receivable and payable.

The company did not enter into any transactions that would be classed derivative financial instruments during the period.

The totals for each category of financial instruments, measured in accordance with IAS 39 and detailed in the accounting policies, are as follows:

| | Note | 2017 £ | 2016 £ |
|--|------|----------------|----------------|
| Financial Assets | | | |
| Cash and cash equivalents | 8 | 13,381 | 5,065 |
| Trade and other receivables | 7 | 166,801 | 129,681 |
| Total Financial Assets | | <u>180,182</u> | <u>134,746</u> |
| Financial Liabilities | | | |
| Financial liabilities at amortised cost: | | | |
| Trade and other payables | 9 | 150,360 | 133,199 |
| Total Financial Liabilities | | <u>150,360</u> | <u>133,199</u> |

LPFE LIMITED

Notes to the Financial Statements (continued)

For the year ended 31 March 2017

16. Financial Risk Management (continued)

Financial Risk Management Policies

The company aims to manage its overall capital structure to ensure it continues to operate as a going concern. The company's capital structure represents the equity attributable to the shareholders of the company together with cash equivalents.

The Board is charged with the overall responsibility of establishing and monitoring the company's risk management policies and processes in order to identify, analyse and monitor the risks that are faced by the company. The company does not enter into or trade financial instruments for speculative purposes.

The main risks that the company is exposed to through its financial instruments are credit risk, liquidity risk and market risk. These are managed as follows:

a. Credit risk

Exposure to credit risk relating to financial assets arises from the potential non-performance by counterparties of contractual obligations that could lead to a financial loss to the company.

The maximum exposure to credit risk, excluding the value of any collateral or other security, at balance sheet date to recognised financial assets, is the carrying amount, net of any provisions for impairment of those assets, as disclosed in the Statement of Financial Position and notes to the financial statements. As at 31 March 2017 none of the company's financial assets were past due or impaired.

Credit risk is managed and reviewed regularly by senior management. It mainly arises from amounts owed by customers.

The nature of the company's business means that it currently only has two customers. By far the largest customer is the City of Edinburgh Council and the company is securely funded by the Council. The smaller customer is Falkirk Council. Given the financial stature of both Councils the credit risk faced by the company is considered to be very small.

b. Liquidity Risk

Liquidity risk arises from the possibility that the company might encounter difficulty in settling its debts or otherwise meeting its financial obligations as they fall due. The company manages this risk through the following mechanisms:

- preparing forward-looking cash flow analysis in relation to its operational, investing and financing activities; and
- ensuring that adequate unutilised borrowing facilities are maintained.

LPFE LIMITED

Notes to the Financial Statements (continued)

For the year ended 31 March 2017

16. Financial Risk Management (continued)

b. Liquidity Risk (continued)

The tables below reflect an undiscounted contractual maturity analysis for financial liabilities.

Financial liability and financial asset maturity analysis

| | Note | Within 1 Year 2017 £ | 1 to 5 Years 2017 £ | Total 2017 £ |
|---|------|-------------------------------|---------------------------|--------------------|
| Financial liabilities due for payment | | | | |
| Trade and other payables | 9 | (150,360) | - | (150,360) |
| | | <u>(150,360)</u> | <u>-</u> | <u>(150,360)</u> |
| Financial assets — cash flows realisable | | | | |
| Cash and cash equivalents | 8 | 13,381 | - | 13,381 |
| Trade and other receivables | 7 | 166,801 | - | 166,801 |
| | | <u>180,182</u> | <u>-</u> | <u>180,182</u> |
| | | <u>29,822</u> | <u>-</u> | <u>29,822</u> |

Cash flows realised from financial assets reflect management's expectation as to the timing of realisation. Actual timing may therefore differ from that disclosed. The timing of cash flows as presented in the table (to settle financial liabilities) reflects the earliest contractual settlement dates.

The company has been granted a £250,000 unsecured revolving loan facility by its parent, The City of Edinburgh Council. The ceiling of the facility has been set at a level to ensure sufficient cash is available to meet the company's short-term cash flow needs, should there be a delay in the City of Edinburgh Council settling invoices for seconded staff.

c. Market risk

Market risk is the risk that changes in market prices, such as foreign exchange rates, interest rates and equity prices will affect the company's financial position. The company has no direct exposure to movements in foreign exchange or equity prices, and has very little exposure to interest rate movements, due to the low level of borrowing. The company monitors this risk but the directors are of the opinion that it is very unlikely to have a significant effect on the company's financial position.

LPFI Limited

Financial Statements

For the year ended 31 March 2017

Registered number SC497542

LPFI LIMITED

Financial statements

For the year ended 31 March 2017

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LPMI LIMITED

Company information

Board of Directors:

Chairman

Hugh Dunn

Executive Directors

Struan Fairbairn

John Burns

William Miller

Clare Scott

Non-executive Director

Leslie Robb

Company Secretary:

D.W. Company Services Limited

Registered office:

4th Floor Saltire Court

20 Castle Terrace

Edinburgh

Lothian

EH1 2EN

Bankers:

The Royal Bank of Scotland plc

Auditor:

Scott-Moncrieff

Exchange Place 3

Semple Street

Edinburgh

EH3 8BL

LPFI LIMITED

Directors' report

For the year ended 31 March 2017

The directors present their report and audited financial statements for the year ended 31 March 2017.

Principal Activity

The principal activity of the company is the provision of FCA regulated investment services to Lothian Pension Fund and other Local Government Pension Scheme funds in Scotland and Northern Ireland.

Results, Dividends and Mutual Trading Surplus

The profit for the year after tax was £432. The directors do not recommend payment of a dividend.

The company's aim is to make a modest trading surplus.

Under the mutual trading agreement with the City of Edinburgh Council (acting in its capacity as the administering authority of the Lothian Pension Fund), the company is required to consider if any of profit arising from the mutual trade can be returned to the Council. Company Law requires that only "distributable profits" are available for distribution. None of the profit for the year is attributable to the mutual trade.

Business Review

The company is wholly owned by the City of Edinburgh Council (acting in its capacity as the administering authority of the Lothian Pension Fund) and has entered into a shareholder agreement with the Council to appropriately address certain governance matters. The company also has a loan facility provided by the City of Edinburgh Council (acting in its capacity as the administering authority of the Lothian Pension Fund) for the purpose of the provision of short term working capital.

LPFI Limited does not employ staff directly, staffing and business support services are provided to company under an intra-group resourcing agreement with the City of Edinburgh Council and LPFE Limited. LPFE Limited is also wholly owned by the City of Edinburgh Council (acting in its capacity as the administering authority of the Lothian Pension Fund).

HMRC has agreed that any profits arising as a result from trade between the company and the City of Edinburgh Council will be covered by the "Mutual Trading" rules and so not subject to Corporation Tax.

The company was granted authorised status by the FCA on 24 June 2016. In December of 2016, LPFI Limited started work with its first client on an infrastructure investment project and a second project was in progress at the year end.

Future prospects

The company's prospects are linked to Lothian Pension Fund's requirement for FCA regulated investment services and the Fund's plans to work with other LGPS funds in the collaborative provision of such services. The company is securely funded by the City of Edinburgh Council (acting in its capacity as the administering authority of the Lothian Pension Fund) which means that it can adapt to future trading needs.

The 2017/18 financial year should see significant expansion of the company's operations.

Directors

The directors who served during the year were:

Hugh Dunn

Struan Fairbairn

John Burns

William Miller

Clare Scott

Leslie Robb

(appointed 7 February 2017)

LPFI LIMITED

Directors' report (continued)

For the year ended 31 March 2017

Statement of directors' responsibilities

The directors are responsible for preparing the financial statements in accordance with applicable laws and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have prepared the financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of its results for that period. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable IFRSs as adopted by the European Union have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Disclosure of information to auditor

As far as each of the directors at the time the report is approved are aware:

- a) there is no relevant information of which the company's auditor is unaware, and
- b) the directors have taken all steps that they ought to have taken to make themselves aware of any relevant audit information and to establish that the auditor is aware of the information.

Auditor

The auditor, Scott-Moncrieff, is deemed to be reappointed under Section 487 (2) of the Companies Act 2006.

Small company provisions

This report has been prepared in accordance with the special provisions for small companies under Part 15 of the Companies Act 2006.

This report was approved by the board and signed on its behalf by:

Date:2017

Hugh Dunn
Chairman

LPFI LIMITED

Independent auditor's report to the members of LPFI Limited

For the year ended 31 March 2017

We have audited the financial statements of LPFI Limited for the year ended 31 March 2017 which comprise the Statement of Profit or Loss and Other Comprehensive Income, Statement of Financial Position, Statement of Changes in Equity, Statement of Cash Flows and related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and, as regards the financial statements, as applied in accordance with the provisions of the Companies Act 2006.

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective Responsibilities of the Directors and the Auditor

As explained more fully in the Statement of directors' responsibilities set out on page 3, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

Scope of the Audit on the Financial Statements

A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate.

Opinion on Financial Statements

In our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 March 2017 and of its profit for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on Other Matter(s) Prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements and the Directors' Report has been prepared in accordance with applicable legal requirements.

In light of the knowledge and understanding of the company and its environment obtained during the course of our audit, we have not identified any material misstatements in the Directors' Report.

LPFI LIMITED

Independent auditor's report to the members of LPFI Limited (continued)

For the year ended 31 March 2017

Matters on Which We Are Required to Report by Exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the company, or returns adequate for our audit have not been received from branches not visited by us; or
- the company financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit; or
- the directors were not entitled to prepare the financial statements in accordance with the small companies regime and take advantage of the small companies' exemption in preparing the directors' report; or
- the directors were not entitled to take advantage of the small companies exemption from the requirement to prepare a strategic report.

Nick Bennett, Senior Statutory Auditor
For and on behalf of Scott-Moncrieff, Statutory Auditor
Exchange Place 3
Semple Street
Edinburgh
EH3 8BL

Date: 2017

LPFI LIMITED

Statement of Profit or Loss and Other Comprehensive Income

For the year ended 31 March 2017

| | Note | 2017 £ | 2016 £ |
|--|-------------|-------------------|-------------------|
| Continuing Operations | | | |
| Revenue | 1e | 23,988 | - |
| Gross profit | | <u>23,988</u> | <u>-</u> |
| Administrative expenses | | (23,348) | - |
| Profit from operations | 2 | <u>640</u> | <u>-</u> |
| Finance costs | 3 | (100) | - |
| Profit before income tax expense | | <u>540</u> | <u>-</u> |
| Corporation tax charge | 4 | (108) | - |
| Profit for the year | 11 | <u>432</u> | <u>-</u> |
| Other comprehensive income | | <u>-</u> | <u>-</u> |
| Total comprehensive income for the year | | <u><u>432</u></u> | <u><u>-</u></u> |

The accompanying notes on pages 10 to 20 form part of these financial statements

LPFI LIMITED

Statement of Financial Position

As at 31 March 2017

| | Note | As at 31 March 2017 £ | As at 31 March 2016 £ |
|--|-------------|--|--|
| Current assets | | | |
| Trade and other receivables | 6 | 13,246 | - |
| Cash and cash equivalents | 7 | 70,661 | 1 |
| Total current assets | | 83,907 | 1 |
| Total assets | | 83,907 | 1 |
| Equity and Liabilities | | | |
| Equity attributable to equity holders of the parent | | | |
| Share capital | 10 | 50,000 | 1 |
| Retained earnings | 11 | 432 | - |
| | | 50,432 | 1 |
| Liabilities | | | |
| Non-current liabilities | | | |
| Trade and other payables | 9 | 16,000 | - |
| Total non-current liabilities | | 16,000 | - |
| Current liabilities | | | |
| Trade and other payables | 8 | 17,475 | - |
| Total current liabilities | | 17,475 | - |
| Total liabilities | | 33,475 | - |
| Total equity and liabilities | | 83,907 | 1 |

The financial statements were authorised for issue by the Board of Directors on 2017 and were signed on its behalf by:

.....
Director

Registered number SC497542

The accompanying notes on pages 10 to 20 form part of these financial statements

LPFI LIMITED

Statement of Changes in Equity

As at 31 March 2017

| | Note | Share Capital £ | Retained Earnings £ | Total £ |
|-----------------------------------|------|-----------------------|---------------------------|------------|
| Share movements | | | | |
| Share allotted upon incorporation | 10 | 1 | - | 1 |
| Comprehensive income | | | | |
| Profit for the year | | - | - | - |
| Balance at 31 March 2016 | | <u>1</u> | <u>-</u> | <u>1</u> |

| | Note | Share Capital £ | Retained Earnings £ | Total £ |
|---------------------------------|------|-----------------------|---------------------------|---------------|
| Balance at 1 April 2016 | | 1 | - | 1 |
| Comprehensive income | | | | |
| Profit for the year | | - | 432 | 432 |
| Share movements | | | | |
| Shares allotted during the year | 10 | 49,999 | - | 49,999 |
| Balance at 31 March 2017 | | <u>50,000</u> | <u>432</u> | <u>50,432</u> |

The accompanying notes on pages 10 to 20 form part of these financial statements

LPFI LIMITED
Statement of Cash Flows

For the year ended 31 March 2017

| | 2017 | 2016 |
|--|-------------|-------------|
| | £ | £ |
| Cash flow from operating activities: | | |
| Profit for the year | 432 | - |
| Changes in assets and liabilities: | | |
| Increase in receivables and other financial assets | (13,246) | - |
| Increase in payables | 17,475 | - |
| Cash flows from operating activities | 4,661 | - |
| Cash flow from financing activities: | | |
| Loans from group entities | 16,000 | - |
| Share capital issued | 49,999 | 1 |
| Net cash flows from financing activities | 65,999 | 1 |
| Net increase in cash and cash equivalents | 70,660 | 1 |
| Cash and cash equivalents at beginning of year | 1 | - |
| Cash and cash equivalents at end of year | 70,661 | 1 |
| Cash at bank and in hand | 70,661 | 1 |

The accompanying notes on pages 10 to 20 form part of these financial statements

LPFI LIMITED

Notes to the Financial Statements

For the year ended 31 March 2017

1. Statement of significant accounting policies

The financial statements of LPFI Limited have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union (IFRSs as adopted by the EU), IFRIC Interpretations and the Companies Act 2006 applicable to companies reporting under IFRS.

Adoption of new and revised standards

The Company has adopted the following new and amended IFRSs as of 1 April 2016.

- IAS1, Presentation of Financial Statements
- IAS19, Employee Benefits
- IFRS7, Financial Instruments: Disclosures

None of these have materially impacted the financial statements of the company.

Guidance in issue but not in force

IAS 8 requires disclosure of guidance in issue but not in force. The minimum disclosure relates to guidance issued by 31 March 2017, and with potential effect.

| International Accounting Standards and Interpretations | Effective for annual periods beginning on or after |
|---|---|
| IAS 7, Statement of Cash Flows* | 1 January 2017 |
| IAS 12, Income Taxes* | 1 January 2017 |
| IAS 39, Financial Instruments: Recognition and Measurement | 1 January 2018 |
| IFRS 7, Financial Instruments: Disclosures | 1 January 2018 |
| IFRS 9, Financial Instruments | 1 January 2018 |
| IFRS 15, Revenue from Contracts With Customers | 1 January 2018 |
| IFRS 16, Leases* | 1 January 2019 |

*Not yet adopted for use in the European Union

The directors have reviewed the requirements of the new standards and interpretations listed above and they are not expected to have a material impact on the company's financial statements in the period of initial application.

Basis of preparation

The financial statements are presented in Sterling (£) as that is the company's functional currency and the currency in which the majority of the company's accounting policies.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the company's accounting policies.

The following significant accounting policies, which are consistent with the previous period unless otherwise stated, have been adopted in the preparation of this report:

LPFI LIMITED

Notes to the Financial Statements (continued)

For the year ended 31 March 2017

1. Statement of significant accounting policies (continued)

a. Going concern

The directors are of the opinion that the company has adequate resources to enable it to undertake its planned activities for a period of at least one year from the date that the financial statements are approved.

b. Current and deferred income tax

The charge for income tax expense for the year is based on the profit for the year adjusted for any non-assessable or disallowed items. It is calculated using tax rates that have been enacted or are substantively enacted by the balance sheet date.

Deferred tax is accounted for using the balance sheet liability method in respect of temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. No deferred income tax will be recognised from the initial recognition of an asset or liability, excluding a business combination, where there is no effect on accounting or taxable profit or loss.

Deferred tax is calculated at the tax rates that are expected to apply to the period when the asset is realised or liability is settled. Deferred tax is credited in the income statement except where it relates to items that may be credited directly to equity, in which case the deferred tax is adjusted directly against equity.

Deferred income tax assets are recognised to the extent that it is probable that future profits will be available against which deductible temporary differences can be utilised.

The amount of benefit brought to account or which may be realised in the future is based on the assumption that no adverse change will occur in income taxation legislation and the anticipation that the economic entity will derive sufficient future assessable income to enable the benefit to be realised and comply with the conditions of deductibility imposed by the law.

c. Impairment

The carrying value of all assets are reviewed for impairment at each reporting date, with the recoverable amount being estimated when events or changes in circumstances indicate that the carrying value may be impaired.

The recoverable amount of all assets is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which it belongs, unless the asset's value in use can be estimated to be close to its fair value.

An impairment exists when the carrying value of the asset or cash-generating units exceeds its estimated recoverable amount. The asset or cash-generating unit is then written down to its recoverable amount.

LPFI LIMITED

Notes to the Financial Statements (continued)

For the year ended 31 March 2017

1. Statement of significant accounting policies (continued)

d. Cash and cash equivalents

For the purposes of the statement of cash flows, cash includes cash on hand and at call deposits with banks or financial institutions, investments in money market instruments maturing within less than two months and is net of bank overdrafts.

e. Revenue

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Company and the revenue can be reliably measured, regardless of when the payment is being made. Revenue is measured at the fair value of the consideration received or receivable, taking into account contractually defined terms of payment and excluding taxes or duty.

Revenue is derived wholly from the provision of FCA-regulated service in the United Kingdom. Revenue from a contract to provide services is recognised by reference to the stage of completion of the contract. The stage of completion of the contract is determined with reference to contractual rates as labour hours and direct expenses are incurred.

All revenue is stated net of the amount of value added tax (VAT).

f. Value added tax

Revenues, expenses and assets are recognised net of the amount of value added tax (VAT), except:

- i. Where the amount of VAT incurred is not recoverable from the taxation authority, it is recognised as part of the cost of acquisition of an asset or as part of an item of expense; or
- ii. For receivables and payables, which are recognised inclusive of VAT.

The net amount of VAT recoverable from, or payable to, the taxation authority is included as part of receivables or payables.

Cash flows are included in the statement of cash flows on a gross basis. The VAT component of cash flows arising from investing and financing activities which is recoverable from, or payable to, the taxation authority is classified as operating cash flows.

g. Share capital

Ordinary shares are classified as equity.

LPFI LIMITED

Notes to the Financial Statements (continued)

For the year ended 31 March 2017

1. Statement of significant accounting policies (continued)

h. Financial instruments

Financial assets and financial liabilities are recognised when the company has become party to the contractual provisions of the instrument.

Trade receivables

Trade receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. A provision for impairment of trade receivables is established when there is objective evidence that the Company will not be able to collect all amounts due according to the original terms of receivables. The amount of the provision is recognised in the statement of comprehensive income.

Trade payables

Trade payables are initially recognised at fair value and subsequently at amortised cost using the effective interest method.

Financial liabilities

Financial liabilities are classified according to the substance of the contractual arrangements entered into.

An instrument will be classified as a financial liability when there is a contractual obligation to deliver cash or another financial asset to another enterprise.

Loans

All interest bearing loans and other borrowings are initially recorded at fair value, which represents the fair value of the consideration received, net of any issue costs associated with other borrowings. Interest bearing bank loans and overdrafts are recorded at the proceeds received, net of direct issue costs.

Finance charges, including premiums payable on settlement or redemption, are accounted for on an amortised cost basis to the statement of comprehensive income using the effective interest method, being recognised in the statement of comprehensive income over the term of such instruments at a constant rate on the carrying amount of the instrument to the extent that they are not settled in the year in which they arise.

Borrowings are classified as current liabilities unless the Company has an unconditional right to defer settlement of the liability for at least 12 months after the reporting date.

i. Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to offset the recognised amount and there is an intention to settle on a net basis or realise the asset and settle the liability simultaneously.

j. Critical accounting estimates and judgements

The directors evaluate estimates and judgements incorporated into the financial report based on historical knowledge and best available current information. Estimates assume a reasonable expectation of future events and are based on current trends and economic data, obtained both externally and within the company. The directors are satisfied that the accounting policies are appropriate and that there are no significant estimates or judgements used in the preparation of the financial statements.

LPFI LIMITED

Notes to the Financial Statements (continued)

For the year ended 31 March 2017

2. Profit from operations

| | 2017 | 2016 |
|---|-------------|-------------|
| | £ | £ |
| Profit from operations has been determined after deducting: | | |
| Auditors' remuneration: | | |
| Audit services | 3,250 | - |
| Non-Audit services | 1,600 | - |
| | 1,600 | - |

3. Finance costs

| | 2017 | 2016 |
|---|-------------|-------------|
| | £ | £ |
| Loan interest payable to group entities (note 13) | 100 | - |
| | 100 | - |

4. Corporation tax charge

| | 2017 | 2016 |
|-----------------------------|-------------|-------------|
| | £ | £ |
| Current tax: | | |
| Corporation tax charge | 108 | - |
| | 108 | - |
| Tax on profits for the year | 108 | - |
| | 108 | - |

Corporation tax expense is calculated at 20% of the assessable profits for the year.

The charge for the year can be reconciled to the profit per the income statement as follows:

| | 2017 | 2016 |
|--|-------------|-------------|
| | £ | £ |
| Profit for the year before taxation | 540 | - |
| | 540 | - |
| Profit for the year at the effective rate of corporation tax of 20% (2016 – 20%) | 108 | - |
| | 108 | - |

LPFI LIMITED

Notes to the Financial Statements (continued)

For the year ended 31 December 2017

5. Employee Benefits Expense

The aggregate payroll costs for the year consisted of fees paid to a non-executive director who was appointed during the year. These were as follows:

| | 2017 | 2016 |
|-----------------------|-------------|-------------|
| | £ | £ |
| Wages and salaries | 2,000 | - |
| Social security costs | 89 | - |
| | 2,089 | - |
| | 2,089 | - |

No pension benefits were accrued by the director during the year. All other staff are employed by LPFE Limited, a company under common control, and an appropriate portion of their employment costs recharged. All other directors are employed by LPFE Limited, a company also under the control of Lothian Pension Fund (administered by the City of Edinburgh Council), and the City of Edinburgh Council. In addition to the payroll costs noted above, the company was also charged £2,344 (2016: £nil) for services provided by directors employed by LPFE Limited during the year.

6. Trade and other receivables

| | 2017 | 2016 |
|---------------|-------------|-------------|
| | £ | £ |
| Trade debtors | 3,988 | - |
| Prepayments | 9,258 | - |
| | 13,246 | - |
| | 13,246 | - |

The directors consider the fair value of receivables to be in line with carrying values.

7. Cash and cash equivalents

| | 2017 | 2016 |
|--------------------------|-------------|-------------|
| | £ | £ |
| Cash at bank and in hand | 70,661 | - |
| | 70,661 | - |

8. Trade and other payables

| | 2017 | 2016 |
|---------------------------------|-------------|-------------|
| | £ | £ |
| Accruals | 5,745 | - |
| Social security and other taxes | 4,233 | - |
| Corporation tax | 87 | - |
| Amounts due to group entities | 7,410 | - |
| | 17,475 | - |
| | 17,475 | - |

LPFI LIMITED

Notes to the Financial Statements (continued)

For the year ended 31 December 2017

9. Non-current liabilities

| | 2017 | 2016 |
|-------------------------------|-------------|-------------|
| | £ | £ |
| Amounts due to group entities | 16,000 | - |
| | 16,000 | - |
| | 16,000 | - |

10. Share Capital

| | 2017 | 2016 |
|---|-------------|-------------|
| | £ | £ |
| <i>Allotted, called up and fully paid</i> Ordinary shares of £1 each | 50,000 | 1 |
| | 50,000 | 1 |
| | 50,000 | 1 |

The company issued 49,999 Ordinary shares of £1 each during the year at par value.

11. Reserves

| | Retained Earnings |
|-----------------------|--------------------------|
| | £ |
| Profit for the period | - |
| At 31 March 2016 | - |
| Profit for the year | 432 |
| At 31 March 2017 | 432 |

12. Controlling interest

The City of Edinburgh Council (acting in its capacity as the administering authority of the Lothian Pension Fund) owns all the issued share capital of the company. The company itself has been established to support the administration of the Lothian Pension Fund. Administering authorities are required to prepare separate financial statements for the Local Government Pension Scheme funds that they administer and so it is considered appropriate to consolidate the company's individual financial statement into Lothian Pension Fund's consolidated financial statements.

Group accounts are available to the public from the following address:

Account Dept.
Lothian Pension Fund
Atria One
144 Morrison Street
Edinburgh
EH3 8EX

LPFI LIMITED

Notes to the Financial Statements (continued)

For the year ended 31 December 2017

13. Related parties

| | 2017 | 2016 |
|--|-------------|-------------|
| | £ | £ |
| Lothian Pension Fund (pension fund administered by City of Edinburgh Council) | | |
| Staff and other cost recharges | 360 | - |
| Payables at the period end | 360 | - |
| Loan facility balance payable at the period end | 16,000 | - |
| Interest payable during the period | 100 | - |
| Interest payable but still accruing at the period end | 89 | - |
| LPFE Limited (company under common control) | | |
| Staff and other cost recharges | 6,940 | - |
| Payables at the period end | 6,940 | - |
| Balance payable for group tax losses utilised | 21 | - |

The company has a loan facility agreement with Lothian Pension Fund for the purpose of the provision of short term working capital. The current agreement covers the period to 1 May 2020 and provides that interest is payable at 2% above the Royal Bank of Scotland base lending rate on the daily balance. In order to minimise the amount of interest payable, the company returns any cash not immediately required and this can result in short periods when the company has returned more cash than has been drawn. On such days the loan interest is negative, reducing the amount of interest payable.

Compensation paid in relation to key management personnel during the period was as follows:

| | 2017 | 2016 |
|---------------------|-------------|-------------|
| | £ | £ |
| Short-term benefits | 2,000 | - |
| | 2,000 | - |
| | 2,000 | - |

All other key management personnel are employed by LPFE Limited, a company also under the control of Lothian Pension Fund (administered by the City of Edinburgh Council), and the City of Edinburgh Council. In addition to the compensation noted above, the company was also charged £2,344 (2016: £nil) for services provided by key management personnel employed by LPFE Limited during the year.

LPFI LIMITED

Notes to the Financial Statements (continued)

For the year ended 31 March 2017

14. Financial Risk Management

The company's financial instruments consist mainly of deposits with banks and accounts receivable and payable.

The company did not enter into any transactions that would be classed derivative financial instruments during the period.

The totals for each category of financial instruments, measured in accordance with IAS 39 and detailed in the accounting policies, are as follows:

| | Note | 2017 £ | 2016 £ |
|--|------|---------------|-------------|
| Financial Assets | | | |
| Cash and cash equivalents | 7 | 70,661 | - |
| Trade and other receivables | 6 | 13,246 | - |
| | | <hr/> | <hr/> |
| Total Financial Assets | | 83,907 | - |
| | | <hr/> <hr/> | <hr/> <hr/> |
| Financial Liabilities | | | |
| Current liabilities - Trade and other payables | 8 | 17,475 | - |
| Non-current liabilities - Trade and other payables | 9 | 16,000 | - |
| | | <hr/> | <hr/> |
| Total Financial Liabilities | | 33,475 | - |
| | | <hr/> <hr/> | <hr/> <hr/> |

Financial Risk Management Policies

The company aims to manage its overall capital structure to ensure it continues to operate as a going concern. The company's capital structure represents the equity attributable to the shareholders of the company together with cash equivalents.

The Board is charged with the overall responsibility of establishing and monitoring the company's risk management policies and processes in order to identify, analyse and monitor the risks that are faced by the company. The company does not enter into or trade financial instruments for speculative purposes.

The main risks that the company is exposed to through its financial instruments are credit risk, liquidity risk and market risk. These are managed as follows:

a. Credit risk

Exposure to credit risk relating to financial assets arises from the potential non-performance by counterparties of contractual obligations that could lead to a financial loss to the company.

The maximum exposure to credit risk, excluding the value of any collateral or other security, at balance sheet date to recognised financial assets, is the carrying amount, net of any provisions for impairment of those assets, as disclosed in the Statement of Financial Position and notes to the financial statements. As at 31 March 2017 none of the company's financial assets were past due or impaired.

Credit risk is managed and reviewed regularly by senior management. It mainly arises from amounts owed by customers. Given the financial stature of its customers the credit risk faced by the company is considered to be very small.

LPFI LIMITED

Notes to the Financial Statements (continued)

For the year ended 31 March 2017

14. Financial Risk Management (continued)

b. Liquidity Risk

Liquidity risk arises from the possibility that the company might encounter difficulty in settling its debts or otherwise meeting its financial obligations as they fall due. The company manages this risk through the following mechanisms:

- preparing forward-looking cash flow analysis in relation to its operational, investing and financing activities; and
- ensuring that adequate unutilised borrowing facilities are maintained.

The tables below reflect an undiscounted contractual maturity analysis for financial liabilities.

Financial liability and financial asset maturity analysis

| | Note | Within 1 Year 2017 £ | 1 to 5 Years 2017 £ | Total 2017 £ |
|---|------|-------------------------------|---------------------------|--------------------|
| Financial liabilities due for payment | | | | |
| Trade and other payables | 8 | (17,475) | (16,000) | (33,475) |
| | | <u>(17,475)</u> | <u>(16,000)</u> | <u>(33,475)</u> |
| Financial assets — cash flows realisable | | | | |
| Cash and cash equivalents | 7 | 70,661 | - | 70,661 |
| Trade and other receivables | 6 | 13,246 | - | 13,246 |
| | | <u>83,907</u> | <u>-</u> | <u>83,907</u> |
| Total anticipated inflows | | <u>83,907</u> | <u>-</u> | <u>83,907</u> |
| | | <u>66,432</u> | <u>(16,000)</u> | <u>50,432</u> |
| Net inflow of financial instruments | | <u>66,432</u> | <u>(16,000)</u> | <u>50,432</u> |

Cash flows realised from financial assets reflect management's expectation as to the timing of realisation. Actual timing may therefore differ from that disclosed. The timing of cash flows as presented in the table (to settle financial liabilities) reflects the earliest contractual settlement dates.

The company has been granted a £75,000 unsecured revolving loan facility by its parent, The City of Edinburgh Council. The ceiling of the facility has been set at a level to ensure sufficient cash is available to meet the company's short-term cash flow needs, should there be a delay in customers settling invoices for services provided.

LPFI LIMITED

Notes to the Financial Statements (continued)

For the period ended 31 March 2017

14. Financial Risk Management (continued)

c. Market risk

Market risk is the risk that changes in market prices, such as foreign exchange rates, interest rates and equity prices will affect the company's financial position. The company has no direct exposure to movements in foreign exchange or equity prices, and has very little exposure to interest rate movements, due to the low level of borrowing. The company monitors this risk but the directors are of the opinion that it is very unlikely to have a significant effect on the company's financial position.



Scott-Moncrieff
Exchange Place,
3 Semple Street
Edinburgh
EH3 8BL

Dear Sirs

Lothian Pension Funds

This representation letter is provided in connection with your audit of the Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund Annual Report and Financial statements for the period ended 31 March 2017 for the purpose of expressing an opinion as to whether the financial statements show a true and fair view of the financial transactions of the Funds during the period from 1 April 2017 to 31 March 2017 and of the amount and disposition at that date of its assets and liabilities (other than liabilities to pay pensions and benefits after the end of the period) in accordance with Part VII of the Local Government (Scotland) Act 1973 and International Financial Reporting Standards as adopted by the European Union, and as interpreted and adapted by the Code of Practice on Local Authority Accounting in the United Kingdom 2016/17 and making a statement about contributions.

By a resolution of the board, passed today, I am directed to confirm to you, in respect of the financial statements of the Funds for the period ended 31 March 2017 the following:-

1. We have fulfilled our responsibilities for preparing financial statements which give a true and fair view in accordance with International Financial Reporting Standards as adopted by the European Union, and as interpreted and adapted by the Code of Practice on Local Authority Accounting in the United Kingdom 2016/17 and for making accurate representations to you.
2. We have provided you with:
 - access to all information of which we are aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;
 - additional information that you have requested from us for the purpose of the audit; and
 - unrestricted access to persons within the entity from whom you determined it necessary to obtain audit evidence.
3. All transactions have been recorded in the accounting records and are reflected in the financial statements.
4. We acknowledge as trustees our responsibilities for the design and implementation of internal control in order to prevent and detect fraud and to prevent and detect error.
5. We have disclosed to you all information in relation to fraud or suspected fraud that we are aware of and that affects the entity and involves:
 - management
 - employees who have significant roles in internal control
 - others where the fraud could have a material effect on the financial statements.
6. We are not aware of any allegations of fraud or suspected fraud with a potential effect on the financial statements which have been communicated to us by employees, former employees, regulators or other third parties.

7. We have disclosed to you all known instances of non-compliance or suspected non-compliance with laws and regulations, whose effects should be considered when preparing the financial statements.
8. We confirm that, in our opinion, the assumptions that have been used in determining fair values, whether such values are disclosed or applied in the financial statements, are reasonable and reflect our ability and intent to carry out specific courses of action, where this is relevant to the determination of those values.
9. In our opinion the significant assumptions used by us in making accounting estimates are reasonable.
10. Where required, the value at which assets and liabilities are recorded in the net assets statement is, in the opinion of the trustees, the market value. We are responsible for the reasonableness of any significant assumptions underlying the valuation, including consideration of whether they appropriately reflect our intent and ability to carry out specific courses of action on behalf of the Funds. Any significant changes in those values since the accounting reference date have been disclosed to you.
11. We have disclosed to you the identity of the company's related parties and all related party relationships and transactions of which we are aware.
12. Related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the requirements of International Financial Reporting Standards as adopted by the European Union.
13. In particular, no trustee, shadow trustee, their connected persons or other officers had any indebtedness, agreement concerning indebtedness or disclosable interest in a transaction with the Funds at any time during the year.
14. The following have been properly recorded and, when appropriate, adequately disclosed in the financial statements:
 - losses arising from sale and purchase commitments;
 - agreements and options to buy back assets previously sold;
 - assets pledged as collateral.
15. We have no plans or intentions that may materially alter the carrying value or classification of assets and liabilities reflected in the financial statements.
16. We have no plans to abandon activities or other plans or intentions that will result in any excess or obsolete stocks, and no stock is stated at an amount in excess of net realisable value.
17. The Funds have satisfactory title to all assets and there are no liens or encumbrances on the Funds' assets, other than as disclosed in the financial statements.
18. We have recorded or disclosed, as appropriate, all liabilities, both actual and contingent, and all guarantees that we have given to third parties.
19. All events subsequent to the date of the financial statements and for which International Financial Reporting Standards as adopted by the European Union require adjustment or disclosure have been adjusted or disclosed. Should any material events occur which may necessitate revision of the figures included in the financial statements or inclusion in the notes thereto, we will advise you accordingly.
20. The Funds have complied with all aspects of contractual agreements that could have a material effect on the financial statements in the event of non-compliance.
21. To the best of our knowledge and belief, the information disclosed in the financial statements in respect of parties which control the Funds is complete and accurate.
22. Except as disclosed in the financial statements, the results for the year were not materially affected by:
 - any change in accounting policies;
 - transactions of a type not usually undertaken by the Funds I group;
 - circumstances of an exceptional or non-recurrent nature; or
 - charges or credits relating to prior periods.
23. There is no pending or potential litigation against the Funds and there are no contingencies of a material amount for which provision has not been made in the financial statements.

24. We confirm that we have reviewed going concern considerations and are satisfied that it is appropriate for the financial statements to have been drawn up on the going concern basis. In reaching this opinion we have taken into account all relevant matters of which we are aware and have considered a future period of at least one year from the date on which the financial statements were approved.
25. We confirm that the effects of uncorrected misstatements are immaterial, both individually and in the aggregate, to the financial statements. A list of uncorrected misstatements is attached to the representation letter.

Yours faithfully

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John Burns

Chief Finance Officer (Section 95 Officer for the Pension Funds)