Notice of meeting and agenda

Pensions Audit Sub-Committee of the Pensions Committee

10.00am, Monday 17 June 2013

Diamond Jubilee Room, City Chambers, High Street, Edinburgh

This is a public meeting and members of the public are welcome to attend

Contact

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Committee Manager

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1. Order of business

1.1 Including any notices of motion and any other items of business submitted as urgent for consideration at the meeting.

2. Declaration of interests

2.1 Members of the Committee and members of the Consultative Panel should declare any financial and non-financial interests they have in the items of business for consideration, identifying the relevant agenda item and the nature of their interest.

3. Deputations

3.1 None

4. Minute

4.1 None.

5. Reports

5.1 Lothian Pension Funds Annual Report 2013 Unaudited – report by the Director of Corporate Governance (circulated)

5.2 Risk Management - report by the Director of Corporate Governance (circulated)

5.3 Internal Audit Bi-Annual Activity Report – June 2013 - report by the Chief Internal Auditor (circulated)

6. Motions

6.1 If any

Carol Campbell

Head of Legal, Risk and Compliance

Committee Members

Councillors Rose (Convener), Bill Cook and Orr.

Information about the Pensions Audit Sub-Committee

The Pensions Audit Sub-Committee consists of 3 Councillors and its membership is appointed by the Pensions Committee. Two members of the Consultative Panel also attend although in a non-voting capacity.

The Pensions Audit Sub-Committee usually meets in the City Chambers on the High Street in Edinburgh. The meeting is open to all members of the public.

Further information

If you have any questions about the agenda or meeting arrangements, please contact Gavin King, Committee Services, City of Edinburgh Council, City Chambers, High Street, Edinburgh EH1 1YJ, Tel 0131 529 4239, e-mail gavin.king@edinburgh.gov.uk.

A copy of the agenda and papers for this meeting will be available for inspection prior to the meeting at the main reception office, City Chambers, High Street, Edinburgh.

The agenda, minutes and public reports for this meeting and all the main Council committees can be viewed online by going to www.edinburgh.gov.uk/cpol.

Pensions Audit Sub-Committee

10am, Monday 17 June 2013

Lothian Pension Funds Annual Report 2013 Unaudited

Item number	5.1
Report number	
Wards	All

Links

Coalition pledges	
Council outcomes	CO26
Single Outcome Agreement	

Alastair Maclean

Director of Corporate Governance

Contact: John Burns, Pensions & Accounting Manager

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Executive summary

Lothian Pension Funds Annual Report 2013 Unaudited

Summary

The purpose of this report is to consider the unaudited Annual Report for the year ended 31 March 2013 for the Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund, prior to its consideration by Pensions Committee on 24 June 2013.

A copy of the unaudited Lothian Pension Funds' Annual Report for the year to 31 March 2013 is attached as Appendix 1. The Accounts show that the Lothian Pension Fund valuation increased from £3,584.2m to £4,094.6m and Lothian Buses Pension Fund increased from £271.4m to £311.9m. The Scottish Homes Pension Fund increased from £131.4m to £140.1m.

Recommendations

The Pensions Audit Sub-Committee is requested to recommend to the Pensions and Trusts Committee that it should approve the unaudited Lothian Pension Funds' Annual Report for the year ended 31 March 2013.

Measures of success

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 2013. This will be determined in due course.

Financial impact

There are no direct financial implications as a result of this report.

Equalities impact

There are no adverse equalities impacts arising from this report.

Sustainability impact

There are no adverse sustainability impacts arising from this report.

Consultation and engagement

The Consultative Panel for the Lothian Pension Funds, comprising employer and member representatives, is integral to the governance of the Funds.

This report will be considered by the Pensions Committee of 24 June 2013 and the recommendation(s) of the Pensions Audit Sub-Committee will be reported orally.

Background reading / external references

None.

Report

Lothian Pension Funds Annual Report 2013 Unaudited

1. Background

1.1 The Scottish Government has issued statutory accounting guidance which requires that Local Government Pension Scheme (LGPS) financial statements be published within an LGPS Annual Report. The statutory guidance provides that for 2010/11 onwards the LGPS Annual Report should be published separately from the Authority's own financial statements and that LGPS Annual Report contents should comply with the requirements of Scottish Statutory Instrument 2010/234 and there should be a separate audit report.

1.2 The Local Government (Scotland) Act 1973 stipulates that unaudited financial statements must be presented to the Council and the Controller of Audit within three months of the financial year end, that is 30 June. It is within the Pensions Committee's governance remit to approve the unaudited Lothian Pension Funds Annual Report. The unaudited Lothian Pension Funds Annual Report 2013 will also be submitted to Council on 27 June 2013 for the purposes of noting and in compliance with Audit Scotland guidance.

2. Main report

Unaudited Lothian Pension Funds Annual Report

2.1 A copy of the unaudited Annual Report for the year to 31 March 2013 for the Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund is attached as Appendix 1. The Accounts show that the Lothian Pension Fund valuation increased from £3,584.2m to £4,094.6m and Lothian Buses Pension Fund increased from £271.4m to £311.9m. The Scottish Homes Pension Fund increased from £131.4m to £140.1m.

2.2 In considering the unaudited Pension Funds' Annual Report, Committee should note the following:

2.3 Section 95 of the Local Government (Scotland) Act 1973 states that "every local authority shall make arrangements for the proper administration of their financial affairs and shall secure that the proper officer of the authority has responsibility for the administration of those affairs". The Head of Finance serves as the Section 95 Officer for all of the City of Edinburgh Council's accounting arrangements, including those of the Pension Funds administered by the

Council. For the Pension Funds, however, this Section 95 responsibility has been delegated to the Pensions and Accounting Manager.

2.4 The Annual Report includes an Annual Governance Statement which sets out details of how the Funds are governed and the internal controls that are in place to manage risk. This mirrors the requirement to have a similar statement within the Financial Statements of the Council.

2.5 The report also includes a Governance Compliance Statement; this is a requirement of the LGPS Regulations. The purpose of this Statement is to record the extent to which the constitutional governance arrangements complies with best practice guidance issued by the Scottish Public Pensions Agency.

2.6 Related to the Annual Governance Statement is the Statement of Responsibilities for the Statement of Accounts. This sets out the respective responsibilities of the Administering Authority and the Pensions & Accounting Manager.

2.7 The unaudited Report includes a section into which the Independent Auditor's Report will be slotted when the audit is completed.

2.8 Each of the three funds has a separate Actuarial Statement provided by the Actuary which provides information on the triennial valuation as at 31 March 2011 and the movement in the funding level since that date.

2.9 Under International Accounting Standard 26 (Retirement Benefit Plans), there is a requirement to disclose the actuarial present value of promised retirement benefits. The basis of the valuation is the same as that used for FRS17 / International Accounting Standard (IAS)19 valuation reports required in the accounts of some individual employers, but covers the liabilities of the whole Fund. The valuation basis is not used for funding purposes and setting contribution levels. The Actuary has provided a value for the liabilities of each of the three Funds and a suitable note has been added to the accounts of each fund (Lothian Pension Fund £4,946m from the previous year's £4,185m, Lothian Buses Pension Fund £321m, from £269m and Scottish Homes £136m from £131m). The increase in the value of the liabilities is largely due to the reduction in bond yields over the year.

2.10 Following the approval of the unaudited Annual Report by Pensions & Trusts Committee, the next steps will be:

2.11 City of Edinburgh Council will be asked to note the unaudited accounts on 27 June 2013.

2.12 In order to meet the statutory timetable, the Pensions Audit Sub-Committee of 20 September 2013 and thereafter the Pensions Committee, at its meeting on 24 September 2013, will consider the International Standard on Auditing (ISA)

260 Audit Report (covering all significant issues arising from the audit of the accounts) and the Audited Annual Report 2013.

2.13 Finally, the external auditor will issue his annual report, which summarises all significant matters arising from the audit and overall conclusions about the management of key risks. This report will be considered by the Pensions Audit Sub-Committee and Pensions Committee at meetings on 16 and 18 December 2013 respectively.

3. Recommendations

3.1 Pensions Audit Sub-Committee is requested to recommend to the Pensions Committee that it should approve the unaudited Annual Report for the year ended 31 March 2013 for the Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund.

Alastair Maclean

Director of Corporate Governance

Links

Coalition pledges	
Council outcomes	CO26 – The Council engages with stakeholders and works in partnerships to improve services and deliver agreed objectives.
Single Outcome Agreement	
Appendices	Unaudited Annual Report 2013 for the Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund

Lothian
PENSION FUND

UNAUDITED ANNUAL REPORT AND ACCOUNTS 2012/2013

LOTHIAN PENSION FUND
LOTHIAN BUSES PENSION FUND
SCOTTISH HOMES PENSION FUND

INVESTORS IN PEOPLE | Gold

CUSTOMER SERVICE EXCELLENCE
CSE

CONTENTS

FOREWORD

Welcome to the 2012/13 Annual Report and Accounts for Lothian Pension Fund, Lothian Buses Pension Fund and the Scottish Homes Pension Fund.

Following the May 2012 local elections, I was delighted to be appointed as the Convener to the Committee with responsibility for the pension funds.

It has been a busy year and we have made significant changes to the way the Funds are governed. We now have a dedicated Pensions Committee and a Pensions Audit Sub-Committee and, for the first time, other pension fund stakeholders are represented on the Committee.

We welcomed Allison Cosgrove (representing UNISON and members) and Darren May from Scottish Water (representing fund employers) to the Committee in December 2012. Both Allison and Darren have been members of the Fund's Consultative Panel for a number of years and bring a different perspective to the Committee.

We also appointed an independent professional observer, Sarah Smart, who will help the Committee scrutinise advice. We made these changes to further strengthen the decision-making processes for the pension funds.

Change within public sector pensions has been a topic of much discussion lately and the Public Service Pensions Act 2013 has set out a framework for all public service pensions, including the Local Government Pension Scheme.

The Act specifies that changes to the Local Government Pension Scheme in Scotland must be implemented by April 2015.

However, whilst details of the changes to the Scheme in England and Wales have been released, the future for the Scheme in Scotland is still under discussion. I look forward to hearing the views of stakeholders once details are announced.

Budgetary constraints across the public sector continued to impact on the membership of Lothian Pension Fund.

Contribution income for Lothian Pension Fund reduced by 2% over the year as many employers reduce workforce numbers.

Severe funding constraints in the public sector have also highlighted the need to improve efficiency and reduce costs. New ways of working such as joint procurement initiatives with other public sector pension funds are being progressed. I am pleased to see officers of the Lothian Pension Fund working closely with those of Falkirk Pension Fund.

Customer service continues to be a priority and we retained the Customer Service Excellence award following an independent assessment. I was also delighted that Lothian Buses Pension Fund received the Local Government Chronicle Investment award for Fund of the Year in the 'Under £750m' category for the second successive year.

The next few years will be challenging for those involved in the Scheme. We have concerns that the changes to the scheme, coupled with pressure on take-home pay, might mean that more members opt-out of the Fund.

We will focus our efforts on communicating the changes to the Scheme when they become available and ensuring that members understand and appreciate the value of the Scheme, which forms a significant part of their remuneration.

Maureen Child

Pensions Committee Convener,
The City of Edinburgh Council
June 2013

REVIEW OF THE YEAR

Investment and Funding

We start our review of the year by looking at the investment markets. These have delivered strong returns over the year. Equity and bond markets rallied, particularly in the first quarter of 2013. The three pension funds all delivered strong returns; 13.9%, 16.4% and 13.0% for Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund respectively.

However, a meaningful reduction in government bond yields has increased the value of liabilities by more than the increase in the value of assets. The Actuary has estimated that the funding levels of all three pension funds at 31 March 2013 are lower than those at the last actuarial valuation at 31 March 2011.

The investment strategies of the pension funds were reviewed over the year. The reviews concluded that there is scope to reduce their investment risk in the long-term but they should maintain exposure to investments which have an explicit, or implicit, link to inflation. The reviews also highlighted the importance of investment income over the next few years as the cashflow in the Funds is expected to reduce over time. The revised investment strategies are being implemented at a measured pace, as investment opportunities become available and as research on opportunities is undertaken. Some changes have been put in place during the 2012/13 financial year and work is ongoing. The investment and funding outlook for the pension funds remain exceptionally challenging as economies struggle to show meaningful growth and government bond yields remain stubbornly low.

Customer Service

We are committed to continually improving the service to our customers.

We communicated regularly with employers in the Fund via newsletters, events and meetings over the year. Our customers continued to rate our service highly, with 86% of customers surveyed agreeing that our service was excellent.

This year we provided benefit statements for active and deferred members on-line for the first time, whilst offering the option to receive paper copies. We made 97% of annual benefits forecasts available by 30 September 2012 and over 9,000 of our members are using the on-line system.

Ensuring timely and accurate data from employers is crucial for delivering a quality pensions service to members. To help us achieve this we have introduced a specialist on-line system that allows employers to upload data securely to our pension administration system. This advancement should help to ensure membership data is updated more frequently and the service to members is improved. It should also deliver efficiencies for both the Fund and employers.

A number of the employers in the Lothian Pension Fund faced organisational changes during the year. These included the merger of Telford, Stevenson and Jewel and Esk Colleges, the transfer of Oatridge College to the Scottish Agricultural College, plans to dissolve the Forth Estuary Transport Association, as well as a number of admitted bodies investigating options to exit the Fund. We have worked with employers during these changes to ensure commitments to the Fund are honoured.

The Pensions Act 2011 introduced a requirement for employers to automatically enrol employees into a qualifying pension scheme. We have updated our procedures accordingly and have provided support to employers as they made the necessary preparations.

REVIEW OF THE YEAR

The Local Government Pension Scheme regulations in Scotland have been changed as a result and employees with contracts of less than three months were allowed to join.
As a result, the number of members in the Lothian Pension Fund has increased over the year by 441. This is particularly notable given the fall in membership numbers over the previous year.

Risk management

The Fund is committed to a strong control environment to ensure that risks are identified, understood, managed and monitored appropriately. The risks faced by the Fund change over time and the ongoing management of risk is crucial.

In this regard, progress was made towards integrating the pensioner payroll system with the pension administration system. The change will reduce risk, increase efficiency and reduce reliance on manual reconciliations.

We also recruited a specialist investment lawyer to the internal team. As well as providing legal assistance for the pension funds, he will play a key role in enhancing risk management.

Local Government Pension Scheme Reform

The Public Service Pensions Act 2013 will bring significant changes and challenges for the Fund in terms of both scheme benefits and governance. There will be significant communication demands on the Fund and delivery risks in meeting service standard expectations, should a new scheme bring additional administrative complexity. Changes in the governance of public service pension schemes will also lead to greater scrutiny of the Fund's service.

By embedding the Fund's new governance arrangements and striving to continually improve our performance, the Fund will be in a strong position to meet these challenges.

Alastair Maclean

Director of Corporate Governance
June 2013

Clare Scott

Investment and Pensions Service Manager
June 2013

How the Funds are run

This section describes the way the Funds work and includes the membership of the Pension Committee and their training.

The City of Edinburgh Council acts as administering authority for the Local Government Pension Scheme in the Lothian area.

Pension matters are delegated by the Council to a Committee whose members act as 'quasi trustees'.

Pensions and Trusts Committee/Pensions Committee

The Pensions and Trusts Committee held meetings in June and September 2012 before being replaced by the Pensions Committee. A new Committee was appointed following the Local Government Elections in May 2012. The new Pensions Committee formed in September 2012 held two meetings in December 2012 and March 2013 and two stakeholder members were appointed from the membership of the Funds' Consultative Panel.

The following tables shows the membership and its changes throughout the period. Pensions Audit Sub-Committee was also formed as part of the governance review. Councillor Cameron Rose is the Convener of the Sub-Committee and the membership is denoted by an asterisk in the Pensions Committee column.

Pensions and Trusts Committee		Pensions Committee
Membership from 1 April to Local Government elections	Membership following Local Government elections to September 2012	Membership from September 2012 to 31 March 2013
Councillor Tim Mackay (Convener)	Councillor Maureen Child (Convener)	Councillor Maureen Child (Convener)
Councillor Maureen Child	Councillor Bill Cook	Councillor Bill Cook*
Councillor Nick Elliot-Cannon	Councillor Jim Orr	Councillor Jim Orr*
Councillor Maggie Chapman	Councillor Cameron Rose	Councillor Cameron Rose*
Councillor Cameron Rose	Councillor Alasdair Rankin	Councillor Alasdair Rankin
		Allison Cosgrove, Unison
		Darren May, Scottish Water

Consultative Panel

The Funds have a Consultative Panel made up of employer and member representatives to act as a sounding board for the Pensions Committee. The Panel make up and membership was also reviewed over the year. The new Panel is now made up of six employer representatives and six member representatives. The membership is shown below.

Lothian Pension Fund Consultative Panel membership			
	Employer	**Representing**	
Employer representatives			
Alan Williamson	Edinburgh College	College/university	
Darren May	Scottish Water	Other employers	
Vacancy	Scottish Government	Scottish Homes	
Eric Adair	EDI	Other employers	
Guy Hughes	Lothian Buses	Lothian Buses	Joined 01/11/12
Norman Strachan	Lothian Buses	Lothian Buses	Resigned 31/10/12
Rebecca Wilson	Barony Housing Association	Admitted bodies	Resigned 31/10/12
Member representatives			
Charlie Boyd	The City of Edinburgh Council	Active Member	
Allison Cosgrove	East Lothian Council	Unison	
Eric MacLennan	The City of Edinburgh Council	Unison	
Owen Murdoch	Retired member	Unison	
John Rodgers	Lothian Buses	Unite	Joined 01/11/12
Archie Arnott	Lothian Buses	Unite	Resigned 31/10/12
Andrew Mitchell	Lothian Buses	Unite	Resigned 31/10/12
Colette Cromar	visitScotland	Active Member	Resigned 31/10/12

Pensions Committee and Consultative Panel training

The Committee and Panel members must attend training events as outlined in the Fund's Trustee training policy. The policy includes a framework, based on the CIPFA Knowledge and Skills Framework, to assess knowledge and identify training to ensure effective decision making. The Framework covers key areas including pension legislation, investment, accounting and auditing standards and actuarial practices.

The five Councillor Committee members were appointed in May 2012 following the Local Government election and the members undertook extensive induction and investment training covering key elements of pension legislation and investments. Members of the Committee and Panel have also attended external events including a Scotland-wide seminar held for new elected members on pensions committees.

The Committee members collectively attended 163.5 hours of in-house and external training over the year. Panel members undertook 43 training hours.

Investment and Pensions Division

The Investment and Pensions Division sits within the City of Edinburgh Council and carries out the day-to-day running of the pension funds. Its functions include investment, pension administration, communications and accounting. The investment responsibilities include monitoring and selecting external investment managers and carrying out in-house investment management.

The senior officers are:

Alastair Maclean, Director of Corporate Governance
Clare Scott, Investment and Pensions Service Manager
Struan Fairbairn, Legal, Risk and Development Manager
John Burns, Pensions and Accounting Manager
Bruce Miller, Investment Manager
Esmond Hamilton, Financial Controller

Investment Strategy Panel

The Pensions Committee sets the overall investment strategy with the implementation of that strategy, including investment monitoring, delegated to the Director of Corporate Governance who takes advice from the Investment Strategy Panel. The Investment Strategy Panel meets quarterly and comprises the Director of Corporate Governance, Investment and Pensions Service Manager, Pensions and Accounting Manager, Investment Manager and three independent advisers. The independent advisors are Gordon Bagot, Scott Jamieson and KPMG, represented by David O'Hara.

INVESTMENT AND FINANCIAL PERFORMANCE

Investments

This section shows key statistics of the financial year, considers the investment markets and the review of investment strategies of the three Funds and shareholder activity.

Investment markets

Investment values fluctuated significantly over the year to 31 March 2013. European equities, for example, suffered a loss of more than 15% in the early part of the year before ending up 13% in sterling terms for the year. Global equities rose even more, up 17% in sterling terms. Gilts and bonds also provided attractive low double digit positive returns. In comparison, the return of less than 5% from emerging market equities was a little disappointing while UK property returned a very low 2.5% over the year.

A crucial moment for financial markets, particularly European equities, stressed by the threat of the break-up of the euro, was a speech by Mario Draghi, Central Bank (ECB) President.

In July 2012, Mario Draghi stated *"Within our mandate, the European Central Bank is ready to do whatever it takes to preserve the euro. And believe me, it will be enough".*

Investors did believe him and financial markets have barely looked back in the expectation that central bank monetary policy would support asset prices. Regulatory developments, which encourage banks to own sovereign debt, have also been supportive of world bond markets.

It would be surprising if investment markets are as buoyant in 2013/14.

In the face of a weakening global economic environment, austerity policies appear to be out of favour, so it is quite possible that more expansionary policies will be introduced over the coming year.

There are pockets of potential strength around the world including Japan fighting deflation by doubling its monetary base and, in US where bank lending is once again growing. However, Europe's banking sector continues to contract. Despite the recent performance of the equity and bond markets, the low real interest rates evident around the world are likely to translate into low real returns over the next few years.

Investment strategies

We reviewed the investment strategies of all three Funds following the 2011 Actuarial Valuation. The reviews concluded there was scope to reduce the investment risk over the next few years and increase the focus on investment income to reduce returns volatility over the coming years.

In the testing environment described above, the following investment themes should help to reduce risk and protect the assets:

- equities are more attractively priced than "safe" government bonds over the long term. High quality, sustainable businesses with strong cash generation should be able to continue to prosper in the challenging environment envisaged.
- financial institutions may be forced to discard sound assets at attractive prices as they rebuild balance sheets in deleveraging economies. Such opportunities could allow the Funds to enhance investment returns.
- the Funds should reduce their reliance on benchmarks based on market capitalisation, which are sub-optimal, and ensure that the objectives and risk tolerances of individual portfolios within the Fund are as closely aligned with the overall objectives of the Fund as possible.
- Capital preservation and growth is more important than following an index.

INVESTMENT AND FINANCIAL PERFORMANCE

The Funds' Statement of Investment Principles describes the decision-making process and types of investment, as well as the balance between risk and expected return.

It also covers the realisation of investments, responsible investment and ownership along with the exercising of voting rights attached to investments. It can be viewed on our website www.lpf.org.uk/publications

Responsible investment

The Funds strive to be active shareholders to enhance the long-term value of our investments, including engagement on environmental, social and governance issues, in a manner which is consistent with fiduciary duties.

Councillor Cameron Rose, a member of the Pensions Committee, is Vice Chair of the Local Authority Pension Fund Forum (LAPFF) which promotes local authority investment pension fund interests and seeks to maximise their influence as shareholders.

We are a signatory to the United Nations Principles for Responsible Investment and publish how we meet the Financial Reporting Council UK Stewardship Code requirements which promotes public disclosure of stewardship activities. We undertake voting and engagement activities through Hermes Equity Ownership Service for the investments of Lothian Pension Fund. Baillie Gifford, UBS and State Street take direct responsibility for stewardship issues in the funds they manage on our behalf.

Over the year, we voted on over 10,700 resolutions at more than 900 company meetings and opposed over 1000 resolutions. We engaged with over 250 companies across the world on topics such as board structure, executive compensation and climate change. We also participate in class action lawsuits and are acting as co-lead plaintiff in a number of court actions.

Financial performance

This section shows the expenditure of the Investment and Pensions Division and its funding strategy.

Funding Strategy Statement

The Funding Strategy Statement sets out how the Fund balances the potentially conflicting aims of affordability and stability of employers' pension contributions whilst taking a prudent long-term view of funding those liabilities. The Funding Strategy Statement was revised at the 2011 Actuarial Valuation and and can be viewed on our website www.lpf.org.uk/publications

Administrative Expenses

A summary of the Division's administrative expenditure for 2012/13, against the budget approved by 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 Fund. Similarly, income is shown exclusive of contributions receivable and pension transfers to the Fund.

The key variances against budget are:-

- Employees - £ 71k underspend. This is mainly due to unfilled posts across the division partly offset by temporary agency costs and early retirement costs;
- Third Party Payments (£ 100k overspend) and Supplies and Services (£ 132k underspend) – These are due to the take up of the accounting service from the Fund's custodian offset by savings from the termination of associated ICT contracts;
- Investment management fees – £ 1,302k underspend. This is primarily due to changes in the fund management arrangements including the termination of active currency overlay contracts.
- Income - £151k less - this is due to stock lending commission being lower than expected.

Administrative expenses

	Approved budget	Actual outturn	Actual variance
	£000	£000	£000
Employees	1,914	1,843	(71)
Transport	27	22	(5)
Supplies and services	864	732	(132)
Investment Managers fees	10,284	8,982	(1,302)
Other third party payments	349	449	100
Depreciation	44	44	-
Direct expenditure	13,482	12,072	(1,410)
Support costs	702	656	(46)
Income	(884)	(733)	151
Total cost to the Funds	13,300	11,995	(1,305)

Our service plan and performance

This section shows how we meet our key performance indicators to deliver our service plan objectives.

Our vision and objectives are set out in our service plan. The plan provides details of key actions, key performance indicators and targets and how we aim to meet them.
The Fund has three objectives

- To provide excellent customer care
- To support and develop staff
- To continue to be a top performing fund

We aim to work together to put the customer first. This means making our services simple, right first time, effective and efficient.

Our key performance indicators are below with more detailed analysis thereafter.

	To provide excellent customer care	Target	Actual
✓	Overall satisfaction of employers, active members and pensioners with our overall services as measured by annual surveys.	85%	86%
✓	Satisfaction of employers, active members and pensioners with our communications as measured by annual surveys.	85%	98%
✓	Proportion of active members receiving a benefit statement by 30/9/12	95%	97%
✓	Maintain Customer Service Excellence Standard	Retain	Retained
	To support and develop staff		
✓	Level of sickness absence	4%	3.87%
△	Staff satisfaction with present job	60%	53%
✓	Annual training average per staff member	2 days	3.8 days
	To continue to be a top performing fund		
✓	% of critical pensions administration work completed within standards	90%	94%
△	Lothian Pension Fund - Three year annualised investment return compared with benchmark	relative return in range 1.0 to +2.0	0.0%
✓	Pension admin cost per member	£24.10	£23.86
✓	Proportion of critical work completed within standard	90%	94.4%
✓	Employer contributions paid within 19 days of month end	97%	97.5%

In 2012/13 all key performance indicator targets were met with the exception of staff satisfaction with present job and investment performance.

Further information on investment can be found in the Investment and Financial Perfromance and Fund sections.

To provide excellent customer care

Customer Service Excellence

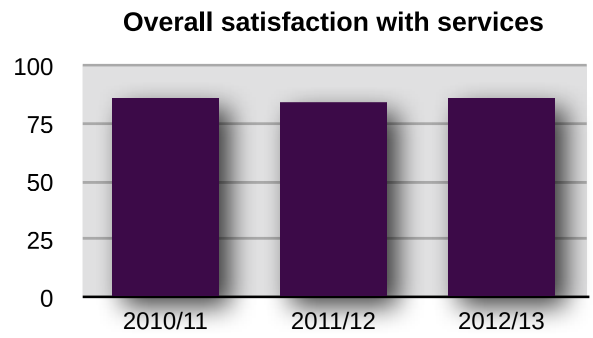
To ensure we provide excellent customer care, the Funds use the Customer Service Excellence (CSE) framework. This provides clear guidelines on how to ensure continuous improvement in our customer services and an external assessment that requires the Funds to demonstrate on an annual basis how we have improved and developed.

This year the Funds again successfully retained the CSE award. The external assessor endorsed our approach to consulting with all our customers and using feedback to improve. The assessment also recognised that we need to improve our partnership working with our employers to deliver services our members expect.

Surveys

We ask for our customers' views on our services in a variety of ways. We use the feedback to improve our services. We survey a sample of active and new members on an ongoing basis and carry out annual surveys of both retired members and employers.

We include an overall question on satisfaction in all our surveys and over the year, 86% agreed with the statement "overall I feel the service provided by the Funds is excellent".

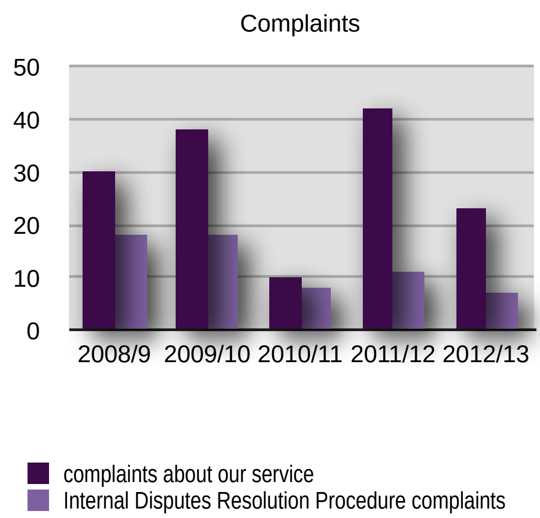


Complaints

We monitor the complaints we receive on a monthly basis. We respond promptly to any complaints, investigate them and learn from them to improve the service.

We categorise our complaints in two ways:

- Complaints about our service
- Complaints about the way we apply the regulations. Under the LGPS members can use a 2 stage dispute process to settle any disagreement or complaint that they may have about decisions made under the scheme rules. We have an independent appointed person to deal with these complaints in an unbiased way. If a member remains unhappy with the appointed person's decision they can ask the Scottish ministers to review the decision.



The graph shows the number of complaints in each category these represent a very low percentage of the over 28,000 procedures we carried out in 2012/13.

Support and develop staff

Our three key performance indicators for our staff are sickness absence, overall satisfaction with present job and annual training average per staff member. Two out of three of these indicators have been met.

One of the ways we gauge how our staff feel is by surveying them on a regular basis. This is also how we measure staff satisfaction. In 2012 overall satisfaction with present job increased by 8% to 53% but was below the target of 60%. The management team has used the feedback from the survey and focussed improvements in particular on two key issues, communication and staff development.

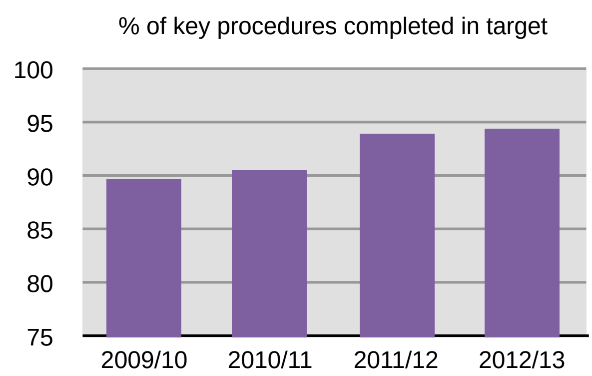
A staff forum gives staff the opportunity to feedback to senior managers, monthly briefings have been introduced via e-mail and face to face to keep staff informed of changes and a review of responsibilities within the division undertaken. Much work is still to be done but it is hoped that this indicator will continue to improve.

To continue to be a top performing Fund

Pensions Administration

Our dedicated in-house team provides pension administration services for the Funds. We monitor the time it takes to complete our procedures. Our key procedures include payment of retirement and dependent benefits, providing information for new members, transfers and retirement quotes.

Performance for these key procedures over the year 2012/13 showed 94.4% of the work completed was within our target, an improvement of 0.5% on the previous year.



Data quality

The administration of pensions relies on good data. Along with the new employer website introduced to assist with the transfer of data, we have adopted other initiatives to improve member information. These include participation in specialist longevity and data analyses through “Club Vita” a service provided by our Funds’ Actuary.

Pension record keeping standards are also measured against the Pension Regulator’s best practice guidance and appropriate assurance attained.

The Pensions Regulator data standards	Target	Actual
Common data		
New data (post June 2010)	100%	100%
Old data (pre June 2010)	95%	96%
Conditional and Numerical Data		
LPF-scheme specific measurement including date of joining; pensionable remuneration; date of leaving; reasons for leaving etc.	98%	98%

PERFORMANCE AND SERVICE PLAN

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

It is vital that employers provide prompt information to the Fund so that we can provide timely and accurate services to our Scheme members. We monitor employer performance regularly, and provide updates to the employers each year, both individually and on a Fund-wide basis at employer events. During the 2012/13 year, we also met with our largest employers to discuss performance and worked with them to improve, providing training and holding follow-up meetings to assess improvements where appropriate.

Employer performance for 2012/13 is shown below, with 2011/12 shown for comparison purposes.

Employer performance		2011/12			2012/13		
Case type	Target (working days)	Number received	Number within target	% within target	Number received	Number within target	% within target
New member: paper forms	20	111	71	64	31	23	74
New member electronic	20	1779	1597	90	2693	2386	89
Leaver information	20	1049	724	69	592	380	64
Retirement information	20	917	358	39	803	314	39
Death in service information	10	39	12	30	37	7	19

Statement of accounting policies and general notes

1 Basis of preparation

The Statement of Accounts summarises the transactions of the Funds for the 2012/13 financial year and their position at year-end as at 31 March 2013. The accounts have been prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2012/13 which is based upon International Financial Reporting Standards (IFRS), as amended for the UK public sector.

The accounts summarise the transactions of the Funds and report on the net assets available to pay pension benefits. The accounts 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 Accounts.

2 Summary of significant accounting policies

Fund account - revenue recognition

a) Contribution income

Normal contributions, both from the members and from employers, are accounted for on an accruals basis at the rate recommended by the Scheme Actuary in the payroll period to which they relate.

Employers' pensions strain contributions are accounted for in the period in which the liability arises. Any amount due in year but unpaid will be classed as a current financial asset. Amounts not due until future years are classed as long-term financial assets.

b) Transfers to and from other schemes

Transfer values represent the amounts received and paid during the year for members who have either joined or left the fund 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.

c) Investment income

i) Interest income

Interest income is recognised in the fund account 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) Property related income

Property-related income consists primarily of rental income. Rental income from operating leases on properties owned by the 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.

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.

v) 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

d) Benefits payable

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

e) Taxation

The fund is a registered public service scheme under section 1(1) of Schedule 36 of the Finance Act 2004 and as such is exempt from UK income tax on interest received and from capital gains tax on the proceeds of 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.

f) 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 Pension Funds. 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 Pension 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. Pension payroll costs are allocated in proportion to the number pensioners in each of the Funds 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.

g) Investment management expenses
All investment management expenses are accounted for 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 cost of obtaining investment advice from external consultants is included in investment management charges.

The costs of the in-house fund management team are charged to the Funds. The basis of allocation is as described above.

Net assets statement

h) 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 as follows:

i) Market quoted investments
The value of an investment for which there is a readily available market price is determined by the bid market price ruling on the final day of the accounting period.

ii) Fixed interest securities
Fixed interest securities are recorded at net market value based on their current yields.

iii) Unquoted investments
The fair value of investments for which market quotations are not readily available is determined as follows:

- valuations of delisted securities are based on the last sale price prior to delisting, or where subject to liquidation, the amount the council expects to receive on wind-up, less estimated realisation costs.

- securities subject to takeover offer – the value of the consideration offered under the offer, less estimated realisation costs.

- directly held investments include investments in limited partnerships, shares in unlisted companies, trusts and bonds. Other unquoted securities typically include pooled investments in property, infrastructure, debt securities and private equity. The valuation of these pools or directly held securities is undertaken by the investment manager or responsible entity and advised as a unit or security price. The valuation standards followed in these valuations adhere to industry guidelines or to standards set by the constituent documents of the pool or the management agreement.

- investments in unquoted property and infrastructure pooled funds are valued at the net asset value or a single price advised by the fund manager.

- the values of the direct 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 IFRS. The valuations are usually undertaken annually at the end of December. Cash flow adjustments are used to roll forward the valuations to 31 March as appropriate.

iv) Pooled investment vehicles

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

v) Freehold and leasehold properties

The properties were valued at open market value at 31 March 2012 by John Symes-Thompson FRICS and Genine Terry MRICS of independent external valuers CB Richard Ellis Ltd in accordance with the Royal Institute of Chartered Surveyors' - Professional Standards (2012) ("the Red Book"). The valuer's opinion of market value and existing use value was primarily derived using comparable recent market transactions on arm's-length terms.

i) 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 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.

j) Derivatives

Derivative contract assets are fair valued at bid prices and liabilities are fair valued at offer prices. Changes in the fair value of derivative contracts are included in change in market value.

The value of futures contracts is 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.

The future value of forward currency contracts is 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.

k) 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.

l) 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 fund becomes party to the liability. From this date any gains or losses arising from changes in the fair value of the liability are recognised.

m) Actuarial present value of promised retirement benefits

The actuarial present value of promised retirement benefits of each of the Funds is assessed on a annual basis by the Scheme Actuary in accordance with the requirements of IAS 19 and relevant actuarial standards.

As permitted under IAS 26, the Funds have opted to disclose the actuarial present value of promised retirement benefits by way of a note to the net assets statements.

n) 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 the pension fund financial statements. Details of contributions paid and the total value of funds invested are disclosed by way of note.

3 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 and infrastructure investments at 31 March 2013 was £508.5m (2012 £440.1m).

For the Lothian Buses Pension Fund, the value of unquoted private equity and infrastructure investments at 31 March 2013 was £12.2m (2012 £7.5m).

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 Fund's 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 Fund.

4 Assumptions made about the future and other major sources of estimation uncertainty

The Statement of Accounts 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 balances cannot be determined with certainty, actual results could be materially different from the assumptions and estimates.

The items in the net assets statement at 31 March 2013 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 pension fund assets. The Fund 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 2013	Approx % increase in liabilities %	Approx monetary amount £m
0.5% decrease in discount rate	9	442
1 year increase in member life expectancy	3	148
0.5% increase in salary increase rate	4	175
0.5% increase in pensions increase rate	5	265

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 2013	Approx % increase in liabilities %	Approx monetary amount £m
0.5% decrease in discount rate	9	30
1 year increase in member life expectancy	3	10
0.5% increase in salary increase rate	3	11
0.5% increase in pensions increase rate	6	19

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 2013	Approx % increase in liabilities %	Approx monetary amount £m
0.5% decrease in discount rate	6	9
1 year increase in member life expectancy	3	4
0.5% increase in pensions increase rate	6	9

b) Unquoted private equity and infrastructure investments

Uncertainties

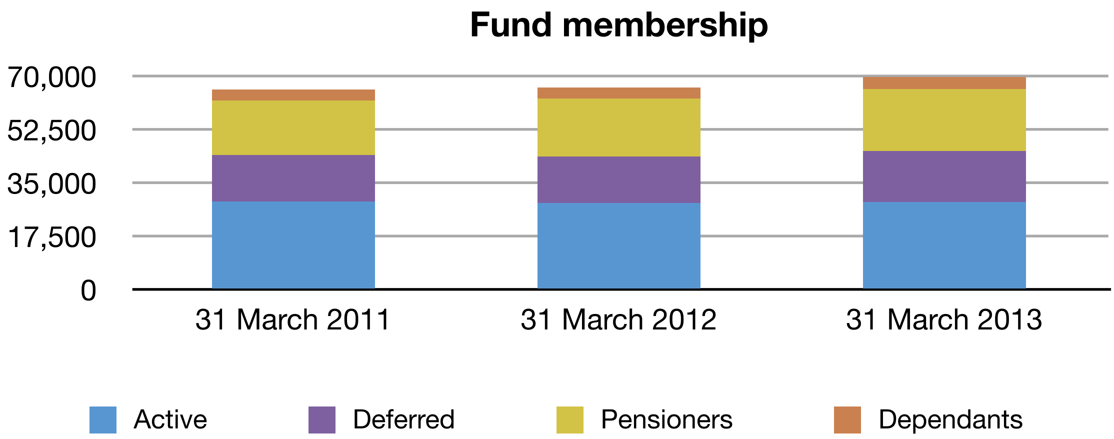
These investments are not publicly listed and as such there is a degree of estimation involved in the valuation.

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.

Membership

Status	Membership at 31/03/2011	Membership at 31/03/2012	Membership at 31/03/2013
Active	28,919	28,337	28,778
Deferred	15,218	15,392	16,577
Pensioners	17,894	18,905	20,469
Dependants	3,682	3,720	4,064
Total	65,713	66,354	69,888



Funding

Benefits are funded by contributions and investment earnings. Contributions are made by active members of the Fund in accordance with the Local Government Pension Scheme (Benefits, Membership and Contributions) (Scotland) Regulations 2008. These contributions depend on pay and for the year ended 31 March 2013 the contribution rates were as follows:

Full time equivalent pensionable pay (2012/13)	Rate
Less than £19,971	5.5%
Between £19,971 and £25,948	Between 5.6% and 6.0%
Between £25,949 and £32,567	Between 6.1% and 6.5%
Between £32,568 and £45,915	Between 6.6% and 7.5%
Between £45,916 and £51,727	Between 7.6% and 8.0%
Between £51,728 and £69,262	Between 8.1% and 9.0%
Between £69,263 and £104,782	Between 9.1% and 10.0%
Between £104,783 and £240,383	Between 10.1% and 11.2%

Employers' contributions are set at the triennial actuarial valuation. The contribution rates for the year ended 31 March 2013 were based on the actuarial valuation as at 31 March 2011. This valuation resulted in a common contribution rate of (i.e. the average of the employers contributions) 18.0% of pensionable earnings, this includes 1.2% in respect of the past service deficit. In practice, each employer pays contributions at a specific rate that relates to its funding experience. For 2012/13, the rates for the major employers ranged from 16.9% to 17.2% for service currently being accrued plus a fixed amount towards the past service deficit.

More information on funding can be found in the Actuarial Statement for 2012/13 at the end of this section.

Investment strategy

Following the completion of the 2011 actuarial valuation, an in-depth review of Lothian Pension Fund's investment strategy has been undertaken.

The review concluded that there is scope to reduce the Fund's investment risk in the long-term. It was recommended that the focus of the investment strategy over the coming years should be on capital preservation, investment income and reducing the absolute volatility of the Fund.

The strategy for 2012-2017 is set out in the table and has private equity reclassified in Equities rather than Alternative investments. Investments in the Alternatives category include property, infrastructure, timber and corporate bonds. Asset allocations limits under normal financial conditions are also shown.

	Interim benchmark at 31 March 2013	Strategy for 2012-2017	Asset allocation limits minimum - maximum
	%	%	%
Equities excluding Private Equity	64		
Equities including Private Equity	-	65	50 - 75
Index-linked gilts	5	7	0 - 20
Alternatives including Private Equity	30	-	-
Alternatives excluding Private Equity	-	28	20 - 35
Cash	1	-	0 - 10
Total	100	100	n/a

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

The Fund will gradually implement the new strategy over the next few years.

Investment performance

Annualised returns to 31 March 2013 (% per year)

	1 year	3 years	10 years
Lothian Pension Fund	13.9	8.1	10.3
Benchmark	13.9	8.1	9.5
Retail Price Index	3.3	4.1	3.3
National Average Earnings	(0.6)	1.0	2.7

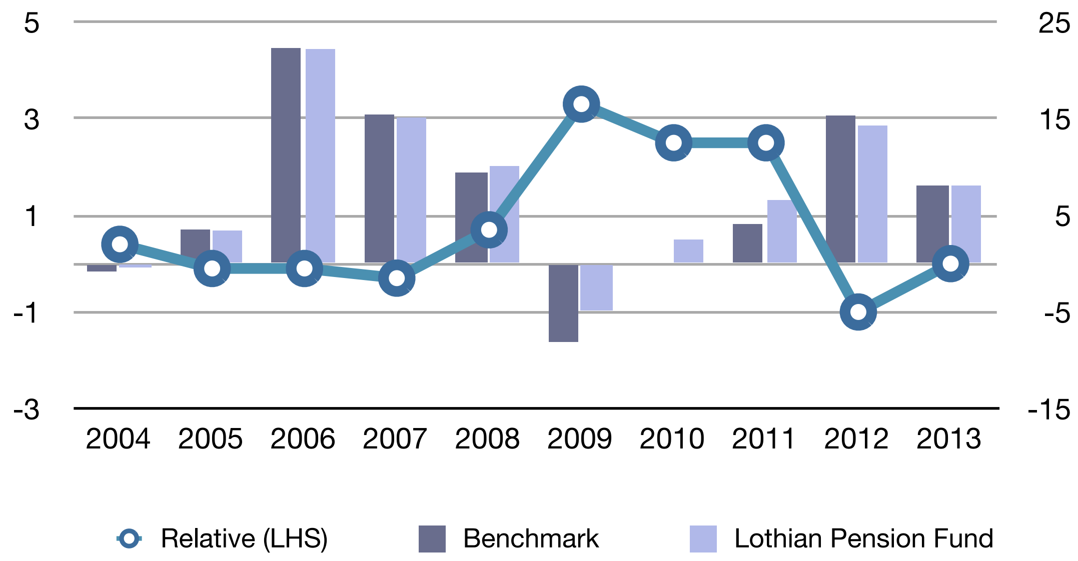
The absolute performance of Lothian Pension Fund over the 12-month period was +13.9% and three-year performance was +8.1% per annum. Over both time periods, the performance was in line with the benchmark returns.

Over 10 years, the Fund returned +10.3% per annum, ahead of its benchmark by 0.8% per year and also well ahead of measures of inflation, including the retail price index and national average earnings.

Despite strong investment returns in excess of expectations, the actual funding level has fallen from 96% at the time of the last actuarial valuation on 31 March 2011 to 87% at 31 March 2013, largely as a result of falling real gilt yields, which caused an increase in the value of liabilities.

LOTHIAN PENSION FUND

Annualised 3 yearly returns ending 31 March (% per year)
Target is for the Fund to outperform the benchmark by 1% per year over 3 years



	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Fund	(0.4)	3.4	22.2	15.1	10.1	(4.8)	2.5	6.6	14.3	8.1
Benchmark	(0.8)	3.5	22.3	15.4	9.4	(8.1)	-	4.1	15.3	8.1
Relative	0.4	(0.1)	(0.1)	(0.3)	0.7	3.3	2.5	2.5	(1)	-

Fund account for the year ended 31 March 2013

2011/12 Restated* £000		Note	2012/13 £000
	Income		
144,484	Contributions from employers	*2*	137,821
40,579	Contributions from members	*3*	40,194
3,171	Transfers from other schemes	*4*	4,484
188,234			182,499
	Less: expenditure		
104,279	Pension payments including increases	*5*	113,181
34,523	Lump sum retirement payments	*6*	33,176
4,306	Lump sum death benefits	*7*	5,362
342	Refunds to members leaving service		191
384	Premiums to State Scheme		147
5,564	Transfers to other schemes	*8*	6,152
1,802	Administrative expenses	*9*	1,925
151,200			160,134
37,034	**Net additions from dealing with members**		22,365
	Returns on investments		
76,435	Investment income	*10*	84,684
17	Change in market value of investments	*12a, 13b*	416,559
(8,525)	Investment management expenses	*11*	(9,572)
67,927	**Net returns on investments**		491,671
104,961	**Net increase in the Fund during the year**		514,036
3,475,662	**Net assets of the Fund at 1 April 2012**		3,580,623
3,580,623	**Net assets of the Fund at 31 March 2013**	*13a*	4,094,659

*The results for the year ended 31 March 2012 have been restated to reflect a change in the accounting policy on income generated by unquoted private equity and infrastructure investments. This change has the effect of increasing the reported investment income by £6.5m and reducing the change in market value of investments by the same amount. See note 24 for details.

Net Assets Statement as at 31 March 2013

31 March 2012 £000		Note	31 March 2013 £000
	Investments		
3,594,935	Assets		4,086,938
(49,024)	Liabilities		(25,042)
3,545,911		*12, 14*	4,061,896
	Fixed assets		
95	Computer systems		157
95			157
	Current assets		
11,192	The City of Edinburgh Council	*20*	4,355
26,350	Cash balances	*14, 20*	34,616
10,078	Debtors	*17*	10,299
47,620			49,270
	Current liabilities		
(13,003)	Creditors	*18*	(16,664)
(13,003)			(16,664)
34,617	**Net current assets**		32,606
3,580,623	**Net assets of the Fund at 31 March 2013**	*13a*	4,094,659

John Burns FCMA CGMA
Pensions and Accounting Manager
June 2013

Note to the Net Assets 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 Events after balance sheet date

There have been no events since 31 March 2013, and up to the date when these accounts were authorised, that require any adjustments to these accounts.

2 Contributions from employers

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

	2011/12 £000	2012/13 £000
By category		
Percentage of pay	113,831	103,781
Fixed deficit contribution	17,620	24,711
Strain costs	7,881	8,929
Cessation contribution	5,152	400
	144,484	137,821
By employer type		
Administering Authority	54,549	56,359
Other Scheduled Bodies	67,626	65,143
Community Admission Bodies	22,030	16,090
Transferee Admission Bodies	279	229
	144,484	137,821

From 1 April 2012, following the actuarial valuation of 31 March 2011, all employers are required to make a fixed contribution towards the past service deficit that relates to their employees. In previous years only some of the larger employers were required to make a fixed contribution. The deficit recovery period varies depending on the individual circumstances of each employer ranging up to 20 years.

Where an 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 that employer.

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

3 Contributions from members

	2011/12 £000	2012/13 £000
By employer type		
Administering Authority	15,682	15,694
Other Scheduled Bodies	19,255	19,047
Community Admission Bodies	5,569	5,394
Transferee Admission Bodies	73	59
	40,579	40,194

4 Transfers in from other pension schemes

	2011/12 £000	2012/13 £000
Group transfers	97	-
Individual transfers	3,074	4,484
	3,171	4,484

5 Pensions payable

By employer type	2011/12 £000	2012/13 £000
Administering Authority	54,793	58,752
Other Scheduled Bodies	41,217	45,050
Community Admission Bodies	8,209	9,288
Transferee Admission Bodies	60	91
	104,279	113,181

6 Lump sum retirement benefits payable

By employer type	2011/12 £000	2012/13 £000
Administering Authority	14,497	16,740
Other Scheduled Bodies	16,822	12,733
Community Admission Bodies	3,119	3,573
Transferee Admission Bodies	85	130
	34,523	33,176

7 Lump sum death benefits payable

By employer type	2011/12 £000	2012/13 £000
Administering Authority	1,535	2,836
Other Scheduled Bodies	2,052	2,310
Community Admission Bodies	719	216
Transferee Admission Bodies	-	-
	4,306	5,362

8 Transfers out to other schemes

	2011/12 £000	2012/13 £000
Group transfers	-	-
Individual transfers	5,564	6,152
	5,564	6,152

9 Administrative expenses

	2011/12 £000	2012/13 £000
Employee costs	928	1,020
The City of Edinburgh Council - pension payroll costs	221	222
The City of Edinburgh Council - other support costs	312	276
System costs	105	183
Actuarial fees	84	23
External audit fees	40	41
Legal fees	45	87
Printing and postage	42	32
Depreciation	35	38
Sundry costs less sundry income	(10)	3
	1,802	1,925

The Investments and Pensions Division of the Council is responsible for administering the three pension Funds. The Division receives an allocation of the overheads of the Council. In turn the Division 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.

In 2012 the overheads were allocated based on the value of the Funds as at the end of the year. In 2013 the allocation basis were modified to a more stable basis which better reflects the underlying cost drivers. Pension payroll costs were allocated based on the number of pensioners during the year and all other costs were allocated based on the number of members of each fund.

10 Investment income

	2011/12 £000	2012/13 £000
Income from fixed interest securities	10,925	11,146
Dividends from equities	41,069	49,976
Unquoted private equity and infrastructure	6,547	5,074
Income from pooled investment vehicles	738	579
Net rents from properties	16,583	17,402
Interest on cash deposits	915	1,354
Stock lending and sundries	1,244	1,119
	78,021	86,650
Irrecoverable withholding tax	(1,586)	(1,966)
	76,435	84,684

11 Investment management expenses	2011/12 £000	2012/13 £000
External management fees	7,221	7,878
Employee costs	656	664
Custody fees	64	454
Engagement and voting fees	65	67
Performance measurement fees	54	45
Investment consultancy fees	26	66
System costs	146	132
Legal fees	215	134
The City of Edinburgh Council - other support costs	-	100
Sundry costs	78	32
	8,525	9,572

The Investments and Pensions Division of the Council is responsible for administering the three pension Funds. The Division receives an allocation of the overheads of the Council. In turn the Division 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.

12 Net investment assets	31 March 2012 £000	31 March 2013 £000
Investment assets		
Fixed interest securities	300,883	326,829
Equities	1,647,371	2,718,320
Pooled investment vehicles	1,217,874	582,535
Properties	246,915	251,480
Derivatives		
Futures	606	1,067
Forward foreign exchange	64,833	3,262
	65,439	4,329
Cash deposits		
Margin balances	1,687	1,769
Deposits	105,153	187,608
	106,840	189,377
Other investment assets		
Due from broker	412	3,029
Dividends and other income due	9,201	11,039
	9,613	14,068
Total investment assets	3,594,935	4,086,938
Investment liabilities		
Derivatives		
Futures	(88)	(622)
Forward foreign exchange	(45,702)	(20,844)
	(45,790)	(21,466)
Other financial liabilities - due to broker	(3,234)	(3,576)
Total investment liabilities	(49,024)	(25,042)
Net investment assets	3,545,911	4,061,896

12a Reconciliation of movement in investments and derivatives

	Market value at 1 April 2012 £000	Purchases at cost and derivative payments £000	Sale proceeds and derivative receipts £000	Change in market value £000	Market value at 31 March 2013 £000
Fixed interest	300,883	110,307	(110,489)	26,128	326,829
Equities	1,647,371	1,224,225	(445,739)	292,463	2,718,320
Pooled investment vehicles	1,217,874	97,793	(850,443)	117,311	582,535
Property	246,915	27,216	(20,215)	(2,436)	251,480
Derivatives - futures	518	3,484	(1,463)	(2,094)	445
Derivatives - fwd foreign exchange	19,131	88,677	(109,010)	(16,380)	(17,582)
	3,432,692	1,551,702	(1,537,359)	414,992	3,862,027
Other financial assets / liabilities					
Margin balances	1,687			-	1,769
Cash deposits	105,153			1,587	187,608
Broker balances	(2,822)			(20)	(547)
Dividends due etc	9,201			-	11,039
	113,219			1,567	199,869
Net financial assets	3,545,911			416,559	4,061,896

	Market value at 1 April 2011 £000	Purchases at cost and derivative payments £000	Sale proceeds and derivative receipts £000	Change in market value £000	Market value at 31 March 2012 £000
Fixed interest	271,947	92,906	(88,128)	24,158	300,883
Equities	1,504,350	570,819	(383,254)	(44,544)	1,647,371
Pooled investments	1,283,737	102,057	(204,598)	36,678	1,217,874
Property	233,470	11,930	(2,059)	3,574	246,915
Derivatives - futures	164	5,851	(4,451)	(1,046)	518
Derivatives - fwd foreign exchange	(13,244)	277,238	(231,967)	(12,896)	19,131
	3,280,424	1,060,801	(914,457)	5,924	3,432,692
Other financial assets / liabilities					
Margin balances	2,022			(28)	1,687
Cash deposits	163,818			(2,864)	105,153
Broker balances	(4,143)			(2,902)	(2,822)
Dividends due etc	7,939			(113)	9,201
	169,636			(5,907)	113,219
Net financial assets	3,450,060			17	3,545,911

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.

12a Reconciliation of movement in investments and derivatives (cont'd)

Transaction costs are included in the cost of purchases and sale proceeds. Transaction costs include costs charged directly to the Fund such as fees, commissions, stamp duty and other fees. Transaction costs incurred during the year amounted to £1,939k (2012 £1,034k). In addition to the transaction costs disclosed above, indirect costs may be incurred through the bid-offer spread on some pooled investment vehicles, the amount of any such costs is not separately provided to the Fund.

12b Analysis of investments (at market value)

	Area	31 March 2012 £000	31 March 2013 £000
Fixed interest securities			
Public sector fixed interest quoted	UK	2,441	2,758
Public sector index linked gilts quoted	UK	134,331	148,478
Corporate quoted	UK	63,232	62,942
Public sector quoted	Overseas	6,308	7,076
Commercial quoted	Overseas	94,571	105,575
		300,883	326,829
Equities			
Quoted	UK	137,513	783,615
Quoted	Overseas	1,509,858	1,934,705
		1,647,371	2,718,320
Pooled investment vehicles			
In-house equities	UK	527,807	-
Managed funds - other	UK	190,220	17,977
Managed funds - property	UK	59,728	56,053
Private equity and infrastructure funds	UK	63,790	85,688
Private equity and infrastructure funds	Overseas	376,329	422,817
		1,217,874	582,535
Properties			
Direct property	UK	246,915	251,480

Derivatives - futures

Contract type	Contract expires	Economic exposure £000	Market value at 31 March 2012 £000	Economic exposure £000	Market value at 31 March 2013 £000
Assets					
UK Fixed Income	< 1 year	-	-	31,120	911
Overseas Fixed Income	< 1 year	(75,349)	606	26,232	156
			606		1,067
Liabilities					
UK fixed income	< 1 year	28,169	(57)	-	-
Overseas fixed income	< 1 year	6,199	(31)	(99,274)	(622)
			(88)		(622)
Net asset			518		445

12b Analysis of investments (at market value) (cont'd)

Derivatives - futures (cont'd)

The economic exposure represents the notional value of securities purchased under the futures contract and therefore the value subject to market movements. All futures contracts are exchange traded. The Fund uses futures for the purposes of efficient portfolio management and/or risk reduction. During the year, the Fund's bond manager transacted futures to manage interest rate exposure.

Derivatives - forward foreign exchange

Summary of contracts held at 31 March 2013

Contract settlement within	Currency bought	Currency sold	Local currency bought	Local currency sold	Asset value	Liability value
			£000	£000	£000	£000
Up to one month	AUD	JPY	44	(4,192)	1	-
Up to one month	EUR	CAD	68	(92)	-	(2)
Up to one month	EUR	GBP	293	(256)	-	(8)
Up to one month	GBP	AUD	90,222	(142,400)	-	(7,481)
Up to one month	GBP	EUR	226,525	(281,138)	363	(11,618)
Up to one month	GBP	JPY	669	(97,068)	2	(14)
Up to one month	GBP	USD	50,605	(79,089)	14	(1,498)
Up to one month	MXN	USD	5,240	(418)	4	-
Up to one month	USD	DKK	25	(138)	1	-
Up to one month	USD	GBP	1,195	(771)	15	-
Up to one month	USD	JPY	233	(22,017)	-	(1)
Up to one month	USD	MXN	6,191	(78,889)	-	(127)
Up to one month	USD	SEK	180	(1,147)	3	-
One to six months	JPY	USD	1,065,000	(11,412)	29	(81)
One to six months	USD	AUD	3,834	(3,770)	-	(14)
One to six months	USD	CHF	8,467	(7,800)	138	-
One to six months	USD	JPY	24,838	(1,950,000)	2,692	-
					3,262	(20,844)
Net forward currency contracts at 31 March 2013						(17,582)

Prior year comparative

Open forward currency contracts at 31 March 2012	64,833	(45,702)
Net forward currency contracts at 31 March 2012		19,131

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 around 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 currency movements. In addition, the Fund's bond manager use forward foreign exchange contracts to add value to the Fund.

12c Investment managers and mandates

Manager	Mandate	Market value at 31 March 2012 £000	Percent of total 31 March 2012 %	Market value at 31 March 2013 £000	Percent of total 31 March 2013 %
In-house	UK large cap equities	527,807	14.9	525,587	13.0
In-house	UK mid cap equities	-	-	80,201	2.0
Total UK equities		527,807	14.9	605,788	15.0
In-house	European equities	222,936	6.3	256,315	6.4
In-house	US equities	247,927	7.0	296,993	7.3
Baillie Gifford	Pacific equities	285,089	8.0	318,547	7.8
Invesco	Pacific equities	118,279	3.3	137,155	3.4
Mondrian	Emerging markets	-	-	111,524	2.7
UBS	Emerging markets	-	-	107,612	2.6
Aberdeen	Emerging markets	195,088	5.5	-	-
Total regional overseas equities		1,069,319	30.1	1,228,146	30.2
In-house	Global equities	-	-	202,357	5.0
Cantillon	Global equities	177,076	5.0	220,072	5.4
Lazard	Global equities	223,242	6.3	261,099	6.4
Harris	Global equities	128,274	3.6	153,319	3.8
Legal and General	Global equities	173,556	4.9	-	-
Total global equities		702,148	19.8	836,847	20.6
AG Bisset	Active / passive	18,599	0.5	(19,098)	(0.5)
JP Morgan	Active	276	-	-	-
Total currency overlay		18,875	0.5	(19,098)	(0.5)
Total listed equities		2,318,149	65.3	2,651,683	65.3
In-house	Private equity unq'ted	193,982	5.4	200,947	4.9
In-house	Private equity quoted	34,365	1.0	47,327	1.2
Total private equity		228,347	6.4	248,274	6.1
Total equities		2,546,496	71.7	2,899,957	71.4
In-house	Index linked gilts	134,863	3.8	145,181	3.6
In-house	Gold	20,928	0.6	21,039	0.5
Total inflation linked bonds and gold		155,791	4.4	166,220	4.1
In-house	Property	56,264	1.6	72,418	1.8
Standard Life	Property	324,575	9.2	289,511	7.1
Total property		380,839	10.8	361,929	8.9

12c Investment managers and mandates (cont'd)

Manager	Mandate	Market value at 31 March 2012 £000	Percent of total 31 March 2012 %	Market value at 31 March 2013 £000	Percent of total 31 March 2013 %
In-house	Infrastructure unq'ted	143,666	4.1	200,486	4.9
In-house	Infrastructure quoted	30,354	0.9	27,219	0.7
In-house	Timber	46,207	1.3	50,621	1.2
Total other real assets		220,227	6.3	278,326	6.8
In-house	Secured loans	22,905	0.6	21,825	0.5
Rogge	Corporate bonds	171,079	4.8	189,578	4.7
Total other bonds		193,984	5.4	211,403	5.2
In-house	Cash	48,574	1.4	143,935	3.6
In-house	Transition	-	-	126	-
Total cash and sundries		48,574	1.4	144,061	3.6
Net financial assets		3,545,911	100.0	4,061,896	100.0

12d Investments representing more than 5% of the net assets of the Fund or 5% of any investment class

	Market value at 31 March 2012 £000	Percent of class 31 March 2012 %	Market value at 31 March 2013 £000	Percent of class 31 March 2013 %
Equities				
MFC Vanguard S&P 500 ETF	92,692	5.6	112,527	4.1
Pooled funds				
Carlyle Europe Real Estate III LP	27,740	2.3	30,437	5.2
L&G N America equity index	84,940	7.0	-	-
L&G UK equity index	13,972	1.1	-	-
In-House UK equities	527,807	43.2	-	-
Property				
Martlesham Heath, Retail Park	-	-	19,050	7.6
London, 119-125 Wardour St	16,325	6.6	16,500	6.6
Sheffield, Bochum Parkway	14,750	6.0	15,175	6.0
Exeter, Bishops Court	15,000	6.1	14,250	5.7
Exeter, David Lloyd Leisure	13,625	5.5	14,150	5.6
London, 100 St John Street	13,725	5.6	14,000	5.6
Portsmouth, Broad Oak Works	12,456	5.0	11,544	4.6
Folkestone, Shearway Business Pk	12,450	5.0	-	-

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

12e Securities lending

During the year Lothian Pension Fund participated in two securities lending arrangements. The arrangement with the Northern Trust Company covers the main investments of the Fund. As at 31 March 2013, £112.3m (2012 £112.1m) of securities were released to third parties. Collateral valued at 107.2% (2012 107.1%) of the market value of the securities on loan was held at that date. The arrangement with Blackrock related to the Fund's holding of FTSE 250 iShares ceased during the year.

12f Property holdings

	2011/12 £000	2012/13 £000
Opening balance	233,470	246,915
Additions	11,930	27,216
Disposals	(2,059)	(20,215)
Net change in market value	3,574	(2,436)
Closing balance	246,915	251,480

As at 31 March 2013, 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, construct or develop any of these properties. Nor does it have any responsibility for any repairs, maintenance or enhancements.

13 Financial Instruments
13a 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.

13a Classification of financial instruments (cont'd)

	31 March 2012 Designated as fair value through fund account £000	31 March 2012 Loans and receivables £000	31 March 2012 Financial liabilities at amortised cost £000	31 March 2013 Designated as fair value through fund account £000	31 March 2013 Loans and receivables £000	31 March 2013 Financial liabilities at amortised cost £000
Financial assets						
Investment assets						
Fixed interest	300,883			326,829		
Equities	1,647,371			2,718,320		
Pooled investments	1,217,874			582,535		
Property leases	12,456			11,544		
Derivative contracts	65,439			4,329		
Margin balances		1,687			1,769	
Cash		105,153			187,608	
Other balances		9,613			14,068	
	3,244,023	116,453	-	3,643,557	203,445	-
Other assets						
City of Edinburgh Council		11,192			4,355	
Cash		26,350			34,616	
Debtors		10,078			10,299	
	-	47,620	-	-	49,270	-
Assets total	3,244,023	164,073	-	3,643,557	252,715	-
Financial liabilities						
Investment liabilities						
Derivative contracts	(45,790)			(21,466)		
Other investment balances	(3,234)			(3,576)		
	(49,024)	-	-	(25,042)	-	-
Other liabilities						
Creditors			(13,003)			(16,664)
Liabilities total	(49,024)	-	(13,003)	(25,042)	-	(16,664)
Net assets total	3,194,999	164,073	(13,003)	3,618,515	252,715	(16,664)
Total net financial instruments			3,346,069			3,854,566
Amounts not classified as financial instruments			234,554			240,093
Total net assets			3,580,623			4,094,659

13b Net gains and losses on financial instruments

	2011/12 £000	2012/13 £000
Designated as fair value through fund account	2,272	417,332
Loans and receivables	(5,907)	1,567
Financial liabilities at amortised cost	-	-
Total	(3,635)	418,899
Gains and losses on directly held freehold property	3,652	(2,340)
Change in market value of investments per fund account	17	416,559

13c 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 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 usually undertaken annually at the end of December. Cash flow adjustments are used to roll forward the valuations to 31 March as appropriate.

13c Valuation of financial instruments carried at fair value (cont'd)

The following table provides an analysis of the financial assets and liabilities of the Fund grouped into Levels 1 to 3, based on the level at which the fair value is observable.

	31 March 2013			
	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
Financial assets				
Designated as fair value through fund account	2,768,341	327,913	547,303	3,643,557
Loans and receivables	252,715			252,715
Total financial assets	3,021,056	327,913	547,303	3,896,272
Financial liabilities				
Designated as fair value through fund account	(25,042)			(25,042)
Financial liabilities at amortised cost	(16,664)			(16,664)
Total financial liabilities	(41,706)	-	-	(41,706)
Net financial assets	2,979,350	327,913	547,303	3,854,566

	31 March 2012			
	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
Financial assets				
Designated as fair value through fund account	2,490,565	300,883	452,575	3,244,023
Loans and Receivables	164,073			164,073
Total financial assets	2,654,638	300,883	452,575	3,408,096
Financial liabilities				
Designated as fair value through fund account	(49,024)			(49,024)
Financial Liabilities at amortised cost	(13,003)			(13,003)
Total financial liabilities	(62,027)	-	-	(62,027)
Net financial assets	2,592,611	300,883	452,575	3,346,069

14 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.

14 Nature and extent of risk arising from financial instruments (cont'd)

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 managers, geographical and industry sectors as well as individual securities
- taking stewardship responsibilities serious 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. Exchange traded 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 below 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	20.0%
Equities - Emerging Markets	30.0%
Private Equity	30.0%
Timber and Gold	30.0%
Secured Loans	10.0%
Corporate Bonds	10.5%
Fixed Interest Gilts	9.0%
Index-Linked Gilts	7.0%
Infrastructure	8.0%
Property	13.0%
Cash and forward foreign exchange	1.6%

Volatility is the standard deviation of annual returns. 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.

14 Nature and extent of risk arising from financial instruments (cont'd)

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. The following table shows the risks at the asset class level and the overall Fund level, with and without allowance for correlation.

The following tables shows how the prices of the Fund's investments would increase and decrease in line with the assumptions above.

Asset type	Value at 31 March 2013 £m	% of fund %	Change + / - %	Value on increase £m	Value on decrease £m
Equities - Developed Markets	2,451	60.4	20.0	2,941	1,961
Equities - Emerging Markets	219	5.4	30.0	285	153
Private Equity	248	6.1	30.0	322	174
Timber and Gold	72	1.8	30.0	94	50
Secured Loans	22	0.5	10.0	24	20
Corporate Bonds	176	4.3	10.5	194	158
Fixed Interest Gilts	10	0.2	9.0	11	9
Index-Linked Gilts	149	3.7	7.0	159	139
Infrastructure	228	5.6	8.0	246	210
Property	362	8.9	13.0	409	315
Cash and forward foreign exchange	125	3.1	1.6	127	123
Total [1]	4,062	100.0	18.5	4,812	3,312
Total [2]	4,062		15.6	4,696	3,428
Total [3]	4,062		14.7	4,659	3,465

[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 illustrates 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]*. 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.

14 Nature and extent of risk arising from financial instruments (cont'd)

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 2013, cash deposits represented £222.2m, 5.4% of total net assets. This was held with the following institutions:

	Moody's Credit Rating 31 March 2013	Balances at 31 March 2012 £000	Balances at 31 March 2013 £000
Held for investment purposes			
Northern Trust Global Investment Limited - liquidity funds	*Aaa*	36,153	75,949
Northern Trust Company - cash deposits	*Aa3*	1,858	17,758
Royal Bank of Scotland - various accounts	*A2*	4,318	-
The City of Edinburgh Council - treasury management	*See below*	62,824	93,901
Total investment cash		105,153	187,608
Held for other purposes			
The City of Edinburgh Council - treasury management	*See below*	26,350	34,616
Total cash		131,503	222,224

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 Fund's cash holding at the year end under its treasury management arrangements was held with the following institutions:

14 Nature and extent of risk arising from financial instruments (cont'd)

Credit risk (cont'd)

	Moody's Credit Rating 31 March 2013	Balances at 31 March 2012 £000	Balances at 31 March 2013 £000
Money market funds			
Deutsche Bank AG, London	*Aaa*	11,792	13,961
Goldman Sachs	*Aaa*	-	13,290
Bank call accounts			
Bank of Scotland	*A2*	7,571	12,714
Royal Bank of Scotland	*A3*	8,212	7,088
Santander UK	*A2*	7,020	21
Barclays Bank	*A2*	6,956	12,531
Svenska Handelsbanken	*Aa3*	11,188	18,117
Clydesdale Bank	*A2*	-	12,502
Bank near-call accounts			
Clydesdale Bank (15 Day Notice)	*A2*	1	-
Bank certificates of deposit			
Standard Chartered	*A1*	-	4,900
Floating rate note			
Rabobank	*Aa2*	-	4,910
Building society fixed term deposits			
Nationwide Building Society	*A2*	2,599	4,893
UK Pseudo-Sovereign risk instruments			
Other Local Authorities [1]	*n/a*	23,817	23,590
UK Government guaranteed FRNs	*n/a*	10,018	-
		89,174	128,517

[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 2013 would have been 'Aa1'). Of the £23.6m on deposit with local authorities, £12.8m is with a local authority which has a 'Aa2' credit rating from Moody's.

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.

14 Nature and extent of risk arising from financial instruments (cont'd)

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 2013, the Fund was due £3.3m from over-the-counter foreign currency derivatives. However, net of liabilities, the Fund owed counterparties £17.6m.

The Fund also transacts in futures which are traded on exchanges. The risk of default is minimal due the collateralisation of the contracts and the exchange having in place controls to cover defaulting counterparties. At 31 March 2013, the Fund was due £1,067k (£445k net of liabilities) from futures.

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 over 75%) of the Fund's investments could be converted to cash within three months in a normal trading environment.

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.

15 Actuarial statement

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

16 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 £4,946m (2012 £4,185m). 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.

Financial assumptions	31 March 2012 % p.a.	31 March 2013 % p.a.
Inflation / pensions increase rate	2.5	2.8
Salary increase rate	4.8	5.1
Discount rate	4.8	4.5

For the year ended 31 March 2013 and 31 March 2012, salary increases were estimated at 1% p.a. nominal for the three years to 31 March 2015 reverting to the long term rate thereafter.

16 Actuarial present value of promised retirement benefits (cont'd)

Longevity assumptions

The life expectancy assumption is based on Fund specific statistical analysis with improvements from 2008 in line with Medium Cohort and a 1% p.a. underpin. Based on these assumptions, the average future life expectancies, in years, at age 65 are summarised below:

	Males	Females
Current pensioners	20.4	22.8
Future pensioners (assumed to be currently 45)	22.6	25.4

This assumption is the same that adopted as at 31 March 2012.

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.

17 Debtors

	31 March 2012 £000	31 March 2013 £000
Contributions due - employers	7,252	7,676
Contributions due - members	1,922	1,976
Benefits paid in advance or recoverable	138	155
Pensions paid on behalf of employers	320	16
Sundry debtors	321	361
VAT	-	13
Prepayments	125	102
	10,078	10,299
Analysis of debtors		
Administering Authority	270	277
Other Scheduled Bodies	7,650	7,512
Community Admission Bodies	1,831	2,131
Transferee Admission Bodies	24	24
Other Local Authorities	-	7
Central Government Bodies	-	13
Other entities and individuals	303	335
	10,078	10,299

18 Creditors

	31 March 2012 £000	31 March 2013 £000
Benefits payable	1,882	3,919
VAT and State Scheme premiums	500	52
Contributions in advance	6,591	10,027
Miscellaneous creditors and accrued expenses	4,030	2,666
	13,003	16,664

18 Creditors (cont'd)

Analysis of creditors	31 March 2012 £000	31 March 2013 £000
Other Scheduled Bodies	6,478	9,952
Community Admission Bodies	113	75
Central Government Bodies	500	52
Other entities and individuals	5,912	6,585
	13,003	16,664

19 Additional Voluntary Contributions

Active members of the Lothian Pension Fund and 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.

Contributions during year	2011/12 £000	2012/13 £000
Standard Life	506	395
Prudential	705	1,120
	1,211	1,515

Value at year end	31 March 2012 £000	31 March 2013 £000
Standard Life	5,491	5,968
Prudential	745	1,572
	6,236	7,540

20 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 Division of the Council is responsible for administering the three Pension Funds. The Division receives an allocation of the overheads of the Council, this is based on the amount of central services consumed. This includes the pension payroll service provided by the Council. In turn, the Division 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.

The Council is also the single largest employer of members of the Fund and contributed £56.4m to the Fund during the year (2012 £54.5m).

20 Related party transactions (cont'd)

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.

Year end balance on holding account	31 March 2012 £000	31 March 2013 £000
	11,192	4,355

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 2013, the fund had an average investment balance of £93.5m (2012 £95.3m), interest earned was £621.9k (2012 £737.8k).

Year end balance on treasury management account	31 March 2012 £000	31 March 2013 £000
Held for investment purposes	62,824	93,901
Held for other purposes	26,350	34,616
	89,174	128,517

Governance

As at 31 March 2013, all members of the Pensions Committee, with the exception of Councillor Bill Cook, were active members of the Lothian Pension Fund.

Each member of the Pensions Committee 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.

Key management personnel

During the period from 1 April 2012 to the date of issuing of these accounts, several employees of the City of Edinburgh Council held key positions in the financial management of the Lothian Pension Fund. 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 2012 £000	Accrued CETV as at 31 March 2013 £000
Alastair Maclean	Director of Corporate Governance	44	67
Clare Scott	Investment and Pensions Service Manager	67	89
Struan Fairbairn	Legal, Risk and Development Manager (Appointed March 2013)	-	1
John Burns	Pensions and Accounting Manager	318	349
Esmond Hamilton	Financial Controller	86	101
Bruce Miller	Investment Manager	65	90

21 Contingent liabilities and contractual commitments

The Fund has commitments relating to outstanding call payments due on unquoted limited partnership funds held in the private equity and infrastructure parts of the portfolio. 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 2012	31 March 2013
	£000	£000
Outstanding investment commitments	175,058	164,316

The Fund has entered into an agreement with Heywood for the provision of an pension payroll system that is integrated with the existing pension administration system (Altair). Implementation of the system will be completed during 2013/14. At 31 March 2013 there was an outstanding contractual commitment of £162k.

As at 31 March 2013, the Fund had a contingent liability in respect of fees resulting from legal action against a former employer, the Scottish Council for Research in Education and the University Court of the University of Glasgow to obtain payment of a cessation valuation. The legal action was not successful and an accrual has been made in the accounts for the Fund's legal costs and those of the defendants that will need to be reimbursed by the Fund. As of the date of the approval of these accounts, the Fund may be liable to pay an uplift on the costs of the defendants. The amount of the liability is contingent on a decision of the Court but could be up to £45k.

22 Contingent assets

There were no contingent assets at the year end.

23 Impairment losses

During the year the Fund recognised a reduction in impairment losses in respect of specific benefit over payments for which reimbursement has been requested of £25.5k. This leaves an impairment of £17.5k at the year end.

24 Prior year adjustment

The results for the year ended 31 March 2012 have been restated to reflect a change in the accounting policy on income generated by unquoted private equity and infrastructure investments. The previous policy was to treat all distributions arising from these investments as capital with the results being reported as a change in market value of investments. The new policy splits distributions into capital and income elements with the later being included under investment income in the Fund Account. The new policy reflects the Fund's increasing investment in infrastructure which produces a significant part of its return as income.

24 Prior year adjustment (cont'd)

The change has the effect of increasing the reported investment income by £6.5m and reducing the change in market value of investments by the same amount. The changes are reported in the Fund Account but the there is no change to the net increase in the Fund for the year ended 31 March 2012 of £104,961k. The adjustments can be summarised as follows:

	2011/12 Statements as restated £000	Adjustments made £000
Fund Account 2011/12		
Investment income	76,435	6,547
Change in market value of investments	17	(6,547)

List of active employers at 31 March 2013

Community Admitted Bodies **CAB**
Scheduled Bodies **SB**
Transferee Admitted Bodies **TAB**

Almond Housing Association Ltd	CAB
Audit Scotland	CAB
BAM Construction Ltd	TAB
Barony Housing Association Ltd	CAB
Broomhouse Centre Representative Council	CAB
Broxburn Family Centre	CAB
Canongate Youth Project	CAB
Canongate Youth Project YTS Ltd	CAB
Capital City Partnership	CAB
Centre for Moving Image (The)	CAB
Children First	CAB
Children's Hearing Scotland	CAB
Children's Hospice Association Scotland	CAB
Citadel Youth Centre	CAB
City of Edinburgh Council (The)	SB
Compass Chartwell	TAB
Convention of Scottish Local Authorities	CAB
Dawn Group Ltd	TAB
Dean Orphanage and Cauvin's Trust	CAB
Donaldson's Trust	CAB
East Lothian Council	SB
EDI Group Ltd	CAB
Edinburgh Business School	CAB
Edinburgh Cyrenians Trust	CAB
Edinburgh Development Group	CAB
Edinburgh International Festival Society	CAB
Edinburgh Leisure	CAB
Edinburgh Napier University	CAB
Edinburgh Woman's Rape and Sexual Abuse Centre	CAB
Edinburgh World Heritage Trust	CAB
Edinburgh Colleges	SB
ELCAP	CAB
Enjoy East Lothian	CAB
Family Advice and Information Resource	CAB
Festival City Theatres Trust	CAB
First Step	CAB
Forth and Oban Ltd	TAB
Forth Estuary Transport Authority	SB
Four Square (Scotland)	CAB
Freespace Housing Association	CAB
Granton Information Centre	CAB
Handicabs (Lothian) Ltd	CAB
Hanover (Scotland) Housing Association	CAB
Health in Mind	CAB
Heriot-Watt University	SB
Homes for Life Housing Partnership	CAB
HWU Students Association	CAB
Improvement Service	CAB
Into Work	CAB
ISS UK Ltd	TAB
Keymoves	CAB
Link In	CAB
Lothian and Borders Fire and Rescue Service	SB
Lothian and Borders Police Force	SB
Lothian Valuation Joint Board	SB
Melville Housing Association	CAB
Mental Welfare Commission for Scotland	CAB
Midlothian Council	SB
Mitie PFI (CEC)	TAB
Mitie PFI (WLC) Ltd	TAB
Morrison Facilities Services Ltd	TAB
Museums Galleries Scotland	CAB
Newbattle Abbey College	CAB
North Edinburgh Dementia Care	CAB
NSL Ltd	TAB
Open Door Accommodation Project	CAB
Penumbra	CAB
Pilton Community Health Project	CAB
Pilton Equalities Project	CAB
Pilton Youth and Children's Project	CAB
Queen Margaret University	CAB
Queensferry Churches Care in the Com Project	CAB
Royal Edinburgh Military Tattoo	CAB
Royal Society of Edinburgh	CAB
Scotland's Learning Partnership	CAB
Scottish Adoption Agency	CAB
Scottish Council for Single Homeless	CAB
Scottish Futures Trust	CAB
Scottish Legal Complaints Commission	CAB
Scottish Mining Museums	CAB
Scottish Police Services Authority	SB
Scottish Water	SB
SESTRAN	SB
Skanska UK	TAB
SSERC	CAB
St Andrew's Children's Society Limited	CAB
St Columba's Hospice	CAB
Stepping Out Project	CAB
Streetwork UK Ltd	CAB
Univ of Edinburgh (Edin College of Art)	CAB
Victim Support Scotland	CAB
Visit Scotland	SB
Waverley Care	CAB
Weslo Housing Management	CAB
West Granton Community Trust	CAB
West Lothian College	SB
West Lothian Council	SB
West Lothian Leisure	CAB
Wester Hailes Land and Property	CAB
Young Scot Enterprise	CAB
Youthlink Scotland	CAB

Actuarial Statement for 2012/13

This statement has been prepared in accordance with Regulation 31A(1)(d) of the Local Government Pension Scheme (Scotland) (Administration) Regulations 2008, and Chapter 6 of the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the UK 2012/13.

Description of Funding Policy

The funding policy is set out in the administering authority's Funding Strategy Statement (FSS), dated March 2012. In summary, the key funding principles are as follows:

- to ensure the long-term solvency of the overall 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
- 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 2011. This valuation revealed that the Fund's assets, which at 31 March 2011 were valued at £3,477 million, were sufficient to meet 96% of the liabilities (i.e. the present value of promised retirement benefits) accrued up to that date. The resulting deficit at the 2011 valuation was £142 million.

Individual employers' contributions for the period 1 April 2012 to 31 March 2015 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 my valuation report dated 15 February 2012.

Method

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

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

The key financial assumptions adopted for the 2011 valuation were as follows:

Financial assumptions	31 March 2011 % p.a. Nominal	31 March 2011 % p.a. Real
Discount rate	5.8%	2.9%
Pay increases *	5.1%	2.2%
Price inflation/Pension increases	2.8%	-

* plus an allowance for promotional pay increases. Short term pay growth was assumed to be 1% p.a. for 2011/12 and 2012/13, reverting to 5.1% p.a. thereafter.

The key demographic assumption was the allowance made for longevity. As a member of Club Vita, the baseline longevity assumptions adopted at this valuation were a bespoke set of VitaCurves that were specifically tailored to fit the membership profile of the Fund. Longevity improvements were in line with standard year of birth mortality tables; with medium cohort projections and a 1% p.a. underpin effective from 2008. Based on these assumptions, the average future life expectancies at age 65 are as follows:

	Males	Females
Current pensioners	20.4 years	22.8 years
Future pensioners	22.6 years	25.4 years

Copies of the 2011 valuation report and Funding Strategy Statement are available on our website at www.lpf.org.uk/publications or on request from the Fund.

Experience over the period since April 2011
The administering authority monitors the funding position on a regular basis as part of its risk management programme with the next funding update to be produced at 31 March 2013. It showed that the funding level (excluding the effect of any membership movements) had fallen from 96% to 87% due, primarily, to falling bond yields. This has been partially offset by strong returns over 2012/13.

The next actuarial valuation will be carried out as at 31 March 2014. The Funding Strategy Statement will also be reviewed at that time.

Richard Warden
Fellow of the Institute and Faculty of Actuaries

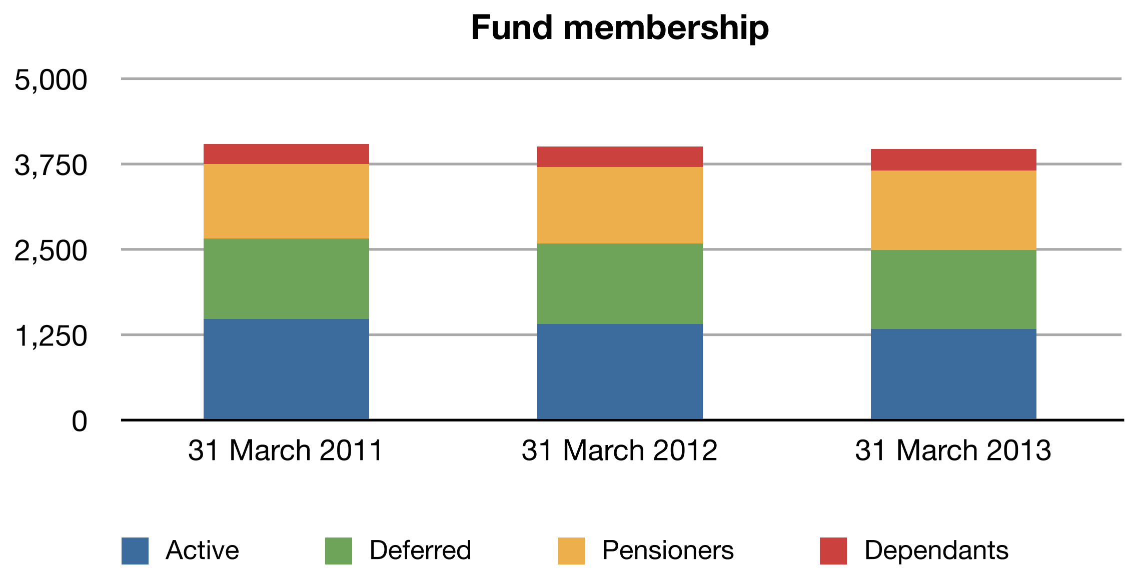
For and on behalf of
Hymans Robertson LLP
20 Waterloo Street
Glasgow
G2 6DB
30 May 2013


L H.179.

LOTHIAN BUSES PENSION FUND

Membership

Status	Membership at 31/03/2011	Membership at 31/03/2012	Membership at 31/03/2013
Active	1,479	1,407	1,335
Deferred	1,182	1,179	1,163
Pensioners	1,092	1,122	1,163
Dependants	292	303	310
Total	4,045	4,011	3,971



Funding

Benefits are funded by contributions and investment earnings. Contributions are made by active members of the Fund in accordance with the Local Government Pension Scheme (Benefits, Membership and Contributions) (Scotland) Regulations 2008. These contributions are payable at a certain rate for a band of earnings, for the year ended 31 March 2013 the contribution rates were as follows:

Full time equivalent pensionable pay (2012/13)	Rate
Less than £19,971	5.5%
Between £19,971 and £25,948	Between 5.6% and 6.0%
Between £25,949 and £32,567	Between 6.1% and 6.5%
Between £32,568 and £45,915	Between 6.6% and 7.5%
Between £45,916 and £51,727	Between 7.6% and 8.0%
Between £51,728 and £69,262	Between 8.1% and 9.0%
Between £69,263 and £104,782	Between 9.1% and 10.0%
Between £104,783 and £240,383	Between 10.1% and 11.2%

Employers' contributions are set at the triennial actuarial valuation. The contribution rates for the year ended 31 March 2013 were based on the actuarial valuation at 31 March 2011. For the nine months to 31 December 2012 the rate was 19.6% of pensionable pay and 19.9% for the three months to 31 March 2013 for service currently being accrued.

More information on funding can be found in the Actuarial Statement for 2012/13 at the end of this section.

Investment strategy

Following the completion of the 2011 actuarial valuation, an in-depth review of Lothian Buses Pension Fund's investment strategy has been undertaken.

The review concluded that there is scope to reduce the Fund's investment risk in the long-term with a focus over the coming years on capital preservation, investment income and reducing the absolute volatility of the Fund.

The strategy for 2012-2017 is set out in the table shown and has private equity reclassified in Equities rather than Alternative investments. Investments in the Alternatives category include property, infrastructure, timber and corporate bonds. Asset allocations limits under normal financial conditions are also shown.

Investment strategy	Interim benchmark at 31 March 2013 %	Strategy for 2012 - 2017 %	Asset allocation limits minimum – maximum %
Equities excluding Private Equity	62.5	-	
Equities including Private Equity	-	55	45 – 65
Index linked gilts	10	15	10 - 30
Alternatives including Private Equity	17.5	30	
Alternatives excluding Private Equity	10	-	10 – 35
Cash	-	-	0 - 10
TOTAL	100	100	

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

The Fund will gradually implement the new strategy over the next few years.

Investment performance

Annualised returns to 31 March 2013 (% per year)

	1 Year	3 Years	10 Years
Lothian Buses Pension Fund	16.4	10.4	11.3
Benchmark	13.8	8.7	10.1
Retail Price Index	3.3	4.1	3.3
National Average Earnings	(0.6)	1.0	2.7

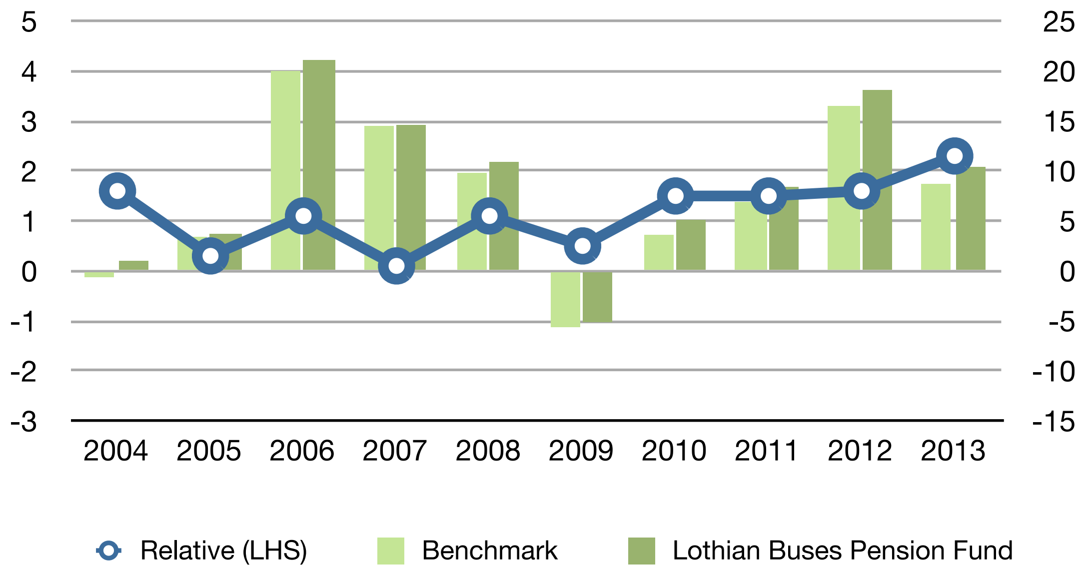
The absolute performance of Lothian Buses Pension Fund was over the 12 month period was +16.4% and three-year performance was +10.4% per annum. Over both time periods the performance was above the benchmark return.

Over 10 years, the Fund returned +11.3% per annum, ahead of its benchmark by 1.0% per year and also well ahead of measures of inflation, including the retail price index and national average earnings.

Despite strong investment returns, the actual funding level has fallen from 112.4% at the time of the last actuarial valuation on 31 March 2011 to 102.5% at 31 March 2013, largely as a result of falling real gilt yields, which caused an increase in the value of liabilities.

LOTHIAN BUSES PENSION FUND

Annualised 3 yearly returns ending 31 March (% per year)
Target is for the Fund to outperform the benchmark by 1.5% per year over 3 years (target prior to October 2009 target was 1%)



	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Fund	1	3.7	21.1	14.6	10.9	(5.1)	5.1	8.4	18.1	10.4
Benchmark	(0.6)	3.4	20	14.5	9.8	(5.6)	3.6	6.9	16.5	8.7
Relative	1.6	0.3	1.1	0.1	1.1	0.5	1.5	1.5	1.6	2.3

Fund Account for the year ended 31 March 2013

2011/12 £000		Note	2012/13 £000
	Income		
8,128	Contributions from employer	*2*	7,147
2,358	Contributions from members		2,261
-	Transfers from other schemes		-
10,486			9,408
	Less: expenditure		
6,580	Pension payments including increases		7,015
1,712	Lump sum retirement payments		2,136
144	Lump sum death benefits		237
67	Transfers to other schemes	*3*	114
145	Administrative expenses	*4*	110
8,648			9,612
1,838	**Net (withdrawals) / additions from dealing with members**		(204)
	Returns on investments		
5,455	Investment income	*5*	5,913
7,784	Change in market value of investments	*7a, 8b*	35,800
(641)	Investment management expenses	*6*	(1,047)
12,598	**Net returns on investments**		40,666
14,436	**Net increase in the Fund during the year**		40,462
257,012	Net assets of the Fund at 1 April 2012		271,448
271,448	**Net assets of the Fund at 31 March 2013**	*8a, 8c*	311,910

Net Assets Statement as at 31 March 2013

31 March 2012 £000		Note	31 March 2013 £000
	Investments		
267,415	Assets		309,255
(245)	Liabilities		(490)
267,170		*7, 9*	308,765
	Current assets		
629	The City of Edinburgh Council	*15*	459
2,759	Cash balances	*9, 15*	1,913
951	Debtors	*12*	894
4,339			3,266
	Current liabilities		
(61)	Creditors	*13*	(121)
4,278	**Net current assets**		3,145
271,448	**Net assets of the Fund at 31 March 2013**	*8a, 8c*	311,910

JOHN BURNS FCMA CGMA
Pensions and Accounting Manager
June 2013

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 Events after the balance sheet date

There have been no events since 31 March 2013, and up to the date when these accounts were authorised, that require any adjustments to these accounts.

2 Contributions from employer

	2011/12	2012/13
Lothian Buses Plc	£000	£000
Normal (ongoing contributions)	7,300	7,147
Deficit funding	556	-
	7,856	7,147
Pension strain	272	-
Total	8,128	7,147

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

In 2011/12 the employer contributions included an element in respect of deficit funding. The part of the contribution attributable to deficit funding as shown above, was calculated based on a future service contribution rate of 21.1% (as stated in the actuarial valuation of 31 March 2008). The deficit recovery period was the estimated future working lifetime of current active members.

In 2012/13, no deficit funding was required (as stated in the actuarial valuation of 31 March 2011). The employer paid an agreed contribution rate of 19.9% on pensionable salaries, this rate is defined in actuarial valuation.

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.

3 Transfers out to other pension schemes

	2011/12	2012/13
	£000	£000
Group transfers	-	-
Individual transfers	67	114
	67	114

4 Administrative expenses

	2011/12	2012/13
	£000	£000
Employee costs	65	58
The City of Edinburgh Council - pension payroll costs	15	13
The City of Edinburgh Council - other support costs	22	16
System costs	7	10
Actuarial fees	24	7
External Audit fees	2	2

4 Administrative expenses (cont'd)

Legal fees	3	-
Printing and postage	3	2
Depreciation	2	2
Sundry costs less sundry income	2	-
	145	110

The Investments and Pensions Division of the Council is responsible for administering the three pension Funds. The Division receives an allocation of the overheads of the Council. In turn the Division 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.

In 2012 the administration costs were allocated based on the value of the funds as at the end of the year. In 2013 the administration costs allocation basis were modified to a more stable basis which better reflects the underlying cost drivers. Pension payroll costs were allocated based on the number of pensioners during the year and all other costs were allocated based on the number of members of each Fund.

5 Investment income

	2011/12	2012/13
	£000	£000
Dividends from equities	3,573	4,054
Income from pooled investment vehicles	1,789	1,802
Interest on cash deposits	45	31
Securities lending and sundries	131	96
	5,538	5,983
Irrecoverable withholding tax	(83)	(70)
	5,455	5,913

6 Investment management expenses

	2011/12	2012/13
	£000	£000
External management fees	545	892
Employee costs	43	51
Custody fees	3	51
Engagement and voting fees	5	5
Performance measurement fees	4	3
Investment consultancy fees	2	15
System costs	11	10
Legal fees	1	4
The City of Edinburgh Council - other support costs	-	8
Sundry costs	27	8
	641	1,047

The Investments and Pensions Division of the Council is responsible for administering the three pension Funds. The Division receives an allocation of the overheads of the Council. In turn the Division 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.

In 2012/13 and 2011/12 the shared investment management expenses were allocated based on the value of the Funds as at the end of the year.

7 Net investment assets

	31 March 2012 £000	31 March 2013 £000
Investment assets		
Equities	169,629	214,633
Pooled investment vehicles	93,708	80,844
Deposits	3,388	11,850
Other investment assets		
Due from broker	-	1,104
Dividends and other income due	690	824
	690	1,928
Total investment assets	267,415	309,255
Investment liabilities		
Other financial liabilities - due to broker	(245)	(490)
Total investment liabilities	(245)	(490)
Net investment assets	267,170	308,765

At 31st March 2013, Lothian Buses Pension Fund was transitioning from UK equities to global equities. As a result, there were balances due to and from brokers in respect of this transition.

7a Reconciliation of movement in investments

	Market value at 1 April 2012 £000	Purchases at cost £000	Sales proceeds £000	Change in market value £000	Market value at 31 March 2013 £000
Equities	169,629	43,698	(27,377)	28,683	214,633
Pooled investment vehicles	93,708	5,889	(25,617)	6,864	80,844
	263,337	49,587	(52,994)	35,547	295,477
Other financial assets / (liabilities)					
Cash deposits	3,388			252	11,850
Broker balances	(245)			1	614
Dividends due	690				824
	3,833			253	13,288
Net financial assets	267,170			35,800	308,765

	Market value at 1 April 2011 £000	Purchases at cost £000	Sales proceeds £000	Change in market value £000	Market value at 31 March 2012 £000
Equities	159,766	31,632	(22,181)	412	169,629
Pooled investment vehicles	91,446	8,293	(13,388)	7,357	93,708
	251,212	39,925	(35,569)	7,769	263,337
Other financial assets / (liabilities)					
Cash deposits	2,387			(17)	3,388
Broker balances	27			-	(245)
Dividends due	485			32	690
	2,899			15	3,833
Net financial assets	254,111			7,784	267,170

7a Reconciliation of movement in investments (cont'd)

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.

Transaction costs are included in the cost of purchases and sale proceeds. Transaction costs include costs charged directly to the Fund such as fees, commissions, stamp duty and other fees. Transaction costs incurred during the year amounted to £82k (2012 £81k). In addition to the transaction costs disclosed above, indirect costs may be incurred through the bid-offer spread on some pooled investment vehicles, the amount of any such costs is not separately provided to the Fund.

7b Analysis of investments (at market value)

	Market value at 31 March 2012 £000	Market value at 31 March 2013 £000
Equities		
UK quoted	29,229	32,742
Overseas quoted	140,400	181,891
	169,629	214,633
Pooled investment vehicles		
UK		
Managed funds - property	24,381	22,931
In-house equities	21,604	-
Managed funds - other bonds	40,164	45,683
Overseas		
Infrastructure and timber	7,559	12,230
	93,708	80,844

7c Investment managers and mandates

Manager	Mandate	Market value at 31 March 2012 £000	% of total funds %	Market value at 31 March 2013 £000	% of total funds %
Baillie Gifford	Multi asset	201,125	75.3	237,568	77.0
In-house	UK equities	21,603	8.1	-	-
In-house	Global equities	-	-	15,516	5.0
Standard Life	Property managed fund	24,381	9.1	22,931	7.4
In-house	Private equity quoted	4,956	1.9	6,370	2.1
In-house	Infrastructure unquoted	4,810	1.8	8,484	2.7
In-house	Infrastructure quoted	4,893	1.8	5,427	1.8
In-house	Timber	2,749	1.0	2,897	0.9
In-house	Secured loans	1,780	0.7	1,552	0.5
In-house	Alternatives cash	115	-	859	0.3
Total alternative investment		19,303	7.2	25,589	8.3
In-house	Cash	758	0.3	7,161	2.3
Net financial assets		267,170	100.0	308,765	100.0

7d Investments representing more than 5% of the net assets of the Fund

	Market value at 31 March 2012 £000	% of net assets of the Fund %	Market value at 31 March 2013 £000	% of net assets of the Fund %
In-house UK equities pooled fund	21,603	8.0	-	-
Standard Life property fund	24,381	9.0	22,931	7.4
Baillie Gifford inv grade bond fund	19,684	7.3	22,551	7.2
Baillie Gifford index linked gilt fund	20,480	7.5	23,132	7.4

7e Investments representing more than 5% of any investment class

	Class	Market value at 31 March 2012 £000	% of net assets %	Market value at 31 March 2013 £000	% of net assets %
In-house UK equities pooled fund	Pooled funds	21,603	23.1	-	-
Standard Life property fund	Pooled funds	24,381	26.0	22,931	28.4
Baillie Gifford inv grade bond fund	Pooled funds	19,684	21.0	22,551	27.9
Baillie Gifford index linked gilt fund	Pooled funds	20,480	21.9	23,132	28.6

7f Securities lending

During the year Lothian Pension Fund participated in two securities lending arrangements. The arrangement with the Northern Trust Company covers the main investments of the Fund. As at 31 March 2013, £9.2m (2012 £12.5m) of securities were released to third parties. Collateral valued at 106.8% (2012 107.1%) of the market value of the securities on loan was held at that date. The arrangement with Blackrock related to the Fund's holding of FTSE 250 iShares ceased during the year.

8 Financial instruments
8a 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.

8a Classification of financial instruments (cont'd)

	31 March 2012			31 March 2013		
	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						
Equities	169,629			214,633		
Pooled investments	93,708			80,844		
Cash		3,388			11,850	
Debtors		-			1,103	
Other investment balances		690			825	
	263,337	4,078	-	295,477	13,778	-
Other assets						
The City of Edinburgh Council		629			459	
Cash		2,759			1,913	
Debtors		951			894	
	-	4,339	-	-	3,266	-
Assets total	263,337	8,417	-	295,477	17,044	-
Financial liabilities						
Investment liabilities						
Other investment balance	(245)			(490)		
	(245)	-	-	(490)	-	-
Other liabilities						
Creditors			(61)			(121)
	-	-	(61)	-	-	(121)
Liabilities total	(245)	-	(61)	(490)	-	(121)
Net asset total	263,092	8,417	(61)	294,987	17,044	(121)
Total net financial instruments			271,448			311,910

8b Net gains and losses on financial instruments

	2011/12 £000	2012/13 £000
Designated as fair value through fund account	7,769	35,547
Loans and receivables	15	253
Financial liabilities at amortised cost	-	
Total	7,784	35,800

8c 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.

8c Valuation of financial instruments carried at fair value (cont'd)

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. Listed 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 unlisted private equity, 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 usually undertaken annually at the end of December. Cash flow adjustments are used to roll forward the valuations to 31 March as appropriate.

The following table provides an analysis of the financial assets and liabilities of the Fund grouped into Levels 1 to 3, based on the level at which the fair value is observable.

	31 March 2013			
	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
Financial assets				
Designated as fair value through fund account	283,247		12,230	295,477
Loans and receivables	17,044			17,044
Total financial assets	300,291	-	12,230	312,521
Financial liabilities				
Designated as fair value through fund account	(490)			(490)
Financial liabilities at amortised cost	(121)			(121)
Total financial liabilities	(611)	-	-	(611)
Net financial assets	299,680	-	12,230	311,910

	31 March 2012			
	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
Financial assets				
Designated as fair value through fund account	255,778		7,559	263,337
Loans and receivables	8,417			8,417
Total financial assets	264,195	-	7,559	271,754
Financial liabilities				
Designated as fair value through fund account	(245)			(245)
Financial liabilities at amortised cost	(61)			(61)
Total financial liabilities	(306)	-	-	(306)
Net financial assets	263,889	-	7,559	271,448

9 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 the 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.

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 risks
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.

Investment 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 investment 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, 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.

The Fund may use equity futures contracts from time to time to manage market risk. Exchange traded 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 below sets out the long-term volatility assumptions used in the Fund's asset-liability modelling undertaken by the Fund's investment adviser KPMG:

9 Nature and extent of risk arising from financial instruments (cont'd)

Asset type	Potential price movement (+ or -)
Equities - developed markets	20.0%
Private equity	30.0%
Timber	30.0%
Secured loans	10.0%
Corporate bonds	10.5%
Index-linked gilts	7.0%
Infrastructure	8.0%
Property	13.0%
Cash	1.6%

Sensitivity analysis

Volatility is the standard deviation of annual returns. 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. The following table shows the risks at the asset class level and the overall Fund level, with and without allowance for correlation.

Asset type	Value at 31 March 2013 £000	% of fund %	Potential Change + / - %	Value on increase £000	Value on decrease £000
Equities - developed markets	207,400	67.2	20.0	248,880	165,920
Private equity	6,370	2.1	30.0	8,281	4,459
Timber	2,897	0.9	30.0	3,766	2,028
Secured loans	1,552	0.5	10.0	1,707	1,397
Corporate bonds	22,551	7.3	10.5	24,919	20,183
Index-linked gilts	23,133	7.5	7.0	24,752	21,514
Infrastructure	13,911	4.5	8.0	15,024	12,798
Property	22,931	7.4	13.0	25,912	19,950
Cash	8,020	2.6	1.6	8,148	7,892
Total [1]	308,765	100.0	17.0	361,389	256,141
Total [2]	308,765		14.8	354,462	263,068
Total [3]	308,765		13.6	350,757	266,773

[1] No allowance for correlations between assets
[2] Including allowance correlations for between assets
[3] I Including allowance for correlation between assets and liabilities.

The value on increase/decrease columns illustrates the £m 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 is lower than the total of the risks to the individual assets*[2]*.

9 Nature and extent of risk arising from financial instruments (cont'd)

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

Cash deposits
At 31 March 2013, cash deposits represented £13.7m, 4.4% of total net assets. This was held with the following institutions:

	Moody's Credit Rating at 31 March 2013	Balances at 31 March 2012 £000	Balances at 31 March 2013 £000
Held for investment purposes			
Northern Trust Global Investment Limited - liquidity funds	*Aaa*	2,144	10,207
Northern Trust Company - cash deposits	*Aa3*	487	947
The City of Edinburgh Council - treasury management	*See below*	757	696
Total investment cash		3,388	11,850
Held for other purposes			
The City of Edinburgh Council - treasury management	*See below*	2,759	1,913
Total cash		6,147	13,763

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 while at the same time seeking innovative and secure cash management opportunities.

As at 31 March 2013 £6.5m of cash was held by Northern Trust in respect of transition activity. Post year end £6.3m of this was transferred to City of Edinburgh Council treasury management.

9 Nature and extent of risk arising from financial instruments (cont'd)

Cash deposits (cont'd)
As well as lending monies to other local authorities, the Council has purchased UK Government Treasury Bills as well as Bonds and Floating Rate Notes with an explicit UK Government Guarantee.

The Fund's cash holding at the year end under its treasury management arrangements was held with the following institutions:

	Moody's Credit Rating at 31 March 2013	Balances at 31 March 2012 £000	Balances at 31 March 2013 £000
Money market funds			
Deutsche Bank AG, London	*Aaa*	465	284
Goldman Sachs	*Aaa*	-	270
Bank call accounts			
Bank of Scotland	*A2*	299	258
Royal Bank of Scotland	*A3*	324	144
Santander UK	*A2*	277	-
Barclays Bank	*A2*	274	255
Svenska Handelsbanken	*Aa3*	442	368
Clydesdale Bank	*A2*	-	254
Bank certificates of deposit			
Standard Chartered	*A1*	-	100
Floating Rate Note			
Rabobank	*Aa2*	-	100
Building Society fixed term deposits			
Nationwide Building Society	*A2*	103	99
UK pseudo-sovereign risk instruments			
Other Local Authorities [1]	*n/a*	938	477
UK Government guaranteed FRNs	*n/a*	394	-
		3,516	2,609

[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 2013 would have been 'Aa1'). Of the £477k on deposit with local authorities at 31 March 2013, £249k is with a local authority which has a 'Aa2' credit rating from Moody's.

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 security lending programme as described above. The Fund is potentially exposed to credit risk in the event of the borrower of stock 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.

9 Nature and extent of risk arising from financial instruments (cont'd)

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. Cashflow projections are prepared on a regular basis to understand and manage the timing of the Fund's cashflow. The majority (estimated to be over 80%) of the Fund's investments could be converted to cash within three months in a normal trading environment.

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.

10 Actuarial statement

The Fund Actuary has provide a statement describing the funding arrangements of the Fund, this can be found in a separate section at the end of this section..

11 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 £321m (2012 £269m). This figure is used for statutory accounting purposes by Lothian Buses 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.

Financial assumptions	31 March 2012 % p.a.	31 March 2013 % p.a.
Inflation / pensions increase rate	2.5	2.8
Salary increase rate	4.8	5.1
Discount rate	4.8	4.5

For the year ended 31 March 2013, salary increases were estimated at 1% p.a. nominal for the three years to 31 March 2015 reverting to the long term rate thereafter.

Longevity assumptions

The life expectancy assumption is based on the Fund's specific statistical analysis with improvements from 2008 in line with the Medium Cohort and a 1% p.a. underpin. Based on these assumptions, the average future life expectancies, in years, at age 65 are summarised below:

	Males	Females
Current pensioners	18.4	21.6
Future pensioners (assumed to be currently 45)	21.7	24.8

This assumption is the same as at 31 March 2012.

11 Actuarial present value of promised retirement benefits (cont'd)

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.

12 Debtors

	31 March 2012 £000	31 March 2013 £000
Contributions due - employers	700	650
Contributions due - employees	209	202
Pensions paid on behalf of employers	27	28
Sundry debtors	15	14
	951	894
Analysis of debtors		
Administering Authority	3	1
Lothian Buses plc	936	880
Other entities and individuals	12	13
	951	894

13 Creditors

	31 March 2012 £000	31 March 2013 £000
Benefits payable	61	121
	61	121
Analysis of creditors		
Other entities and Individuals	61	121
	61	121

14 Additional Voluntary Contributions

Active members of the Lothian Pension Fund and 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.

	2011/12 £000	2012/13 £000
Contributions during year		
Standard Life	506	395
Prudential	705	1,120
	1,211	1,515
Value at year end at 31 March		
Standard Life	5,491	5,968
Prudential	745	1,572
	6,236	7,540

15 Related party transactions

The City of Edinburgh Council

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 Division of the Council is responsible for administering the three pension funds. The Division receives an allocation of the overheads of the Council, this is based on the amount of central services consumed. This includes the pension payroll service provided by the Council. In turn, the Division allocates its costs to the three 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 Funds are managed via a holding account, each month the Funds are paid a cash sum leaving a working balance in the account to cover the month's pension payroll costs and other expected costs.

Year end balance on holding account	31 March 2012 £000	31 March 2013 £000
	629	459

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 2013, the Fund had an average investment balance of £3.3m (2012 £4.6m), interest earned was £22.0k (2012 £35.6k).

Year end balance on treasury management account	31 March 2012 £000	31 March 2013 £000
Held for investment purposes	757	696
Held for other purposes	2,759	1,913
	3,516	2,609

The Council owns 91.01% of the shares of Lothian Buses plc, the Fund being operated solely for the employees of Lothian Buses Plc.

Key management personnel

During the period from 1 April 2012 to the date of issuing of these accounts, several employees of the City of Edinburgh Council held key positions in the financial management of the Lothian Buses Pension Fund. These employees and their financial relationship with the Fund (expressed as cash-equivalent transfer values or CETV) are:

15 Related party transactions (cont'd)

Key management personnel (cont'd)

Name	Position held	Accrued CETV as at 31 March 2012 £000	Accrued CETV as at 31 March 2013 £000
Alastair Maclean	Director of Corporate Governance	44	67
Clare Scott	Investment and Pensions Service Manager	67	89
Struan Fairbairn	Legal, Risk and Development Manager (appoint	-	1
John Burns	Pensions and Accounting Manager	318	349
Esmond Hamilton	Financial Controller	86	101
Bruce Miller	Investment Manager	65	90

16 Contingent liabilities and contractual commitments

The Fund has commitments relating to outstanding call payments due on private equity and infrastructure unquoted limited partnership funds. 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 2012 £000	31 March 2013 £000
2,627	3,041

17 Contingent assets

There were no contingent assets at the year end.

18 Impairment losses

No impairment losses have been identified during the year.

Actuarial Statement for 2012/13

This statement has been prepared in accordance with Regulation 31A(1)(d) of the Local Government Pension Scheme (Scotland) (Administration) Regulations 2008, and Chapter 6 of the CIPFA/ LASAAC Code of Practice on Local Authority Accounting in the UK 2012/13.

Description of Funding Policy

The funding policy is set out in the administering authority's Funding Strategy Statement (FSS), dated March 2012. In summary, the key funding principles are as follows:

- to ensure the long-term solvency of the overall 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.

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 2011. This valuation revealed that the Fund's assets, which at 31 March 2011 were valued at £257 million, were sufficient to meet 112% of the liabilities (i.e. the present value of promised retirement benefits) accrued up to that date. The resulting surplus at the 2011 valuation was £28 million.

Employer's contributions for the period 1 April 2012 to 31 March 2015 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 details used are described in my valuation report dated 16 December 2011.

Method

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

Assumptions

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

The key financial assumptions adopted for the 2011 valuation were as follows:

Financial assumptions	31 March 2011 % p.a. Nominal	% p.a. Real
Discount rate	5.8%	2.9%
Pay increases *	5.1%	2.2%
Price inflation/Pension increases	2.8%	-

* plus an allowance for promotional pay increases. Short term pay growth was assumed to be 2.4% p.a. for 2011/12, 3.1% p.a. for 2012/13, reverting to 5.1% p.a. thereafter.

The key demographic assumption was the allowance made for longevity. As a member of Club Vita, the baseline longevity assumptions adopted at this valuation were a bespoke set of VitaCurves that were specifically tailored to fit the membership profile of the Fund. Longevity improvements were in line with standard year of birth mortality tables; with medium cohort projections and a 1% p.a. underpin effective from 2008. Based on these assumptions, the average future life expectancies at age 65 are as follows:

	Males	Females
Current pensioners	18.4 years	21.6 years
Future pensioners	21.7 years	24.8 years

Copies of the 2011 valuation report and Funding Strategy Statement are available on www.lpf.org.uk/publications or on request from the Fund.

Experience over the period since April 2011

The administering authority monitors the funding position on a regular basis as part of its risk management programme. The most recent funding update was produced at 31 March 2013. It showed that the funding level (excluding the effect of any membership movements) had fallen from 112% to 103% due, primarily, to falling real bond yields. This has been partially offset by strong asset returns over 2012/13.

The next actuarial valuation will be carried out as at 31 March 2014. The Funding Strategy Statement will also be reviewed at that time.

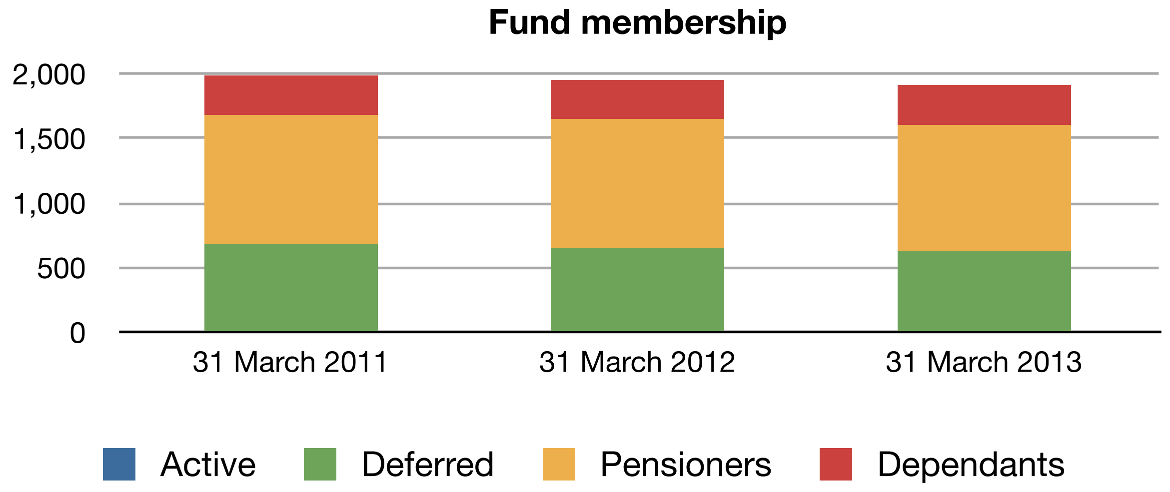
Richard Warden
Fellow of the Institute and Faculty of Actuaries

For and on behalf of
Hymans Robertson LLP
20 Waterloo Street
Glasgow
30 May 2013

SCOTTISH HOMES PENSION FUND

Membership

Status	Membership at 31/03/2011	Membership at 31/03/2012	Membership at 31/03/2013
Active	-	-	-
Deferred	684	650	626
Pensioners	996	999	978
Dependants	308	303	308
Total	1,988	1,952	1,912



Funding

As the Scottish Homes Pension Fund has no active members, benefits are funded by investment earnings and payments from the Scottish Government in line with the guarantee agreement.

Payments under the guarantee agreement are set at triennial actuarial valuations. The amount payable for the year ended 31 March 2013, of £771,000, was based on the actuarial valuation as at 31 March 2011.

More information on funding can be found in the Actuarial Statement for 2012/13 at the end of this section..

Investment strategy

Pensions Committee approved a new investment strategy in October 2012 to be implemented over the following 5 years.

The revised strategy reduces the allocation to equities and property and increases the allocation to bonds. It is designed to reduce investment risk as the Fund is closed to new members and the liabilities will mature over time.

The new strategy continues to recognise the latent inflation potential at the heart of current central bank monetary policy and maintains significant exposure to real investments, such as index-linked gilts and equities, which have a history of protecting purchasing power, after the effects of inflation have been taken into account.

SCOTTISH HOMES PENSION FUND

The revised investment strategy is set at the broad asset class level of equities, bonds and property, which are the key determinants of investment risk and return. The revised strategy for the next 5 years is set out in the table below.

	Previous strategic benchmark %	Strategy for 2012 - 2017 %	Asset allocation limits minimum - maximum %
Equities			
UK	8.8		
US	12.4		
Europe (ex UK)	8.0		
Pacific inc Japan	7.6		
Emerging markets	3.2		
Sub-total	40.0	30	20-35
Bonds			
UK Fixed Interest Gilts	10.0		
UK Index Linked Gilts	40.0		
Subtotal	50.0	65	60-75
Property	10.0	5	5-10
Cash	0.0	0	0-5
Total	100	100	100

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

The Fund will gradually implement the new strategy over the next few years.

Investment performance

The absolute performance of Scottish Homes Pension Fund over the 12-month period was +13.0% and three-year performance was +11.2% per annum. Over both time periods, the performance was broadly in line with the benchmark return.

Since inception in July 2005, the Fund has returned +8.8% per annum, in line with its benchmark, which is well ahead of measures of inflation, including the retail price index and national average earnings.

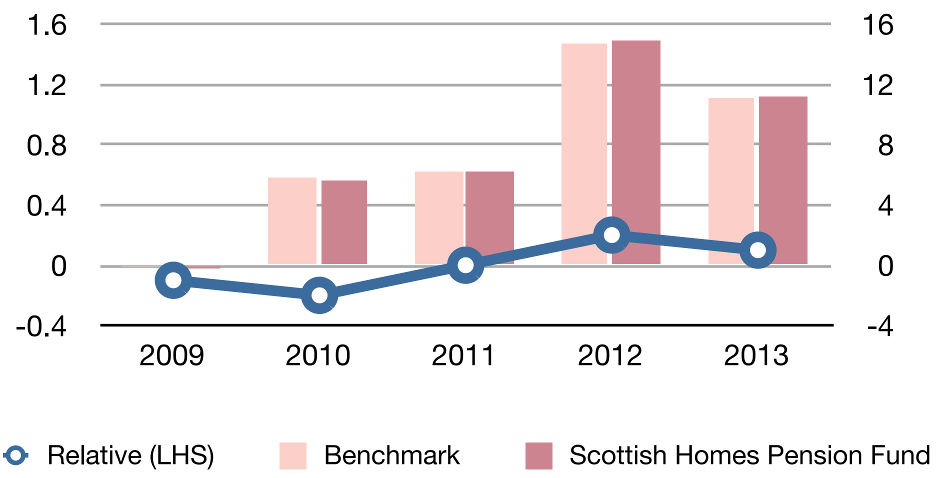
Despite strong investment returns, the actual funding level has fallen marginally from 86% at the time of the last actuarial valuation on 31 March 2011 to 85% at 31 March 2013, largely as a result of falling real gilt yields, which caused an increase in the value of liabilities.

Annualised returns to 31 March 2013 (% per year)

	1 year	3 years	Since inception (July 2005)
Scottish Homes Pension Fund	13.0	11.2	8.8
Benchmark	13.0	11.1	8.8
Retail Price Index	3.3	4.1	3.9
National Average Earnings	(0.6)	1.0	2.2

SCOTTISH HOMES PENSION FUND

Annualised 3 yearly returns ending 31 March (% per year)
Target is for the Fund to outperform the benchmark by 0.5% per year over 3 years



	2009	2010	2011	2012	2013
Fund	(0.2)	5.6	6.2	14.9	11.2
Benchmark	(0.1)	5.8	6.2	14.7	11.1
Relative	(0.1)	(0.2)	-	0.2	0.1

Fund Account for the year ended 31 March 2013

2011/12 £000		Note	2012/13 £000
	Income		
100	Contributions from employer	*2*	794
-	Transfers from other schemes		-
100			794
	Less: expenditure		
6,913	Pension payments including increases		7,070
683	Lump sum retirement payments		488
9	Lump sum death benefits		2
209	Transfers to other schemes	*3*	82
98	Administrative expenses	*4*	61
7,912			7,703
(7,812)	**Net withdrawals from dealing with members**		(6,909)
	Returns on investments		
357	Investment income	*5*	333
14,691	Change in market value of investments	*7a, 8b*	15,420
(126)	Investment management expenses	*6*	(145)
14,922	**Net returns on investments**		15,608
7,110	**Net increase in the Fund during the year**		8,699
124,308	Net assets of the Fund at 1 April 2012		131,418
131,418	**Net assets of the Fund at 31 March 2013**	*8a, 8c*	140,117

Net Assets Statement as at 31 March 2013

31 March 2012 £000		Note	31 March 2013 £000
	Investments		
129,886	Assets		138,006
-	Liabilities		-
129,886		*7, 9*	138,006
	Current assets		
268	The City of Edinburgh Council	*15*	-
1,200	Cash balances	*9, 15*	2,514
98	Debtors	*12*	55
1,566			2,569
	Current liabilities		
-	The City of Edinburgh Council	*15*	(442)
(34)	Creditors	*13*	(16)
(34)			(458)
1,532	**Net current assets**		2,111
131,418	**Net assets of the Fund at 31 March 2013**	*8a, 8c*	140,117

JOHN BURNS FCMA CGMA
Pensions and Accounting Manager
June 2013

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 Events after the balance sheet date

There have been no events since 31 March 2013, and up to the date when these accounts were authorised, that require any adjustments to these accounts.

2 Contributions

	2011/12 £000	2012/13 £000
Deficit funding	-	671
Administration expenses contribution	100	100
Strain costs	-	23
	100	794

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

Following the actuarial valuation at 31 March 2011 deficit funding of £671,000 per year is to be paid by the Scottish Government over the period April 2012 to March 2015. In addition, the Scottish Government has 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.

3 Transfers out to other schemes

	2011/12 £000	2012/13 £000
Group transfers	-	-
Individual transfers	209	82
	209	82

4 Administrative expenses

	2011/12 £000	2012/13 £000
Employee costs	42	27
The City of Edinburgh Council - pension payroll costs	10	12
The City of Edinburgh Council - other support costs	14	8
System costs	5	5
Actuarial fees	20	6
External audit fees	2	1
Legal fees	2	-
Printing and postage	2	1

4 Administrative expenses (cont'd)

Depreciation	1	1
Sundry costs less sundry income	-	-
	98	61

The Investments and Pensions Division of the Council is responsible for administering the three pension Funds. The Division receives an allocation of the overheads of the Council. In turn the Division 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.

In 2011/12 the administration costs were allocated based on the value of the Funds as at the end of the year. In 2012/13, the allocation basis were modified to a more stable basis which better reflects the underlying cost drivers. Pension payroll costs were allocated based on the number of pensioners during the year and all other costs were allocated based on the number of members of each fund.

5 Investment income

	2011/12 £000	2012/13 £000
Property pooled investment income	343	316
Interest on cash deposits	13	16
Sundries	1	1
	357	333
Irrecoverable withholding tax	-	-
	357	333

6 Investment management expenses

	2011/12 £000	2012/13 £000
External management fees	66	68
Employee costs	21	23
Engagement and voting fees	2	2
Performance measurement fees	2	2
Investment consultancy fees	1	13
The City of Edinburgh Council - other support costs	-	3
Custodian fees	-	15
System costs	5	5
Legal fees	-	-
Sundry costs	29	14
	126	145

The Investments and Pensions Division of the Council is responsible for administering the three pension Funds. The Division receives an allocation of the overheads of the Council. In turn the Division 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.

In 2012/13 and 2011/12 the investment management expenses were allocated based on the value of the Funds as at the end of the year.

7 Net investment assets

	31 March 2012 £000	31 March 2013 £000
Pooled investment vehicles	129,886	138,006
Net investment assets	129,886	138,006

7a Reconciliation of movement in investments

	Value at 1 April 2012 £000	Purchases at cost £000	Sales proceeds £000	Change in market value £000	Value at 31 March 2013 £000
Pooled investment vehicles	129,886	4,876	(12,176)	15,420	138,006

	Value at 1 April 2011 £000	Purchases at cost £000	Sales proceeds £000	Change in market value £000	Value at 31 March 2012 £000
Pooled investment vehicles	122,595	16,932	(24,332)	14,691	129,886

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.

No direct transaction costs were incurred during the year. Indirect transaction costs may be incurred through the bid-offer spread on some pooled investment vehicles, the amount of any such costs is not separately provided to the Fund.

7b Analysis of Investments (at market value)

	31 March 2012 £000	31 March 2013 £000
Pooled investment vehicles		
UK managed funds - property	12,808	11,352
UK managed funds - other	117,078	126,654
	129,886	138,006

7c Investment managers and mandates

Manager	Mandate	Market value at 31 March 2012 £000	% of total funds %	Market value at 31 March 2013 £000	% of total funds %
Managed Funds					
State Street	UK equity	11,404	8.8	12,351	8.9
	Overseas equities		-		
State Street	N American equities	16,348	12.5	18,253	13.2
State Street	European equities	10,409	8.0	11,408	8.3
State Street	Pacific (ex Jpn) equit	4,198	3.2	4,661	3.4
State Street	Japanese equities	5,664	4.4	6,581	4.8
State Street	Emerging mkts equiti	3,994	3.1	4,362	3.2
		40,613	31.2	45,265	32.9

7c Investment managers and mandates (cont'd)

Manager	Mandate	Market value at 31 March 2012 £000	% of total funds %	Market value at 31 March 2013 £000	% of total funds %
Managed Funds					
State Street	UK fixed interest	12,766	9.8	12,540	9.1
State Street	UK index-linked	52,295	40.3	56,498	40.9
State Street	Total	117,078	90.1	126,654	91.8
Schroders	Property	7,674	5.9	7,509	5.4
Standard Life	Property	5,134	4.0	3,843	2.8
		12,808	9.9	11,352	8.2
		129,886	100.0	138,006	100.0

7d Investments representing more than 5% of the net assets of the Fund or 5% of any investment class

The Fund currently invests all its money in a range of pooled funds. Investments representing more than 5% of the net assets of the Fund or 5% of any investment class are described above.

7e Securities lending

The Fund has not participated in any securities lending arrangements in the last two years.

8 Financial instruments

8a 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.

8 Financial instruments
8a Classification of financial instruments (cont'd)

	31 March 2012			31 March 2013		
	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
Financial assets	£000	£000	£000	£000	£000	£000
Investment assets						
Pooled investments	129,886			138,006		
	129,886	-	-	138,006		
Other assets						
The City of Edinburgh Council		268			-	
Cash		1,200			2,514	
Debtors		98			55	
	-	1,566	-		2,569	
Assets total	129,886	1,566	-	138,006	2,569	
Financial liabilities						
Other liabilities						
The City of Edinburgh Council						(442)
Creditors			(34)			(16)
	-	-	(34)		-	(458)
Liabilities total	-	-	(34)		-	(458)
Net assets total	129,886	1,566	(34)	138,006	2,569	(458)
Total net financial instruments			131,418			140,117

8b Net gains and losses on financial instruments

	2011/12	2012/13
	£000	£000
Designated as fair value through fund account	14,691	15,420
Loans and receivables	-	-
Financial liabilities at amortised cost	-	-
Total	14,691	15,420

8c 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.

8 Financial instruments
8c Valuation of financial instruments carried at fair value (cont'd)

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. Listed 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 private equity are based on valuations provided by the general partners to the private equity 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). Valuations are usually undertaken annually at the end of December. Cash flow adjustments are used to roll forward the valuations to 31 March as appropriate.

The following table provides an analysis of the financial assets and liabilities of the pension fund grouped into Levels 1 to 3, based on the level at which the fair value is observable.

	31 March 2013			
	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
Financial assets				
Designated as fair value through fund account	138,006			138,006
Loans and receivables	2,569			2,569
Total financial assets	140,575	-	-	140,575
Financial liabilities				
Designated as fair value through fund account	-			-
Financial liabilities at amortised cost	(458)			(458)
Total financial liabilities	(458)	-	-	(458)
Net financial assets	140,117	-	-	140,117

8 Financial instruments
8c Valuation of financial instruments carried at fair value (cont'd)

	31 March 2012			
	Level 1	Level 2	Level 3	Total
	£000	£000	£000	£000
Financial assets				
Designated as fair value through fund account	129,886			129,886
Loans and receivables	1,566			1,566
Total financial assets	131,452	-	-	131,452
Financial liabilities				
Designated as fair value through fund account	-			-
Financial liabilities at amortised cost	(34)			(34)
Total financial liabilities	(34)	-	-	(34)
Net financial assets	131,418	-	-	131,418

9 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 funding objective is outlined in the guarantee document, agreed by the Administering Authority, the Scottish Government and the Fund's Actuary.

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 risks
There are various ways of considering investment risks for pension funds. For the purposes of this note, investment 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.

Investment 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

9 Nature and extent of risk arising from financial instruments (cont'd)

- diversification of investments in terms of type of asset, 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.

The Fund may use equity futures contracts from time to time to manage market risk. Exchange traded 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 below sets out the long-term volatility assumptions used in the Fund's asset-liability modelling:

Asset type	Potential price movement (+ or -)
Equities - Developed Markets	20.0%
Equities - Emerging Markets	30.0%
Fixed interest gilts	9.0%
Index-linked gilts	7.0%
Property	13.0%

Volatility is the standard deviation of annual returns. 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.

Asset type	Value at 31 March 2013 £000	% of fund %	Change + / - %	Value on increase £000	Value on decrease £000
Equities - Developed Markets	53,254	38.6	20.0	63,905	42,603
Equities - Emerging Markets	4,362	3.2	30.0	5,671	3,053
Fixed Interest Gilts	12,540	9.1	9.0	13,669	11,411
Index-Linked Gilts	56,498	40.9	7.0	60,453	52,543
Property	11,352	8.2	13.0	12,828	9,876
Total [1]	138,006	100.0	13.4	156,526	119,486
Total [2]	138,006		10.5	152,497	123,515
Total [3]	138,006		9.0	150,427	125,585

[1] No allowance for correlations between assets
[2] Including allowance for correlations between assets
[3] Including allowance for correlations between assets and liabilities

9 Nature and extent of risk arising from financial instruments (cont'd)

The value on increase/decrease columns illustrates 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 is lower than the total of the risks to the individual assets *[2]*.

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 funds 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 a major area of credit exposure where credit risk is not reflected in market prices.

Cash deposits

At 31 March 2013 cash deposits represented £2.5m, 1.8% of total net assets. This was held as follows:

	Moody's Credit Rating at 31 March 2013	Balances at 31 March 2012 £000	Balances at 31 March 2013 £000
Held for investment purposes			
The City of Edinburgh Council - treasury management	*See below*	-	-
Total investment cash		-	-
Held for other purposes			
The City of Edinburgh Council - treasury management	*See below*	1,200	2,514
Total cash		1,200	2,514

All the 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 while at the same time seeking innovative and secure cash investment opportunities.

9 Nature and extent of risk arising from financial instruments (cont'd)

As well as lending monies to other local authorities, the Council has purchased UK Government Treasury Bills as well as Bonds and Floating Rate Notes with an explicit UK Government Guarantee.

The Fund's cash holding under its treasury management arrangements at 31 March 2013 was held with the following institutions:

	Moody's credit rating at 31 March 2013	Balances at 31 March 2012 £000	Balances at 31 March 2013 £000
Money market funds			
Deutsche Bank AG, London	*Aaa*	159	273
Goldman Sachs	*Aaa*	-	260
Bank call accounts			
Bank of Scotland	*A2*	102	249
Royal Bank of Scotland	*A3*	111	139
Santander UK	*A2*	94	-
Barclays Bank	*A2*	94	245
Svenska Handelsbanken	*Aa3*	151	355
Bank near-call accounts			
Clydesdale Bank (15 Day Notice)	*A2*	-	245
Bank certificates of deposit			
Standard Chartered	*A1*	-	96
Floating Rate Note			
Rabobank	*Aa2*	-	96
Building society fixed term deposits			
Nationwide Building Society	*A2*	35	96
UK pseudo-sovereign risk instruments			
Other Local Authorities [1]	*n/a*	320	460
UK Government Guaranteed FRNs	*n/a*	134	
UK Government Guaranteed Bonds	*n/a*	-	
		1,200	2,514

[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 2013 would have been 'Aa1'). Of the £460k above, £240k is with a local authority which has a 'Aa2' credit rating from Moody's.

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.

9 Nature and extent of risk arising from financial instruments (cont'd)

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. Cashflow projections are prepared on a regular basis to understand and manage the timing of the Fund's cashflow.

The majority (estimated to be over 85%) of the Fund's investments could be converted to cash within three months in a normal trading environment.

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.

10 Actuarial statement

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

11 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 £136m (2012 £131m). 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.

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 2012 % p.a.	31 March 2013 % p.a.
Inflation / pensions increase rate	2.5	2.8
Discount rate	4.8	4.5

Longevity assumptions
The life expectancy assumption is based on standard SAPS mortality tables with improvements in line with Medium Cohort and a 1% p.a. underpin effective from 2008. Based on these assumptions, the average future life expectancies, in years, at age 65 are summarised below:

	Males	Females
Current pensioners	21.1	23.9
Future pensioners (assumed to be currently 45)	23.0	25.7

This assumption is the same as at 31 March 2012.

11 Actuarial present value of promised retirement benefits (cont'd)

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.

12 Debtors

	31 March 2012 £000	31 March 2013 £000
Sundry debtors	98	55
	98	55
Analysis of debtors		
Administering Authority	1	1
Scottish Government	70	29
Other entities and individuals	27	25
	98	55

13 Creditors

	31 March 2012 £000	31 March 2013 £000
Benefits payable	34	16
	34	16
Analysis of creditors		
Other entities and individuals	34	16
	34	16

14 Additional Voluntary Contributions

As the Fund has no active members, there are no AVC arrangements provided.

15 Related party transactions

The City of Edinburgh Council

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 Division of the Council is responsible for administering the three pension funds. The Division receives an allocation of the overheads of the Council, this is based on the amount of central services consumed. This includes the pension payroll service provided by the Council. In turn, the Division allocates its costs to the three 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.

11 Actuarial present value of promised retirement benefits

	31 March 2012 £000	31 March 2013 £000
Year end balance on holding account	268	(442)

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 2013, the Fund had an average investment balance of £2.5m (2012 £1.6m), interest earned was £16.5k (2012 £12.7k).

Year end balance on treasury management account	31 March 2012 £000	31 March 2013 £000
Held for investment purposes	-	-
Held for other purposes	1,200	2,514
	1,200	2,514

Key management personnel

During the period from 1 April 2012 to the date of issuing of these accounts, several employees of the City of Edinburgh Council held key positions in the financial management of the Fund. 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 2012 £000	Accrued CETV as at 31 March 2013 £000
Alastair Maclean	Director of Corporate Governance	44	67
Clare Scott	Investment and Pensions Service Manager	67	89
Struan Fairbairn	Legal, Risk and Development Manager (appointed March 2013)	-	1
John Burns	Pensions and Accounting Manager	318	349
Esmond Hamilton	Financial Controller	86	101
Bruce Miller	Investment Manager	65	90

16 Contingent liabilities and contractual commitments

There were no contingent liabilities or contractual commitments at the year end.

17 Contingent assets

There were no contingent assets at the year end.

18 Impairment losses

No impairment losses have been identified during the year.

Actuarial Statement for 2012/13

This statement has been prepared in accordance with Regulation 31A of the Local Government Pension Scheme (Scotland) (Administration) Regulations 2008, and Chapter 6 of the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the UK 2012/13.

Description of funding policy

The Administering Authority's Funding Strategy Statement (FSS), dated March 2012, states that a bespoke funding strategy has been adopted for the Fund. Contributions payable by the Scottish Government (previously known as the Scottish Executive) as Guarantor are determined in line with a Scottish Executive Guarantee agreement dated June 2005. In broad terms, the funding strategy is to ensure that assets held by the Fund, together with any contributions payable by the Guarantor under the terms of the agreement, meet all of the Fund's liabilities until they are extinguished.

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 2011. This valuation revealed that the Fund's assets, which at 31 March 2011 were valued at £124 million, were sufficient to meet 86% of the liabilities (i.e. the present value of promised retirement benefits) accrued up to that date. The resulting deficit at the 2011 valuation was £20 million.

The Guarantor's contributions for the period 1 April 2012 to 31 March 2015 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 my valuation report dated 16 December 2011.

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 assets at their market value.

The key financial assumptions adopted for the 2011 valuation were as follows:

	% p.a. Nominal	% p.a. Real
Discount rate (pensioners)	3.9%	1.3%
Discount rate (deferreds)	4.3%	1.5%
GMP increases before SPA	5.1%	2.3%
Price inflation/pension increases (pensioners)	2.6%	-
Price inflation/pension increases (deferreds)	2.8%	-

SCOTTISH HOMES PENSION FUND

The key demographic assumption was the allowance made for longevity. The baseline longevity assumptions adopted at this valuation were in line with standard SAPS mortality tables, and included improvements based on medium cohort projections and a 1% p.a. underpin effective from 2008. Based on these assumptions, the average future life expectancies at age 65 are as follows:

	Males	Females
Current Pensioners	21.1 years	23.9 years
Future Pensioners	23.0 years	25.7 years

Copies of the 2011 valuation report and Funding Strategy Statement are available on request from the City of Edinburgh Council, administering authority to the Fund.

Experience over the period since April 2011

The administering authority monitors the funding position on a regular basis as part of its risk management programme. The most recent funding update was produced at 31 March 2013. It showed that the funding level (excluding the effect of any membership movements) had fallen from 86% to 85% due to falling real bond yields and partially offset by strong asset performance.

The next actuarial valuation will be carried out as at 31 March 2014. The Funding Strategy Statement will also be reviewed at that time.

Richard Warden
Fellow of the Institute and Faculty of Actuaries
For and on behalf of

Hymans Robertson LLP
20 Waterloo Street
Glasgow
G2 6DB

30 May 2013

STATEMENT OF RESPONSIBILITIES FOR THE STATEMENT OF ACCOUNTS

Statement of responsibilities for the Statement of Accounts

The Administering Authority's responsibilities require it to:

- make arrangements for the proper administration of the financial affairs of the pension 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 of the Council's accounting arrangements, including those of the Lothian Pension Funds. For the Lothian Pension Funds, however, this Section 95 responsibility has been delegated to the Pensions and Accounting Manager.

- manage its affairs to secure economic, efficient and effective use of its resources and safeguard its assets.

The Pensions and Accounting Manager is responsible for the preparation of the Pension Funds' statement of accounts which, in terms of the CIPFA / LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2012/13 (the Code of Practice), is required to present a true and fair view of the financial position of the Pension Funds at the accounting date and their income and expenditure for the year (ended 31 March 2013).

In preparing this statement of accounts, the Pensions and Accounting Manager 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 Pensions and Accounting Manager has also:

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

Statement of Accounts

The Statement of Accounts presents a true and fair view of the financial position of the Pension Funds as at 31 March 2013, and their income and expenditure for the year ended 31 March 2013.

JOHN BURNS, FCMA CGMA
Pensions and Accounting Manager
June 2013

Independent Auditor's report

The Statement of Accounts is subject to audit in accordance with the requirement of Part VII of the Local Government (Scotland) Act 1973.

The Auditor Appointed for this purpose by the Accounts Commission for Scotland is:

Audit Scotland
Osborne House
1/5 Osborne Terrace
Edinburgh

Annual Governance Statement

Scope of Responsibility
The City of Edinburgh Council is responsible for ensuring that its business is conducted in accordance with the law and appropriate standards, and that public money is safeguarded, properly accounted for, and used economically, efficiently, effectively and ethically. The Council also has a duty to make arrangements to secure continuous improvement in the way its functions are carried out.

In discharging these 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.

To this end, the Council has approved and adopted a Local Code of Corporate Governance that is consistent with the principles of the CIPFA / 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. It also includes a statement on internal financial control.

The Governance framework of the Council and Lothian Pension Funds
The governance framework, which was reviewed during 2012/13, comprises the systems, processes, cultures and values by which the Council and Lothian Pension Funds are directed and controlled. It also describes the way it engages with, accounts to and leads the various stakeholders.

The Council's Local Code of Corporate Governance is supported by evidence of compliance which is regularly reviewed and available for inspection. The Council has implemented arrangements for monitoring each element of the framework and providing evidence of compliance. The Head of Internal Audit has reviewed the arrangements and is satisfied that the Code continues to be adequate and effective. The framework meets the principles of effective governance.

Internal financial controls
The Funds place reliance upon the internal financial controls within the City of Edinburgh Council's financial systems and the monitoring in place to ensure the effectiveness of these controls. Within the overall control arrangements, the system of internal financial control is intended to ensure that assets are safeguarded, transactions are authorised and properly recorded, and material errors or irregularities are either prevented or would be detected within a timely period. The key elements of the Council's governance framework include financial regulations, financial monitoring, financial and administrative procedures (including segregation of duties, management supervision, and a system of delegation and accountability).

The system includes:
- budgeting systems;
- reviews of financial and performance reports against forecasts;
- consideration of external and internal audit reports by the Governance, Risk and Best Value Committee (for Council) and by the Pensions Committee and Pensions Audit Sub-Committee (for Lothian Pension Funds).

These arrangements also include:
- identifying the Council's objectives in the Single Outcome Agreement;
- identifying the objectives of the Funds in Funding Strategy Statement, Statement of Investment Principles and Service Plan;
- monitoring of the achievement of objectives by the Council, Pensions Committee and senior officers;
- a systematic approach to monitoring service performance by Committee, senior officers and stakeholders;

- describing the role of the Council and its Committees, including the Pensions Committee, in Council Standing Orders, which also sets out the decision-making powers delegated to officers;
- Financial Regulations (or equivalent) that specify the controls over budgeting, income, expenditure and financial performance;
- the Council's Monitoring Officer and the Fund's Legal, Risk and Development Manager who ensure compliance with laws and regulations, with a detailed compliance framework covering key activities;
- a risk management policy, including a regularly reviewed risk register, serves to manage risk to the Funds appropriately;
- the Council's Audit Committee (the Governance, Risk and Best Value Committee) and its successor in respect of the Lothian Pension Funds, the Pensions Audit-Sub Committee, whose core functions comply with CIPFA standards
- comprehensive budget and expenditure monitoring systems
- targets against which financial and operational performance can be assessed
- clearly defined capital expenditure guidelines;
- formal project management disciplines;
- codes of conduct for elected members , Consultative Panel members and officers
- a structured programme to ensure that 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' Statements of Investment Principles ;
- compliance with the CIPFA Principles for Investment Decision Making in the Local Government Pension Scheme and the Myners Principles on investment;
- 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 quality and cost against other Local Government Pension Scheme funds.

A significant part of the governance framework is the system of internal control, which is based on an ongoing process to identify and prioritise risks to achieve the objectives of the Funds.

Following his appointment in September 2011, in view of concerns over the robustness of the Council's systems of internal control and risk management arrangements, the Director of Corporate Governance commissioned an independent review of their effectiveness. The results of this assessment were reported in May 2012, with a total of forty-three recommendations made. Twelve of these served to mitigate weaknesses exposing the Council, either individually or in combination, to risk of significant loss or error.

While good progress has been made in implementing the required improvements, a number remained outstanding as of 31 March 2013, including development of corporate debt and anti-fraud policies and procedures to reduce the volume of payments falling outside the control afforded by the three-way matching process. Further improvements are also required in the Council's ICT governance arrangements.

In addition to the specific measures put in place to strengthen elements of the financial control framework, following Council's approval of the adoption of a co-sourced operating model, the internal audit function is being realigned to widen its focus to include non-financial controls and mitigate the Council's risk exposure through developing additional capacity in this area. Although the new operating arrangements are now in place and working well, the necessary skills transfer will take place over the full three-year period of the partnership and thus remains in its initial stages.

While the system is designed to enable the Funds to manage risk effectively, it cannot eliminate all risks of failure to implement policies and achieve objectives. Therefore, it provides a reasonable, but not absolute, assurance of effectiveness.

Review of effectiveness
The Internal Audit Section operates in accordance with CIPFA's Code of Practice for Internal Audit and complies with the ISO 9001/2008 quality standard. The Audit Section undertakes an annual work programme based on an agreed audit strategy and formal assessments of risk that are reviewed regularly during the year. During the year the Head of Internal Audit reported to the Head of Finance but had free access to the Chief Executive, all directors and elected members, and had the right to report to the Audit Committee and Pensions Committee in her own name.

The Head of Internal Audit has provided an assurance statement on the effectiveness of the system of internal control, which was informed by:

- the certified assurances from the Investment and Pensions Service Manager
- senior officers' management activities
- Internal Audit's review work
- Audit Scotland's review work leading to its Annual Audit Report
- risk management procedures.

Section 95 of the Local Government (Scotland) Act 1973 states that "every local authority shall make arrangements for the proper administration of their financial affairs and shall secure that the proper officer of the authority has responsibility for the administration of those affairs". The Head of Finance serves as the Section 95 Officer for all of the Council's accounting arrangements, including those of the Lothian Pension Funds. For the Pension Funds, however, this Section 95 responsibility has been delegated to the Pensions and Accounting Manager.

In compliance with standard accounting practice, the Pension and Accounting Manager has provided the Chief Executive with a statement of the effectiveness of the internal financial control system of the Funds for the year ended 31 March 2013. It is the Pension and Accounting Manager's opinion that reasonable assurance can be placed upon its effectiveness.

Certification
It is our opinion that, in light of the foregoing, reasonable assurance can be placed upon the adequacy and effectiveness of the systems of governance of the Funds.

SUE BRUCE	ALASTAIR MACLEAN	COUNCILLOR MAUREEN CHILD
Chief Executive	Director of Corporate Governance	Pensions Committee Convener
June 2013	June 2013	June 2013

GOVERNANCE COMPLIANCE STATEMENT

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.

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	The City of Edinburgh Council acts as administering authority and delegates all pension scheme matters to a committee of 7 members (Pensions Committee) made up as follows: - 5 City of Edinburgh elected members - 2 external members taken from the Lothian Pension Fund Consultative Panel (1 employer representative and 1 member representative).
	That representatives of participating LGPS employers, admitted bodies and scheme members (including pensioner and deferred members) are members of either the main or secondary committee established to underpin the work of the main committee.	Yes	The Pensions Committee includes two external places for pension fund stakeholders i.e. 1 employer representative and 1 member representative that are taken from the Lothian Pension Fund's Consultative Panel. Fund members and employers are also represented by a Lothian Pension Funds' Consultative Panel. Membership includes 6 employer representatives and 6 member representatives.
	That where a secondary committee or panel has been established, the structure ensures effective communication across both levels.	Yes	The Lothian Pension Funds' Consultative Panel attends the Pensions Committee meetings in an advisory, non-voting capacity and takes part in training events. Two members of the Panel are also full voting members of the Pensions Committee. Implementation of investment strategy is delegated to the Director of Corporate Governance, who takes advice from the Investment Strategy Panel. The Panel meets quarterly and reports to the Pensions Committee annually.
	That where a secondary committee or panel has been established, at least one seat of the main committee is allocated for a member from the secondary committee or panel.	Yes	Membership of the Lothian Pension Funds' Consultative Panel consists of the Convener of the Pensions Committee, the 2 external members of the Pensions Committee and 10 other representatives. The Investment Strategy Panel consists of Director of Corporate Governance, Investment and Pensions Service Manager, Pensions and Accounting Manager, Investment Manager and three independent advisers.

GOVERNANCE COMPLIANCE STATEMENT

Principle		Full Compliance	Comments
Representation	a) 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); • Scheme members (including deferred and pensioner scheme members)	Yes	The Lothian Pension Funds' Consultative Panel consists of a mix of representatives: - 6 employer representatives from non-administering authority employers (of which 2 places are reserved for Lothian Buses plc and Scottish Government) - 6 member representatives including 1 pensioner representative, 3 members (active or deferred) appointed by the Trade Union Consultative Committee and 2 members (active or deferred) appointed through an alternative route.
	• Where appropriate, independent professional observers, and • Expert advisors (on an ad-hoc basis).	Yes	An Independent Professional Observer was appointed in March 2013 to help Committee scrutinise advice. Three independent investment advisers sit on the Investment Strategy Panel. A separate specialist Pension's Audit Sub-Committee consisting of 3 members (including at least 2 elected members from the City of Edinburgh Council) undertake the audit scrutiny of the pension funds.
	b) 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	The Lothian Pension Funds' Consultative Panel attends the Pensions Committee meetings in an advisory capacity and take part in all Committee training events. The Pensions Committee takes account of the views of the Lothian Pension Fund's Consultative Panel when making decisions.
Selection and Role of Lay Members	a) That committee or panel 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	A comprehensive training programme including induction is in place. Pensions Committee is expected to attend 3 days training each year and Lothian Pension Funds Consultative Panel members one day's training each year. A code of conduct is conditional to the appointment to members of the Lothian Pension Funds' Consultative Panel.
	b) 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	The declaration of members' interests is a standard item on the agenda of the Pensions Committee. A Code of Conduct also applies to all members of the Pension Committee and to the Lothian Pension Funds' Consultative Panel.

GOVERNANCE COMPLIANCE STATEMENT

Principle		Full Compliance	Comments
Voting	The policy of individual administering authorities on voting rights is clear and transparent, including the justification for not extending voting rights to each body or group represented on main LGPS committees.	Yes	5 of the 7 places in 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 constitution of the Lothian Pension Funds' Consultative Panel clearly documents how 1 employer and 1 member representative will be elected to the Pensions Committee.
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 policy has been adopted. The Lothian Pension Fund budget includes an allowance for training. The CIPFA framework is used to identify gaps in knowledge and understanding. Training organised for Committee is also provided to the Panel. Sometimes separate sessions are held depending on the material. Attendance at meetings and training is monitored and reported.
Training / Facility Time / Expenses	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 policy ensures all members are treated equally. Members of the Lothian Pension Funds Consultative Panel are encouraged to attend in-house training events. Advisers have their own professional continued professional development.
	c) That the administering authority considers the adoption of annual training plans for committee members and maintains a log of all such training.	Yes	Each Pensions Committee member receives at least three days of training each 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 Lothian Pension Funds Consultative Panel attends all the Pensions Committee meetings. Further meetings are held if necessary. The Investment Strategy Panel meets quarterly or more frequently, as required.

GOVERNANCE COMPLIANCE STATEMENT

Principle		Full Compliance	Comments
Meetings frequency	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 panels have equal access to committee papers, documents and advice that falls to be considered at meetings of the main committee.	Yes	Committee papers and minutes are publicly available on the Council's website and all Committee and Consultative Panel members have equal access.
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 Pension Audit Sub-Committee consisting of 3 members (including at least 2 elected members from the City of Edinburgh Council) undertake the audit scrutiny of the pension funds.
Publicity	That administering authorities have published details of their governance arrangements in such a way that stakeholders with an interest in the way in which the scheme is governed, can express an interest in wanting to be part of those arrangements.	Yes	The City of Edinburgh Council is responsible for the appointment of members to the Pensions Committee. However on an annual basis: - the employer representative to be nominated for the Pensions Committee is selected by the employer representatives of the Consultative Panel - the member representative to be nominated to the Pensions Committee is selected by the member representatives of the Consultative Panel. Membership of the Consultative Panel is rotated every 3 years. Lothian Pension Fund publishes governance documents and communicates regularly with employers and scheme members. Two members of the Consultative Panel are recruited by self nomination.

Risk Management Statement

The Fund is committed to a strong control environment to ensure that risks are identified, understood, managed and monitored appropriately. The risks faced by the Fund change over time and ongoing management of risk is crucial.

The most significant risks at 31 March 2012 were as follows:

Description	Impact	Likelihood	Risk score before controls	Risk score at 31 March 2012
Under funding leading to pressure on employer contributions.	8	7	56	5
Recruitment and retention of appropriate key staff	8	7	56	20
Risk of incorrect pension payments	7	8	56	49
The collapse of an Employer body member, leading to pressure on other employers	6	7	42	6
Fraud/theft of Council/Pension Fund assets	7	6	42	16
Employers make HR decisions without considering the impact on the pension fund	6	7	42	12

As at 31 March 2013, the most significant risks, as assessed by the Investment and Pensions Service Management Team, were as follows:

Description	Impact	Likelihood	Risk score before controls	Risk score at 31 March 2012 Score
Under funding leading to pressure on employer contributions.	8	7	56	20
Recruitment and retention of appropriate key staff	8	7	56	24
Risk of incorrect pension payments	7	8	56	49
The collapse of an employer body member, leading to pressure on other employers	5	9	45	32
Fraud/theft of Council/Pension Fund assets	7	6	42	16

Impact and likelihood are each scored out of 10, so the current risk scores after control actions represents moderate risks in terms of the Council's overall risk matrix.

The Funds also have a compliance policy and each manager is responsible for ensuring compliance within their area of responsibility. Risk management has been further strengthened in the year by the appointment of a Legal, Risk and Compliance Manager.

ADDITIONAL INFORMATION

Key documents online

You can find further information on what we do and how we do it, on our website www.lpf.org.uk The following documents are on the website's Publications section:

- Actuarial Valuation reports
- Communications strategy
- Consultative Panel constitution and operation guidance
- Funding Strategy Statement
- Annual Report and Accounts
- Service Plan
- Statement of Investment Principles
- Trustee training policy

Fund advisers

Actuaries:	Hymans Robertson LLP
Auditor:	David McConnell, Assistant Director of Audit, Audit Scotland
Bankers:	Royal Bank of Scotland
Investment consultancy:	KPMG LLP Gordon Bagot 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 Prudential
Property valuations:	CB Richard Ellis Ltd
Solicitors:	The City of Edinburgh Council

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.

Photographs

Photographs of the Edinburgh and Lothian area are courtesy of the City of Edinburgh Council and www.edinburgh-inspiringcapital.com

Contact details

If you would like further information about Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Home Pension Fund, please contact us.

Address: Lothian Pension Fund, 3/3 Waverley Court, 4 East Market Street, Edinburgh, EH8 8BG
Telephone: 0131 529 4638
Fax: 0131 529 6229
Email: pensions@lpf.org.uk
Web: www.lpf.org.uk

Pensions Audit Sub-Committee

10am, Monday, 17 June 2013

Risk Management

Item number	5.2
Report number	
Wards	All

Links

Coalition pledges	
Council outcomes	CO26
Single Outcome Agreement	

Alastair Maclean

Director of Corporate Governance

Contact: Struan Fairbairn, Legal, Risk and Development Manager

E-mail: Struan.Fairbairn@edinburgh.gov.uk | Tel: 0131 529 6229

Executive summary

Risk Management

Summary

Following the recent Committee training on Governance & Risk, we have looked to develop our approach to risk management in order to

(i) refine our current risk register to include more operational detail and a greater alignment between the various risks, our action to mitigate these risks and measuring the current status of the risk (the "**Operational Risk Register**"), and

(ii) produce a summary report of the risk register for the Committee and the Audit Sub-Committee which more clearly highlights the significant risks themselves and the progress being made over time (the "**Committee Risk Summary**").

The Operational Risk Register will allow us to capture a greater number of risks across the pension funds, more quickly identify areas for improvement/corrective action and enable us to provide a meaningful overview to the Committee and Audit Sub-Committee on a regular basis to ensure that they remain fully informed of the key risks/trends facing the pension funds.

The Operational Risk Register will be circulated to the conveners of the Committee and the Audit-Sub-Committee at the end of each quarter.

The proposed form of Committee Risk Summary, to be tabled at each Committee and Audit Sub-Committee meeting, is set out in the appendix to this report.

Recommendations

We recommend noting that the officers in the Investment & Pensions division will continue to refine and implement the Operational Risk Register and provide the Committee and Audit Sub-Committee with the Committee Risk Summary along the lines of the template set out in the appendix.

Measures of success

Improved visibility/analysis of the risks facing the fund and our progress in mitigating these risks. Regular, focused and relevant risk updates to the Committee and Audit Sub-Committee should increase general awareness and also allow productive analysis/feedback by the Committee/Audit Sub-Committee members on these fundamental issues.

Ultimately, risk management should lead to less third party exposure, improved financial position/productivity and have a positive impact on the reputation of the pension funds.

Financial impact

There are no direct financial implications as a result of this report.

Equalities impact

None.

Sustainability impact

None.

Consultation and engagement

The Consultative Panel for the Lothian Pension Funds, comprising employer and member representatives, is integral to the governance of the Funds.

Background reading / external references

None.

Links

Coalition pledges	
Council outcomes	CO26 – The Council engages with stakeholders and works in partnerships to improve services and deliver agreed objectives.
Single Outcome Agreement	
Appendices	Appendix 1 - Draft form of Committee Risk Summary

DRAFT

QUARTERLY RISK OVERVIEW

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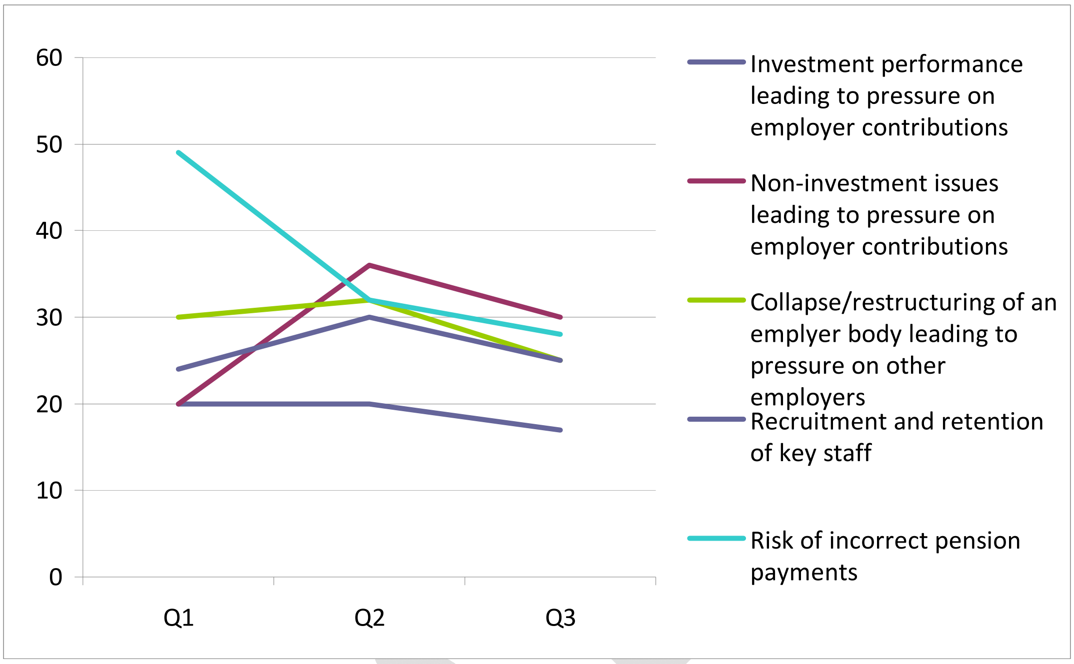
UPDATE ON TOP 5 RISKS

Risk	Update
Investment performance leading to pressure on employer contribution	Investment returns added as an explicit risk, having previously been included in a broader 'Employer Contribution' risk. Implementation of the new investment strategy has started and is ongoing.
Non-investment issues leading to pressure on employer contributions	The Public Service Pensions Bill has now been enacted. Negotiations at the Scottish Local Government Pensions Advisory Group (SLOGPAG) continue to review the implications for the scheme in Scotland. Timescale for implementation by April 2015 is very tight. Initial meeting held with the Funds' Actuary to schedule analysis on employer contributions and funding assumptions ahead of the 2014 actuarial valuation.
Collapse/restructuring of an employer body leading to pressure on other employers	Engagement with employers and guarantors scheduled for late 2013. Reporting to Committee on the conclusions is scheduled for December 2013.
Recruitment and retention of key staff	Posts created in pension administration to provide development opportunities and defend against further staff losses. Staff survey scheduled for June 2013.
Risk of incorrect pension payments	The project to integrate the pensions payroll into the pensions administration IT system is on target to complete by the end of 2013. The project was recently subjected to an internal audit.

TOP 5 RISKS: PROGRESSION OF CURRENT RISK/ACCOUNTING FOR CONTROLS



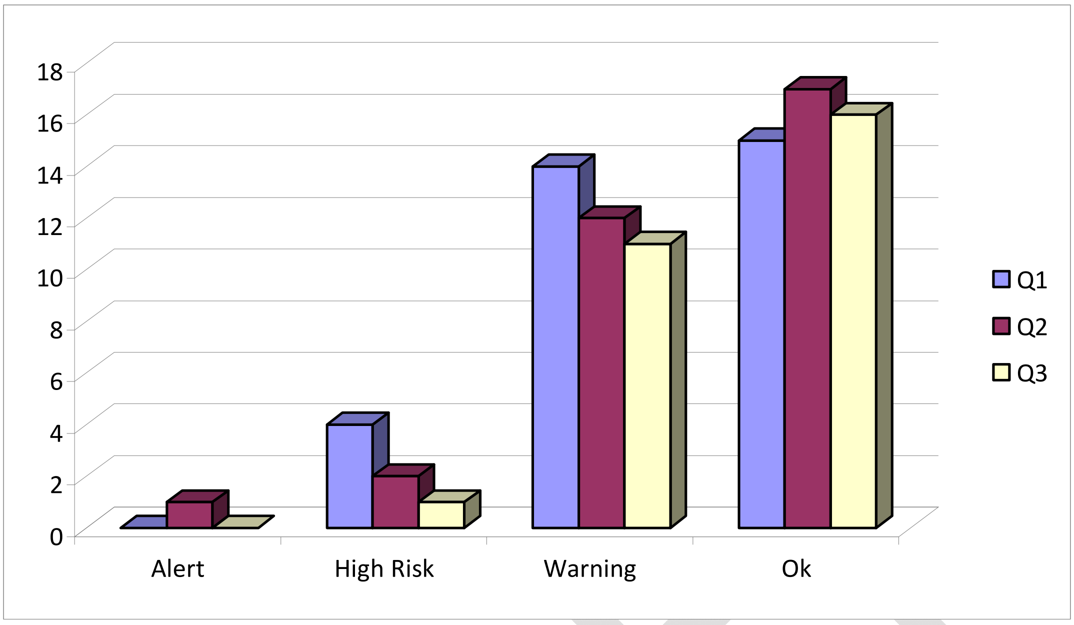
OTHER KEY POINTS

	Comments
New Top 5 Risks	Investment returns added as an explicit risk, previously included in 'Employer Contribution' risk
New Risks	Pension Liberation Fraud; Breach of contract/regulations; Document management/retention
New Controls	Updated Transfer Out Procedure to mitigate risk of Liberation Fraud
Eliminated Risks	-
Notable initiatives / actions	Engaging with existing alternative fund managers and the Information Commissioner in relation to our approach to regular requests to disclose 'fund level' information to industry journalists/consultants.

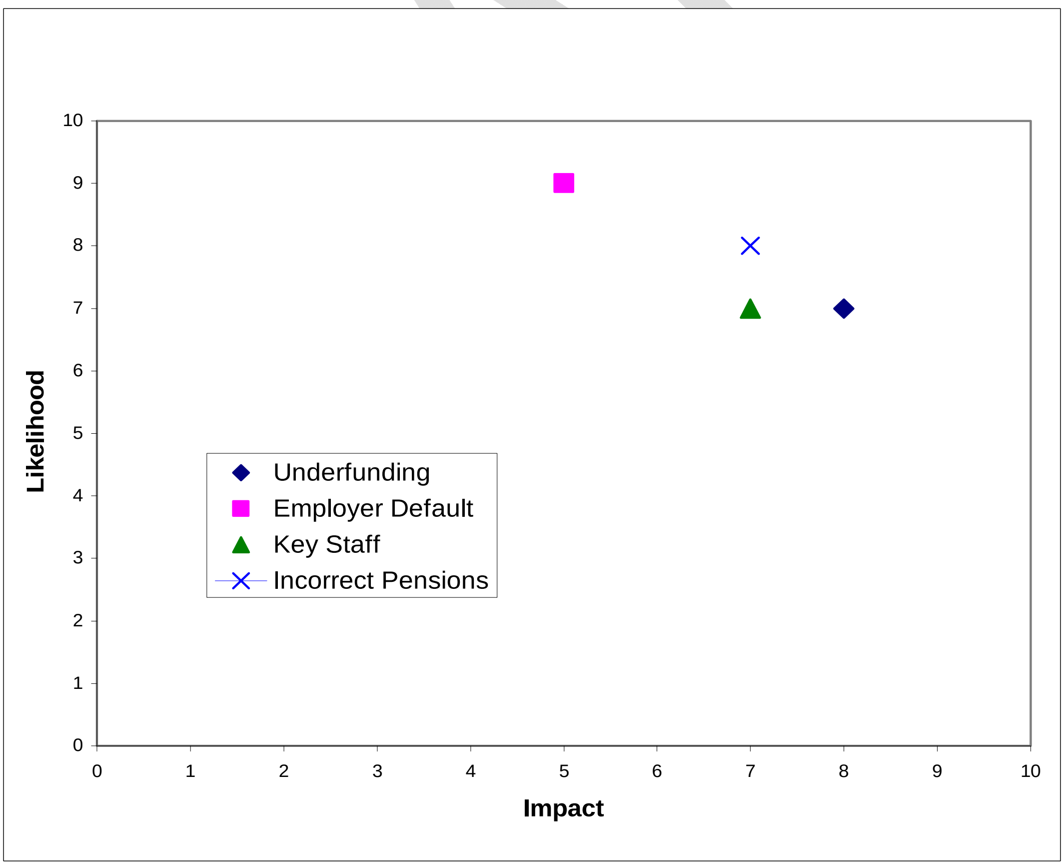
Material Litigation	None

Lothian
PENSION FUND

All Risks: Status Overview



All Risks: Impact and Likelihood Overview



Pensions Audit Sub-Committee

10.00am, Monday 17 June 2013

Internal Audit Bi-Annual Activity Report – June 2013

Item number	5.3
Report number	
Wards	All

Links

Coalition pledges	
Council outcomes	
Single Outcome Agreement	

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Executive summary

Internal Audit Bi-Annual Activity Report – June 2013

Summary

Internal Audit has continued delivery of the 2012/13 audit plan within the period, as well as completing a follow-up report from the 2011/12 plan.

Set out in appendix 1 is a list of completed and draft internal audit reports/ management letters completed since the 1 September 2012. A copy of all final reports is available to members.

Recommendations

The Committee is requested to note the progress of Internal Audit in respect of the 2012/13 internal audit plan and the areas of higher priority findings.

Measures of success

The Action Plans of these reports, when implemented, will demonstrate that the Council continues to strengthen its control framework and approach to risk management.

Financial impact

None.

Equalities impact

No full ERIA is required.

Sustainability impact

None.

Consultation and engagement

None.

Background reading / external references

Appendix 1 - Internal Audit reports issued since 1 October 2012.

Appendix 1

Internal Audit Bi-Annual Activity Report – March 2013: Internal Audit Reports since 1 September 2012

1. Background

Completed Internal Audit reviews since 1 September 2012

Title of Review	High Risk Findings	Medium Risk Findings	Low risk Findings	Comments
Review of Controls around the new payroll system	-	-	1	The project is well controlled and managed and at this stage there is no reason to suggest it should not meet its objectives

Completed Internal Audit follow- up reviews since 1 September 2012

- Pension Fund Investments Follow-up

Internal Audit is pleased to note that action has been taken to complete six of the recommendations. Of the remaining two recommendations which are low risk, one is progressing and management have advised that the other will be completed by 30/9/13.

In addition internal audit are currently auditing the pensions administration system and expect to issue a final report in July 2013. A second review of the new payroll system is scheduled for completion in August 2013.