

Notice of meeting and agenda

Pensions Audit Sub Committee

2.30pm, Monday 22 September 2014

Dunedin Room, City Chambers, High Street, Edinburgh

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

Contact

Gavin King

Committee Services Manager

E-mail: Gavin.king@edinburgh.gov.uk

Tel: 0131 529 4239

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 Previous Minute 17 June 2014 – Submitted for approval as a correct record (circulated)

5. Reports

- 5.1 Agenda Planning – report by the Director of Corporate Governance (circulated)
- 5.2 Audited Annual Report 2014 of the Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund - report by the Director of Corporate Governance (circulated)
- 5.3 Review of Investment Operations - report by the Director of Corporate Governance (circulated)
- 5.4 Pension Fund Investment Staffing - report by the Director of Corporate Governance (circulated)
- 5.5 Audit of Foreign Exchange Transaction Costs - report by the Director of Corporate Governance (circulated)
- 5.6 Pensions Administration Data Quality - report by the Director of Corporate Governance (circulated)
- 5.7 Prevention of Fraudulent Pension Payments - report by the Director of Corporate Governance (circulated)
- 5.8 Irrecoverable Overpayment of Pensions - report by the Director of Corporate Governance (circulated)
- 5.9 Risk Management - report by the Director of Corporate Governance (circulated)

6. Motions

- 6.1 If any

Carol Campbell

Head of Legal, Risk and Compliance

Committee Members

Councillor Rankin (Convener), Councillor Child, Councillor Bill Cook, Councillor Orr and Councillor Rose, John Anzani and Darren May.

Information about the Pensions Committee

The Pensions Committee consists of 5 Councillors and 2 external members and is appointed by the City of Edinburgh Council. The Pensions Committee usually meets every eight weeks.

The Pensions 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 of the Pensions Committee

10.00 am, Monday 16 June 2014

Present

Councillors Rose (Convener), Bill Cook and Orr.

Consultative Panel Members Present:

Eric Adair and Eric MacLennan.

1. Minute

Decision

To approve the minute of the Pensions Audit Sub-Committee of the Pensions Committee of 16 December 2013 as a correct record.

2. Agenda Planning

An indication was provided of potential reports for future Pensions Committee and Pensions Audit Sub-Committee meetings in the rest of 2014 and March 2015.

Decision

To note the agenda planning document.

(Reference – report by the Director of Corporate Governance, submitted.)

3. Lothian Pension Fund – Internal Audit Monitoring 14/15

A summary was provided of the audit activity during the six month period covering 1 October 2013 to 31 March 2014 and the proposed annual internal audit plan for 1 April 2014 to 31 March 2015 was outlined.

Decision

- 1) To note the summary of audit activity covering the six month period to 31 March 2014.
- 2) To note the planned internal audit activity for the year 2014/15.

- 3) To request that the Director of Corporate Governance considers whether a test of the disaster recovery system was necessary to establish sufficient assurance.

(Reference – report by the Director of Corporate Governance, submitted.)

4. Lothian Pension Funds Annual Report 2014 Unaudited

The unaudited Annual Report for the year ended 31 March 2014 for the Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund was detailed for scrutiny prior to consideration by the Pensions Committee.

The Accounts showed that the Lothian Pension Fund valuation increased from £4,094.6m to £4,377.5m and Lothian Buses Pension Fund increased from £311.9m to £337.1m. The Scottish Homes Pension Fund decreased from £140.1m to £136.3m.

Decision

To note the report.

(Reference – report by the Director of Corporate Governance, submitted.)

5. Risk Management

The quarterly risk overview as at 22 May 2014 was detailed.

Decision

To note the quarterly risk overview.

(Reference – report by the Director of Corporate Governance, submitted.)

Pensions Audit Sub Committee

2.30 p.m., Monday, 22 September 2014

Agenda Planning

| | |
|--------------------------|-----|
| Item number | 5.1 |
| Report number | |
| Executive/routine | |
| Wards | All |

Executive summary

This document provides Committee with an indication of the agenda for future meetings of the Pensions Committee and Audit Sub Committee. It also provides a more general overview of the current cycle of papers for the Committee.

There will, of-course, be specific matters and papers which need to be brought to the attention of the Pension Committee and the Audit Sub-Committee in addition to those set out herein.

Links

Coalition pledges

Council outcomes

CO26 –The Council engages with stakeholders and works in partnership to improve services and deliver on agreed objectives.

Single Outcome Agreement

Report

Agenda Planning

Recommendations

- 1.1 That Committee notes the agenda planning document and highlights any points that it would like to raise at the Pensions Committee on 23 September 2014.

Background

- 2.1 In order for the Pensions Committee and Consultative Panel to gain an overview of the content of the Committee Cycle it was agreed that an agenda planning document be submitted each quarter.

Main report

- 3.1 Based on the Committee cycle and the current position, the proposed agendas for the remaining meetings in 2014/15 are set out below.

December 2014

| Pensions Committee | Pensions Audit Sub Committee |
|---|---|
| <ul style="list-style-type: none">• Agenda Planning• Referrals / recommendations from Pensions Audit-Sub Committee• Annual Report by External Auditor• Pension Fund Governance• Actuarial Valuations (if complete)• Funding Strategy Statement (if complete)• EU Tax Claims and Income Recovery• Class actions• Environmental Social and Governance Activity Update• Cost Benchmarking• Service Plan Update• Risk management summary | <ul style="list-style-type: none">• Agenda Planning• Annual Report by External Auditor• EU Tax Claims and Income Recovery<ul style="list-style-type: none">• Investment Income Review- Cross Border Withholding Tax• Class actions• Investment Controls and Compliance (custody, currency, taxation, stock lending)• Risk management summary |

The Annual Performance Report & Benchmarking report has not been included in the agenda for the September 2014 Pensions Committee. The performance reporting within the 2013/14 Annual Report & Accounts has evolved to be in-line with the previous Annual Performance Report, hence making it redundant.

Data has been provided to providers for benchmarking of investment costs and pensions administration costs and it is proposed that Benchmarking is considered by the Pensions Committee in December 2014.

March 2015

The following papers are currently scheduled for the Pensions Committee meeting:

- Audit plans and reports (internal and external)
- Pension Fund Governance
- 2014-17 Service Plan update
- 2015-18 Service Plan and Budget
- Policy Reviews (if any)
- Training Activity (Committee and Panel)
- Internal Investment Risks & Controls (progress in implementing recommendations from external assessment of controls, including FCA and staffing matters)
- Update on Employer Admissions in Lothian Pension Fund
- Actuarial Valuations and Funding Strategy Statement (if not addressed in December 2014)
- Risk management summary

It is proposed that the Pensions Audit Sub-Committee does not meet in March 2015. Audit plans for 2015/16 will be developed in consultation with the Convener of the Audit Sub-Committee before consideration by the Pensions Committee.

Measures of success

- 4.1 The Committee and Consultative Panel will have greater clarity regarding the content of the Committee Cycle.

Financial impact

- 5.1 None.

Risk, policy, compliance and governance impact

- 6.1 There is no direct impact as a result of this report. The forward planning of the Committees' agendas should facilitate improved risk management and governance for the pension funds.

Equalities impact

- 7.1 None.

Sustainability impact

- 8.1 None.

Consultation and engagement

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

Background reading / external references

None.

Alastair Maclean

Director of Corporate Governance

Struan Fairbairn, Legal & Risk Manager

E-mail: struan.fairbairn@edinburgh.gov.uk | Tel: 0131 529 4689

Links

Coalition pledges

Council outcomes CO26 –The Council engages with stakeholders and works in partnership to improve services and deliver on agreed objectives.

Single Outcome Agreement

Appendices Appendix 1 - Agenda planning appendix.

| Frequency | Pensions Committee | Audit Sub Committee | Month |
|-----------|---|---|-----------|
| Annually | Audit plans and reports (internal and external) | N/A - Draft audits and plan will be developed in consultation with the Convenor of the Audit Sub Committee. | March |
| | Service Plan and Budget | N/A | March |
| | Policies/Strategies/Training | N/A | March |
| | LPF Annual Report (& Accounts) Unaudited | LPF Annual Report & Accounts (Unaudited) | June |
| | Statement of Investment Principles | N/A | June |
| | Investment Strategy Panel Activity | N/A | June |
| | Annual Investment and funding – LPF/LBPF/SHPF | N/A | June |
| | LPF Annual Report & Accounts Audited | LPF Annual Report & Accounts (Audited) | September |
| | ISA 260 Audit Report | ISA 260 Audit Report | September |
| | N/A | Pensions Data Quality | September |
| | N/A | Delegated authorities: Write offs - | September |
| | N/A | Fraud Prevention | September |
| | Annual Performance & Benchmarking | N/A | September |
| | N/A | Audit of Foreign Exchange Transaction Costs | September |
| | Consultative Panel Membership | N/A | December |
| | Annual Report by External Auditor | Annual Report by External Auditor | December |
| | EU Tax Claims & Income Recovery | EU Tax Claims & Income Recovery | December |
| | Class Actions | Class Actions | December |
| | N/A | Investment Income Review-Cross-Border withholding tax | December |
| | Environmental Social and Governance Activity | N/A | December |
| N/A | Investment Controls & Compliance | December | |

| Frequency | Pensions Committee | Audit Sub Committee | Month |
|-------------------------|--|-----------------------------------|-------------------------------------|
| Semi Annually | Update on Employer Admissions in LPF | N/A | March & September |
| 3 Times per year | Service Plan Update | N/A | March, September & December |
| | Referrals / recommendations from Pensions Audit-Sub | N/A | June, September & December |
| Quarterly | Risk management summary | Risk management summary | March, June, September and December |
| Every 3 years | Actuarial Valuation: LPF/LBPF/SHPF Funding Strategy Statement | | December or March |
| As required | Delegated authorities (provider appointments) | N/A | |
| | Discretions (death grants etc.) | Audit reports | |
| | N/A | Internal Audit Reports | |
| | Regulatory Update | N/A | |
| | Investment Strategy Reviews (at least every 3 years) | N/A | |
| | N/A | Risk management (in depth review) | |

Pensions Audit Sub Committee

2.30 p.m., Monday, 22 September 2014

Audited Annual Report 2014 of the Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund

| | |
|-------------------|-----|
| Item number | 5.2 |
| Report number | |
| Executive/routine | |
| Wards | All |

Executive summary

The Annual Report for the year ended 31 March 2014 for the Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund has now been considered by Audit Scotland. International Standard on Auditing (ISA) 260 requires the External Auditor to communicate his findings to those charged with governance of the Funds. Accordingly, the ISA 260 Report by Audit Scotland is included at Appendix 1, with the Lothian Pension Funds Annual Report 2014 Audited shown at Appendix 2.

The only numerical adjustment made to the unaudited financial statements as a result of the external audit is shown in the Net Assets Statement. Whilst there is no change to total Current Assets, there is a movement between external debtors and the balance due from City of Edinburgh Council of £2.869M. This reflects the billing of discretionary unfunded pension payments to the employing authority. The analysis of total debtors has been adjusted accordingly, with the balance attributable to the City of Edinburgh Council being increased by this sum and external debtors reduced.

Some minor presentational changes have also been incorporated.

Links

Coalition pledges

Council outcomes

CO26 –The Council engages with stakeholders and works in partnership to improve services and deliver on agreed objectives.

Single Outcome Agreement

Audited Annual Report 2014 of the Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund

Recommendations

1.1 Committee is requested to:

- Note the External Auditor's report on the audit of the Annual Report for the year ended 31 March 2014 for the Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund.
- Note the Audited Annual Report 2014 for the Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund.
- Highlight any points that it would like to raise at the Pensions Committee on 23 September 2014.

Background

2.1 Pensions Committee approved the Unaudited Annual Report 2014 for the Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund at its meeting on 17 June 2014, with the Council noting this same report at its meeting on 26 June 2014.

Main report

External Auditor's Report

3.1 Under statutory accounting guidance issued by the Scottish Government, Administering Authorities are required to issue a separate Annual Report covering the Local Government Pension Scheme (LGPS) funds that they are responsible for. These Annual Reports are subject to a separate external audit. The external audit is required to comply with the International Standard on Auditing (UK and Ireland) 260 (ISA 260). As part of the standard, the External Auditor is required to communicate to those charged with governance his view of the following:

- Any significant qualitative aspects within the Funds' accounting practice;
- Any significant difficulties encountered during the audit;
- Any material weakness in the design, implementation or operating effectiveness of the system of internal control;

- Any significant matters arising from the audit discussed with management;
- Any representations that have been requested from management; and
- Any other matter that is significant.

The findings of the external audit are contained in the ISA 260 report (attached as Appendix 1). Audit Scotland will present the report and answer any questions arising.

The External Auditor will issue a further annual report in late 2014. That report will summarise all significant matters arising from the audit, together with overall conclusions as to the management of key risks. This will be considered by the Pensions Audit Sub-Committee and Pensions Committee at meetings on 16 and 17 December 2014 respectively.

Audited Annual Report 2014 for Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund

- 3.2 With the completion of the work of the External Auditor, the Audited Annual Report 2014 for the Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund has been finalised and is included at Appendix 2. The Independent Auditor's Report, including certification, can be found on page 93. There are no qualifications to this report.
- 3.3 The only numerical adjustment made to the unaudited financial statements as a result of the external audit is shown in the Net Assets Statement. Whilst there is no change to total Current Assets, there is a movement between external debtors and the balance due from City of Edinburgh Council of £2.869M. This reflects the billing of discretionary unfunded pension payments, that is compensatory added years and ex gratia payments, to the employing authority. The analysis of total debtors has been adjusted accordingly, with the balance attributable to the Council being increased by this sum and external debtors reduced.
- 3.4 Some minor presentational changes have also been incorporated.

Measures of success

- 4.1 The prime objective of the Council, as administering authority of the Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund, is to ensure an unqualified audit opinion of the Annual Report 2014. This has been achieved.

Financial impact

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

Risk, policy, compliance and governance impact

- 6.1 The financial statements have been prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2013/14 and also in compliance with the requirements of the Local Government Scotland Act 1973.

Equalities impact

- 7.1 There are no adverse equalities impacts arising from this report.

Sustainability impact

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

Consultation and engagement

- 9.1 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.

Alastair Maclean

Director of Corporate Governance

John Burns, Pensions & Accounting Manager

E-mail: john.burns@edinburgh.gov.uk | Tel: 0131 469 3711

Links

Coalition pledges

Council outcomes CO26 –The Council engages with stakeholders and works in partnership to improve services and deliver on agreed objectives.

Single Outcome Agreement

Appendices ISA 260 Report by Audit Scotland
Audited Annual Report 2014 for the Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund

Lothian Pension Funds

**Report to those charged
with governance on the
2013/14 audit**



Prepared for members of the Pensions Audit Sub-Committee, Pensions Committee and the
Controller of Audit
September 2014

Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. It provides services to the Auditor General for Scotland and the Accounts Commission. Together they ensure that the Scottish Government and public sector bodies in Scotland are held to account for the proper, efficient and effective use of public funds.

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Introduction

1. International Standard on Auditing (UK and Ireland) 260 (ISA 260) requires auditors to report specific matters arising from the audit of the financial statements to those charged with governance of a body in sufficient time to enable appropriate action.
2. This report sets out for consideration of the Pensions Audit Sub-Committee and the Pensions Committee the matters arising from the audit of the financial statements for 2013/14 that require to be reported under ISA 260. We are drawing to your attention those matters we think are worthy of note, so that you can consider them before the financial statements are approved and certified. An audit of the financial statements is not designed to identify all matters that may be relevant to those charged with governance. It is the auditor's responsibility to form and express an opinion on the financial statements prepared by management, however this does not relieve management of their responsibilities in this respect. This report has been prepared for the use of Lothian Pension Funds and no responsibility to any third party is accepted.

Status of the Audit

3. Our work on the financial statements is now substantially complete. The issues arising from the audit were included in a matters arising schedule discussed with the Pensions and Accounting Manager and the Investment and Pensions Service Manager on 15 August 2014.
4. We received the unaudited financial statements on 7 June 2014, in advance of the agreed timetable. The working papers were of a high standard and the staff provided good support to the audit team and we completed our on-site fieldwork on 1 August 2014.

Matters to be reported to those charged with governance

Conduct and scope of the audit

5. Information on the integrity and objectivity of the appointed auditor and audit staff, and the nature and scope of the audit, were outlined in the Annual Audit Plan presented to the Pensions Committee on 24 March 2014 and follow the requirements of the Code of Audit Practice prepared by Audit Scotland in May 2011.
6. As part of the requirement to provide full and fair disclosure of matters relating to our independence we can confirm that we have not undertaken non-audit related services. The 2013/14 agreed fee for the audit was disclosed in the Annual Audit Plan and as we did not require to carry out any additional work outwith our planned audit activity this fee remains unchanged.

Fraud

7. In our Annual Audit Plan we highlighted the responsibility audited bodies have for establishing arrangements to prevent and detect fraud and other irregularities. In presenting this report to

the Pensions Audit Sub-Committee and the Pensions Committee we seek confirmation from those charged with governance of any instances thereof that have arisen that should be brought to our attention. A specific confirmation from management in relation to fraud has been included in the draft letter of representation.

Audit opinion & representations

8. Subject to the satisfactory conclusion of any outstanding matters and receipt of a revised set of financial statements for final review, we anticipate being able to issue an unqualified auditor's report on 23 September (the proposed report is attached at [Appendix A](#)). There are no anticipated modifications to the audit report.
9. We are required to report to those charged with governance all unadjusted misstatements which we have identified during the course of our audit, other than those of a trivial nature which we regard as errors less than £1,000.
10. A number of presentational adjustments were identified within the financial statements during the course of our audit. These were discussed with senior finance officers who agreed to amend the unaudited financial statements. One monetary adjustment was identified and further detail can be found at paragraph 19.
11. As part of the completion of our audit we seek written assurances from the Pensions and Accounting Manager, in his role as Section 95 Officer for pensions, on aspects of the financial statements and judgements and estimates made. A draft letter of representation under ISA580 is attached at [Appendix B](#). This should be signed and returned by the Pensions and Accounting Manager with the signed financial statements prior to the independent auditor's opinion being certified.

Accounting and internal control systems

12. No material weaknesses in the accounting and internal control systems were identified during the audit which could adversely affect the ability to record, process, summarise and report financial and other relevant data so as to result in a material misstatement in the financial statements.

Significant findings from the audit

13. In our view, the following issues require to be brought to your attention regarding the appropriateness of accounting policies or accounting estimates and judgements, the timing of transactions, the existence of material unusual transactions or the potential effect on the financial statements of any uncertainties.
14. **Investment management expenses:** The CIPFA Code on Local Authority Accounting in the UK recommends that investment management expenses be shown as a separate item in the fund account and further analysed in a note. In 2012/13 we highlighted that investment management expenses disclosed in the Pension Fund Accounts and supporting notes did not fully reflect the fees charged. Fees relating to private equity funds were accounted for within

'changes in market value of investments' and 'investment income' and it was not always possible to separately identify these fees. This issue did not relate solely to Lothian Pension Funds but also applied to other Pension Funds in Scotland.

15. Officers stated at the time that they would aim to improve the transparency of management fees in accordance with CIPFA's requirements by consulting with CIPFA, other Local Authority Pension Funds, the Funds' investment managers and custodian. CIPFA has recently published guidance on accounting for pension scheme management costs, to assist fund comparability. Whilst the June 2014 publication date for this guidance made it too late in the accounts preparation cycle for pension funds generally to apply it in 2013/14, Lothian Pension Funds' officers have been working closely with CIPFA on the development of the guidance and have taken the opportunity to review their policy on accounting for management fees for 2013/14.
16. Information from investment managers has allowed the fund to apply the principles of the CIPFA guidance and recognise these particular investment management costs as a cost in the fund account, rather than a reduction in the change in market value of investments. As part of our audit we have reviewed the reasonableness of the methodology applied and sample checked the calculations undertaken to determine the investment management costs. We are satisfied that the application of the methodology is reasonable and has enhanced the transparency of disclosed management expenses within the financial statements. We will continue to review the application of this methodology in future years, and how it contributes to enhanced comparability across pension funds.
17. **Additional Voluntary Contributions (AVCs):** The financial statements include disclosure notes setting out AVCs made by employees in the Lothian Pension Fund and Lothian Buses Pension Fund. However, the notes do not separately identify the contributions and fund values between funds. Pension officers requested that the fund managers provide the AVC figures on a per member basis, to allow the summary information to be presented separately for each fund, however the information made available does not yet enable this reporting for 2013/14.

Resolution: Further narrative has been added to accompany the AVC notes in each Fund. It emphasises that the sums presented relate to both Lothian and Buses members. Officers continue to seek the required information from fund managers to facilitate reporting of additional voluntary contributions separately for the Lothian and Buses Funds in 2014/15.

18. **Group Transfer:** Note 8 of the Lothian Pension Fund accounts discloses a group transfer out of Lothian Pension Fund of £5.287 million. The transfer relates to 37 employees of the Edinburgh College of Art who transferred employment to the University of Edinburgh in August 2011. Unlike individual transfers, which are recognised in the fund accounts on a cash basis, group transfers should be accounted for on an accruals basis. However, no accrual was included in the accounts for 2011/12 or 2012/13 as the respective actuaries had not agreed the transfer value. Agreement on the actual transfer value of £5.287 million was reached on 19 April 2013, at which point the cash settlement was made.

Resolution: Further narrative will be included in note 8 of the 2013/14 Lothian Pension Fund accounts to provide detail on the characteristics of this transfer. For any future bulk (group) transfers, a reasonable estimate of the transfer value based on the best information available should be accrued at the point of transfer, and adjusted as new information is received until such time as the final value is agreed between actuaries and settlement made.

19. **Unfunded Pension Payments:** As per note 17 of the Lothian Pension Fund unaudited accounts, debtors of £14.155 million include £2.869 million in relation to pensions paid on behalf of employers. These unfunded payments relate to items such as the award of discretionary years, where the pension costs are met by the individual employers. Pension payments are paid out through a City of Edinburgh bank account and this unfunded element is recovered through the issue of sales invoices on behalf of City of Edinburgh Council to the relevant employer. However, following system access changes, the sales invoices issued in 2013/14 were posted to the pension fund ledger, rather than City of Edinburgh Council.

Resolution: The debtors balance on the Lothian Pension Fund account has been reduced by £2.869 million to recognise this is properly a City of Edinburgh Council debtor. A compensating increase of £2.869 million has been made to the City of Edinburgh holding account balance, to recognise the payover of the £2.869 million is no longer due. The change in holding account balances has been discussed and agreed with City of Edinburgh Council officers. The impact of these adjustments on the current assets in the pension fund accounts is nil.

20. **Custodian Fees:** During 2013/14 it was highlighted to officers by the custodian system provider, Northern Trust, that the Funds' were due a rebate on custodian fees previously paid. The rebate due to Lothian Pension Fund and Lothian Buses Pension Fund was £0.219 million and £0.021 million respectively. Although the discount partly relates to fees paid in prior years (£0.131 million for Lothian and £0.015 million for Buses), the rebate amounts were recognised fully in the current financial year. This accounting treatment was assessed as having no material effect on the financial statements and we would concur with this approach.

Outstanding matters

21. **ISA 580 - Letter of Representation:** The signed letter of representation is required prior to the auditor's certification of the financial statements.

Acknowledgements

22. We would like to express our thanks to the staff of Lothian Pension Funds for their help and assistance during the audit of this year's financial statements which has enabled us to provide an audit report within the agreed timetable.

Appendix A: Proposed Independent Auditor's Report

Independent auditor's report to the members of City of Edinburgh Council as administering body for Lothian Pension Funds and the Accounts Commission for Scotland

I certify that I have audited the financial statements of Lothian Pension Funds for the year ended 31 March 2014 under Part VII of the Local Government (Scotland) Act 1973. The financial statements comprise the fund accounts, the net assets statements and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union, and as interpreted and adapted by the Code of Practice on Local Authority Accounting in the United Kingdom 2013/14 (the 2013/14 Code).

This report is made solely to the parties to whom it is addressed in accordance with Part VII of the Local Government (Scotland) Act 1973 and for no other purpose. In accordance with paragraph 125 of the Code of Audit Practice approved by the Accounts Commission for Scotland, I do not undertake to have responsibilities to members or officers, in their individual capacities, or to third parties.

Respective responsibilities of the Pensions and Accounting Manager and auditor

As explained more fully in the Statement of Responsibilities, the Pensions and Accounting Manager is responsible for the preparation of financial statements and for being satisfied that they give a true and fair view. My responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) as required by the Code of Audit Practice approved by the Accounts Commission for Scotland. Those standards require me to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the funds' circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Pensions and Accounting Manager; and the overall presentation of the financial statements. In addition, I read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially

inconsistent with, the knowledge acquired by me in the course of performing the audit. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my report.

Opinion on financial statements

In my opinion the financial statements:

- give a true and fair view in accordance with applicable law and the 2013/14 Code of the financial transactions of the funds during the year ended 31 March 2014, and of the amount and disposition at that date of their assets and liabilities;
- have been properly prepared in accordance with IFRSs as adopted by the European Union, as interpreted and adapted by the 2013/14 Code; and
- have been prepared in accordance with the requirements of the Local Government (Scotland) Act 1973 and the Local Government in Scotland Act 2003.

Opinion on other prescribed matters

In my opinion the information given in the sections titled Review of the Year, How the funds work, Investments and Financial Performance for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which I am required to report by exception

I am required to report to you if, in my opinion:

- adequate accounting records have not been kept; or
- the financial statements are not in agreement with the accounting records; or
- I have not received all the information and explanations I require for my audit; or
- the Governance Compliance Statement does not comply with guidance from the Scottish Ministers; or
- the Annual Governance Statement does not comply with Delivering Good Governance in Local Government.

I have nothing to report in respect of these matters.

David McConnell
Assistant Director of Audit
Audit Scotland
4th Floor, South Suite
The Athenaeum Building
8 Nelson Mandela Place
Glasgow, G2 1BT

Date

Appendix B: ISA 580 - Letter of Representation

David McConnell
Assistant Director of Audit
Audit Scotland
4th Floor, South Suite
The Athenaeum Building
8 Nelson Mandela Place
Glasgow, G2 1BT

Dear David

Lothian Pension Funds Annual Accounts 2013/14

This representation letter is provided in connection with your audit of the financial statements of the Lothian Pension Funds for the year ended 31 March 2014 for the purpose of expressing an opinion as to whether the financial statements give a true and fair view of the financial transactions of the funds during the year ended 31 March 2014, and of the amount and disposition at that date of their assets and liabilities.

I confirm to the best of my knowledge and belief, and having made appropriate enquiries of the relevant officers of the Funds, the following representations given to you in connection with your audit of the Lothian Pension Funds for the year ended 31 March 2014.

General

I acknowledge my responsibility and that of the Lothian Pension Funds for the financial statements. All the accounting records requested have been made available to you for the purposes of your audit. All material agreements and transactions undertaken by the funds have been properly reflected in the financial statements. All other records and information have been made available to you, including minutes of all management and other meetings.

The information given in the Annual Report to the financial statements, including Review of the Year, presents a balanced picture of the funds and is consistent with the financial statements.

I confirm that the effects of uncorrected misstatements are immaterial, individually and in aggregate, to the financial statements as a whole. I am not aware of any uncorrected misstatements other than those identified in the auditor's report to those charged with governance (ISA260).

Legality of Financial Transactions

The financial transactions of the funds are in accordance with the relevant legislation and regulations governing its activities.

Financial Reporting Framework

The financial statements have been prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2013/14 and in accordance with the requirements of Local Government (Scotland) Act 1973 including all relevant presentation and disclosure requirements.

Disclosure has been made in the financial statements of all matters necessary for them to show a true and fair view of the transactions and state of affairs of the funds for the year ended 31 March 2014.

Accounting Policies & Estimates

All material accounting policies adopted are as shown in the Statement of Accounting Policies included in the financial statements. The continuing appropriateness of these policies has been reviewed since the introduction of IAS 8 and on a regular basis thereafter, and takes account of the requirements set out in the Code of Practice on Local Authority Accounting in the United Kingdom 2013/14.

The significant assumptions used in making accounting estimates are reasonable and properly reflected in the financial statements. There are no changes in estimation techniques which should be disclosed due to their having a material impact on the accounting disclosures.

Actuarial Assumptions

The pension assumptions made by the actuary in the IAS19 report on the funds have been reviewed and I can confirm that they are consistent with management's own view.

Fraud

I have considered the risk that the financial statements may be materially misstated as a result of fraud. I have disclosed to the auditor any allegations of fraud or suspected fraud affecting the financial statements. There have been no irregularities involving management or employees who have a significant role in internal control or that could have a material effect on the financial statements.

Corporate Governance

I acknowledge, as the officer with responsibility for the proper administration of the Fund's financial affairs under section 95 of the Local Government (Scotland) Act 1973, my responsibility for the corporate governance arrangements and internal controls. I have reviewed the governance compliance statement and the disclosures I have made comply with the guidance from the Scottish Ministers. There have been no changes in the corporate governance arrangements or issues identified, since the 31 March 2014 which require disclosure.

Related Party Transactions

All transactions with related parties have been disclosed in the financial statements. I have made available to you all the relevant information concerning such transactions, and I am not aware of any other matters that require disclosure in order to comply with the requirements of IAS24, as interpreted by the Code of Practice on Local Authority Accounting in the United Kingdom 2013/14.

Investment Assets and Current Assets

On realisation in the ordinary course of the fund's business the investment and current assets in the net asset statement are expected, in my opinion, to produce at least the amounts at which they are stated. In particular, adequate provision has, in my opinion, been made against all amounts owing which are known or may be expected to be irrecoverable.

Investment Liabilities and Current Liabilities

All liabilities have been provided for in the books of account as at 31 March 2014.

Contractual commitments

All outstanding call payments due to unquoted limited partnership funds have been fully included in the accounts for the period to 31 March 2014.

Employer / Employee Contributions

A high level analysis is carried out at the year end comparing the total monthly contributions in the pension system with the amounts recorded in the financial ledger. In addition, monthly checks are performed on contributions received from employers during the year with any unexpected differences followed-up and investigated.

Events Subsequent to the Net Asset Statement

There have been no material events since the date of the net asset statement which necessitate revision of the figures in the financial statements or notes thereto including contingent assets and liabilities.

Since the date of the net asset statement no events or transactions have occurred which, though properly excluded from the financial statements, are of such importance that they should be brought to your notice.

Yours sincerely

John Burns
Pensions and Accounting Manager (s.95 officer for pensions)



2013/14

AUDITED
ANNUAL REPORT
AND
ACCOUNTS

LOTHIAN PENSION FUND
LOTHIAN BUSES PENSION FUND
SCOTTISH HOMES PENSION FUND



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Report from the Convener of the Pensions Committee

I am pleased to introduce the 2013/14 Annual Report for Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund.

This has been another challenging year for local government and for those who deliver services on its behalf. As the 'trustees' of the Local Government Pension Scheme (LGPS) in the Lothian area, I and my colleagues on the Pensions Committee are very conscious of our responsibilities to our 76,000 members and 101 employers.

For a number of years the Consultative Panel has been an integral part of the pension funds' governance. The twelve people on the Panel, representing the members and employers in the Funds, attend meetings of the Pensions Committee and contribute to decision making. However, this was the first full year that two of its members have been part of the Pensions Committee formally recognising the involvement of stakeholders in the Funds' governance. Allison Cosgrove then John Anzani (before/after December 2013 respectively) and Darren May have had full voting rights on the Committee.

This is also the first full year we have had a Pensions Audit Sub-Committee and an independent professional observer, Sarah Smart, in place. Pension issues can be technical and complex and these changes have helped to scrutinise advice in more detail and further strengthen the governance of the Funds. I was particularly pleased that the Lothian Pension Fund won the Engaged Investor Award for its Governance during the year. This is testimony to our commitment to ensuring open and transparent decision making.

The reform of pensions across the public sector moves ahead and the new Scottish Local Government Pension Scheme comes into force in April 2015. It will bring changes to members' benefits as well as changes to governance. We will continue to work closely with our members and employers to support them through the changes.

We welcome the intention to review the structure of the Local Government Pension Scheme in Scotland. Conflicts do arise from the fact that the administering authorities and pension funds are the same legal entity, performing different functions that are the subject of potentially different priorities. We are generally comfortable that our open and transparent governance structure is a strong defence against potential conflicts. However, structural change could make this clearer and more workable. Consistency of data between the funds in Scotland, particularly those relating to investment costs, will also be important for the review and I am pleased to see increased transparency of investment costs in the Funds' accounts.

I would also like to thank all those involved in the management of the Funds over the last year.

Councillor Alasdair Rankin
Pensions Committee Convener
The City of Edinburgh Council
23 September 2014



Report by the
Convener of the
Pensions Audit
Sub-Committee

The new Sub-Committee was created in 2012 following a review of Council and Funds governance. Its role is to assess the control of the Funds to provide assurance of effective and efficient operations and to make appropriate recommendations to the Pensions Committee.

Over the 2013/14 year, the Pensions Audit Sub-Committee met three times. It consists of three members of the Pensions Committee. Two members of the Consultative Panel (Eric Adair and Eric Maclennan) and the independent professional observer also attend. The Sub-Committee considered the 2012/13 accounts, findings from internal and external audits, fraud prevention, recovery of income tax on investment income and the service from the Funds' investment custodian.

Previously the accounts were scrutinised by the City of Edinburgh Council's Audit Committee. I believe the Pensions Sub-Committee, ensures a sharper focus in assessing operations, controls and risks in greater detail. It also draws on appropriate specialist knowledge, understanding and expertise to scrutinise the operation of the Funds.

I am confident the new Audit Sub-Committee provides added benefit to the Funds and ultimately to members and employers.

Councillor Cameron Rose
Audit Sub Committee Convener
The City of Edinburgh Council
23 September 2014



Report by the
Independent
Professional Observer

I was delighted to be appointed to Lothian Pension Fund as an Independent Professional Observer in March 2013. The purpose of my role is to assist the Pensions Committee to exercise their governance responsibilities as effectively and as efficiently as possible.

I have been involved with the world of institutional investment since 1999 and have been a pension trustee of various schemes since 2004. I now hold a portfolio of pension trustee and non-executive positions, all of which provides me with a depth and breadth of experience with which to assist the Pensions Committee.

The Pensions Committee is made up of individuals who have a high level of intelligence and are extremely competent in their own fields. However they are not pensions experts. My job is to help them apply their intelligence and competence to the area of pensions and investment. I do this by attending meetings, helping with training for Committee and Panel members and challenging independent advice to the Funds as appropriate. My role is not to take over the role of governance, but to help the Committee and Consultative Panel members to be better equipped to exercise their governance responsibilities.

Since joining Lothian Pension Fund, members of the Committee have all been very welcoming and have shown enormous enthusiasm for engaging with the issues that they are presented with for consideration. I have been impressed with the level of debate that occurs in Committee meetings and the way in which Committee members challenge recommendations made by the Officers to ensure they fully understand all the consequences of decisions to be made.

Sarah Smart
Independent Professional Observer
23 September 2014

Review of the year

Funding & Investment

During 2013/14 investment markets provided relatively strong returns despite periods of volatility. The Funds all delivered positive returns over the one year period: 6.8%, 8.9% and 2.1% for Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund respectively.

Lothian Pension Fund's Fund Account shows income from members and employers increased marginally from £178m in 2012/13 to £182m in 2013/4. Pensions paid out continued to increase from £113m to £120m as programmes of workforce downsizing continued for some of our larger employers. In total, net additions from dealing with members reduced from £22m to £13m. Investment income of £124m is expected to provide ample cover for future increases in pension payments over the coming years.

Reducing income and increasing expenditure is evident in the Lothian Buses Pension Fund - this is inevitable as the employer has not permitted new employees to join since 2008.

Net dealings with members for Scottish Homes Pension Fund continues to be negative as there are no active members in the Fund and employer contributions are relatively small. The net reduction from dealing with members is broadly unchanged over the year: £6.9m in 2012/13 and £6.7m in 2013/14.

A number of changes have been made to the investments of the Lothian Pension Fund, moving decisively away from portfolios that are constructed based on the size of companies. Assessing a company's ability to preserve capital and for growth is more important for the Funds. Investments held in regional portfolios have also been reduced in favour of global portfolios, as the country in which an investment is listed has become less important in the ever-increasing global economy. Over the long term, the changes are expected to enhance the Fund's risk-adjusted returns. Similar changes have also been made to the investments of Lothian Buses Pension Fund.

The Lothian Pension Fund and the Lothian Buses Pension Fund have also continued to identify and invest in attractive assets within the Alternative category, which includes assets with attractive yields and inflation protection, such as infrastructure and timber. Investments made over the year include co-investments in UK Private Finance Initiative (PFI) projects, such as schools and hospitals, which offer stable income over the term of the concession periods and some protection against inflation.

Unlike most Local Government Pension Schemes, we employ a number of skilled staff that manage some of the investments in-house. During the year, we subjected our investment controls to external scrutiny and this provided comfort that our operations are well structured and effective. It has also provided direction for further improvement in our controls and we will be seeking authorisation from the Financial Conduct Authority over the coming year. This is an important step for the Funds in making them responsive and prepared for the challenges ahead in public sector pensions.

Despite the positive investment markets, there are still significant challenges ahead. The investment and funding outlook for the pension funds remain exceptionally challenging as western economies struggle to show meaningful growth and government bond yields remain stubbornly low. This, together with the abolition of contracting out from the State Earnings Related Pension Scheme, could mean significant increases in costs for employers and higher National Insurance contributions for members. In order to provide budgetary certainty for employers over the next few years, a contribution stability mechanism has been put in place for certain employers in Lothian Pension Fund. The financial position of all three Funds, and the employer contributions for the coming years, will be assessed at the 2014 actuarial valuation.

Customer Service

We continue to use a variety of engagement techniques to develop our understanding of members and employers, for example face to face meetings, surveys and customer journey mapping techniques. Their needs, experiences of our service and their perception of the Funds help us to continually improve and become more efficient and effective. During the year, the Funds were, once again, successful in retaining the Customer Service Excellence award and achieved specific recognition for 'commitment to putting the customer at the heart of service delivery'.

In 2013/14, we increased the use of the online service by offering members the option to carry out retirement and voluntary redundancy quotes online. Over 12,000 members are registered to use the service. Further services will be offered online in the coming year and we expect an upgrade to improve usability of the system.

During the year, our new employer on-line system was rolled out to employers. It facilitates secure electronic data transfer from employers to the Funds, increasing efficiency and reducing the risk of manual errors. A quarter of our employers are now using this facility to provide details of monthly contributions for each member. This ensures any changes in membership are identified and acted upon quickly, facilitating an improved service to members. During 2014/15, monthly reporting will be rolled out to all employers.

We have worked alongside The Pensions Regulator's high profile campaign to warn members of the risk of pension liberation fraud. Our process and documentation relating to pension transfers have been reviewed to try to prevent such fraud and to seek to ensure that members are making fully informed decisions when transferring benefits out of the Funds.

Over the year we also integrated the pensioner payroll system with our pension administration system. The change has reduced risk, increased efficiency and facilitated data reconciliations.

Employers in the Lothian Pension Fund continue to face organisational changes and during the year a number of admitted bodies investigated options to exit the Fund. We continue to work with employers to facilitate changes and also to ensure commitments to the Fund are honoured.

Local Government Pension Scheme Reform

The new Scottish Local Government Pension Scheme will start in April 2015. It will introduce a career average scheme, fundamentally different to the final salary scheme currently in place. Officers have been involved in the development of the new scheme over the year and will continue to do so, as work progresses on the finer detail.

There will be significant communication challenges to explain the new career average pension scheme to both members and employers. It will be more complex to administer and there will also be greater scrutiny of the Funds by The Pensions Regulator.

We are participating in a working group to develop a Scotland-wide communication strategy and liaising with our software provider to ensure that the pension administration system will be updated in a timely manner. We will continue to work closely with our employers and members to support them through the forthcoming changes.

ALASTAIR MACLEAN
Director of Corporate Governance
The City of Edinburgh Council
23 September 2014

CLARE SCOTT
Investment and Pensions Service Manager
The City of Edinburgh Council
23 September 2014

How the Funds work

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 Committee

Membership 1 April 2013 to 31 March 2014



Councillor Alasdair Rankin
(Convener from 22/8/13)



Councillor Maureen Child
(Convener until 21/8/13)



Councillor Jim Orr
(Pensions Audit Sub-
Committee member)
(Resigned 4/3/14)



Councillor Bill Cook
(Pensions Audit Sub-
Committee member)



Councillor Cameron Rose
(Convener of Pensions Audit Sub-
Committee)

John Anzani (nominated
by Consultative Panel)
(Appointed 21/11/13)

Darren May
(nominated
by Consultative Panel)

Allison Cosgrove
(nominated by Consultative
Panel) (Resigned from
Committee 20/11/13)

The Pensions Committee held four meetings during the year. Membership of the Committee during the year is shown above. Changes to the Committee included the appointment of Councillor Rankin as Convener, the resignation of Councillor Orr and the appointment of John Anzani, who replaced Allison Cosgrove.

The Pensions Audit Sub-Committee met three times during the year.

Consultative Panel

The Consultative Panel made up of employer and member representatives act as a sounding board for the Pensions Committee. The Panel made up of six employer representatives and six member representatives. who are shown below.

| Consultative Panel membership 1 April 2013 to 31 March 2014 | | | |
|---|-------------------------------|-----------------------|----------------------|
| | Employer | Representing | |
| Employer representatives | | | |
| Alan Williamson | Edinburgh College | Colleges/universities | |
| Darren May* | Scottish Water | Other employers | |
| Helen Carter | Scottish Government | Scottish Homes | Appointed 16/12/13 |
| Eric Adair | EDI | Other employers | |
| Guy Hughes | Lothian Buses | Lothian Buses | |
| Sharon Dalli | Police Scotland | Other employers | Appointed 19/09/13 |
| Member representatives | | | |
| Charlie Boyd | The City of Edinburgh Council | Active members | |
| Allison Cosgrove | East Lothian Council | Unison | Resigned 31/12/2013 |
| Eric MacLennan | The City of Edinburgh Council | Unison | |
| Owen Murdoch | Retired member | Unison | |
| John Rodgers | Lothian Buses | Unite | |
| John Anzani* | Midlothian Council | Active members | Appointed 24/09/2013 |

* denotes member of the Pensions Committee at 31 March 2014.

Pensions Committee and Consultative Panel training

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

All Committee members undertook extensive training covering key elements of pension legislation and investments. This included induction training for new members and external events including the Reform of the Local Government Pension Scheme (Scotland) Seminar.

Committee members collectively attended 259 hours of training over the year. Panel members undertook 103 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 all three pension funds. The Division functions include investment, pension administration and payroll, 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 and Risk Manager
- Bruce Miller, Investment Manager
- John Burns, Pensions and Accounting 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 advisers are Gordon Bagot, Scott Jamieson and KPMG, represented by David O'Hara.

Investments

Investment markets

With the Bank of England's official interest rate pegged at 0.5%, the lowest rate in its 320 year history by some margin and quantitative easing (bond buying by the central bank) continuing, the new governor, Mark Carney, appears more concerned about the economy's growth potential than the risks of inflation. Carney is not alone amongst global monetary policymakers. However, 2013/14 was the year when outgoing chairman of the US central bank, Ben Bernanke, alerted the world that monetary policy had been so easy for so long that a change was overdue. The word "tapering" entered the financial market lexicon to describe a reduction in the pace of quantitative easing by central banks, effectively a tightening in monetary policy.

The price movements of equities, bonds and currencies around the world over 2013/14 largely demonstrated countries' relative vulnerability to tapering. Given the excellent stock market returns since 2009, investors are obviously nervous about a reversal of policies that have supported asset prices and which foreshadow interest rate increases. Developed world equities in the UK, Europe and the US wobbled occasionally, but marched higher over the year, rising between 8% and 14% in sterling terms. Asian and Emerging Market equities fell, in some cases quite sharply. Worst affected were the prices of assets in countries with large current account deficits where central banks increased interest rates to defend their currencies. This tightening of monetary policy portends slower economic growth and potential repayment problems for issuers of foreign currency denominated debt. Bond markets around the world too produced negative returns over the year, and in the UK, conventional gilts fell 8% and index-linked gilts almost 4%.

Investment strategies

The review of investment strategies for all three funds following the 2011 Actuarial Valuation concluded that there was scope to reduce investment risk over the next few years. Given valuations of fixed income markets, the Funds' current focus is on robust income generation and lower risk from other assets, including equities. The allocations to index-linked gilts provide a good match to liabilities and a measure of diversification for the Funds, but they provide a very low real return.

The Funds have made considerable progress in moving away from market capitalisation benchmarks, which are regarded as sub-optimal, and continue to focus on ways to ensure that the objectives and risk tolerances of individual portfolios are closely aligned with the overall objectives of the Funds as possible. Capital preservation and growth are more important than following an index.

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.

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 majority of the investments of Lothian Pension Fund. Baillie Gifford, UBS and State Street take direct responsibility for stewardship issues in the investments they manage on our behalf.

Over the year, we voted on over 10,500 resolutions at more than 900 company meetings and opposed over 900 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.

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.

Financial performance

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 can be viewed on our website at www.lpf.org.uk/publications.

Administrative Expenses

A summary of the Division's administrative expenditure for 2013/14, against the budget approved by Pensions Committee, is shown in the table below.

The budget focuses on controllable expenditures and therefore excludes all benefit payments and transfers of pensions from the Fund. Similarly, income does not include contributions receivable and pension transfers to the Fund.

The key variances against budget were:-

- Employees - £177k underspend. This arose from savings in unfilled posts and also the timing of recruitment.
- Third party payments -£157k underspend and Supplies and Services -£138k underspend. These resulted from the refund of overpaid global custodian fees and savings in computer system charges.
- Investment management fees -£381k underspend. This saving arose from greater use of in-house investment management expertise, this factor serving to offset additional charges payable from the fee linkage to enhanced Fund Manager investment performance.
- Securities lending revenue exceeded budget by £147k.

Administrative expenses (comparison with approved budget)

| | Approved budget | Actual outturn | Actual variance |
|--|-----------------|----------------|-----------------|
| | £000 | £000 | £000 |
| Employees | 2,161 | 1,984 | (177) |
| Transport | 27 | 25 | (2) |
| Supplies and services | 843 | 705 | (138) |
| Investment Managers fees | 10,093 | 9,712 | (381) |
| Other third party payments | 612 | 455 | (157) |
| Depreciation | 74 | 75 | 1 |
| Direct expenditure | 13,810 | 12,956 | (854) |
| Support costs and office accommodation | 552 | 594 | 42 |
| Income | (870) | (1,017) | (147) |
| Total cost to the Funds | 13,492 | 12,533 | (959) |

The budget excluded certain investment management fees relating to pooled investment funds, including private equity, infrastructure and property. This reflected the previous accounting policy, whereby such costs were included within "changes in market value of investments" and "investment income".

For 2013/14, these costs together with a reconciliation of the gross costs for 2013/14 are shown below in anticipation of CIPFA guidance on greater transparency of investment management fees:

| | Actual outturn |
|---|----------------|
| | £000 |
| Actual outturn on budgeted items above | 12,533 |
| Add back securities lending revenue included in income above | 938 |
| Investment property administration costs | 781 |
| Investment transaction costs | 3,075 |
| Investment management fees deducted from capital | 13,946 |
| Total cost to the Funds (inclusive of full investment management fees) | 31,273 |
| Per Fund Accounts | |
| Lothian Pension Fund | 27,933 |
| Lothian Buses Pension Fund | 3,092 |
| Scottish Homes Pension Fund | 248 |
| Total | 31,273 |

Our service plan and performance




The Fund's vision, objectives, performance indicators and key actions are set out in the annual service plan. Progress of performance indicators and key actions are reported to the Pensions Committee regularly throughout the year and monitored monthly by the Fund's senior management team.

The Fund has three objectives

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

Our key performance indicators are split into three main categories in line with our objectives - customers, staff and performance. Our performance indicator targets and final performance are set out below with comment and analysis thereafter. Investment performance for each pension fund is provided in the relevant section later in this report.

Service plan objective 1 - To provide excellent customer care

| | Target | Actual |
|--|--------|----------|
|  Overall satisfaction of employers, active members and pensioners with our services as measured by surveys | 86% | 85% |
|  Proportion of active members receiving a benefit statement by 30/9/13 | 95% | 96% |
|  Maintain Customer Service Excellence Standard | Retain | Retained |

Customer Service Excellence

Lothian Pension Fund is committed to providing an excellent service to customers. Using the Customer Service Excellence (CSE) framework ensures continuous improvement in our customer services. An annual external assessment monitors how we have improved and developed.

In February 2014, the Pension Fund again retained CSE for another year. The external assessor commented on the high quality and varied approaches the Fund uses for customer consultation ensuring differing customer views are gained. The assessment also noted the many changes the Fund had experienced and commented that 'the leadership have maintained a clear focus on delivering for customers during this difficult period'.

A key area for improvement has been identified as the exchange of information with employer partners and the impact this has. For example, new scheme members who have experienced delay in service from the Fund due to delays caused by some employers.

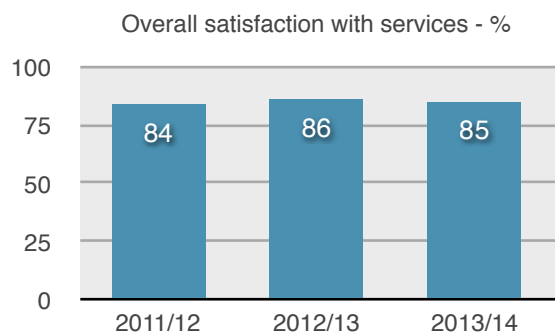
CUSTOMER
SERVICE
EXCELLENCE

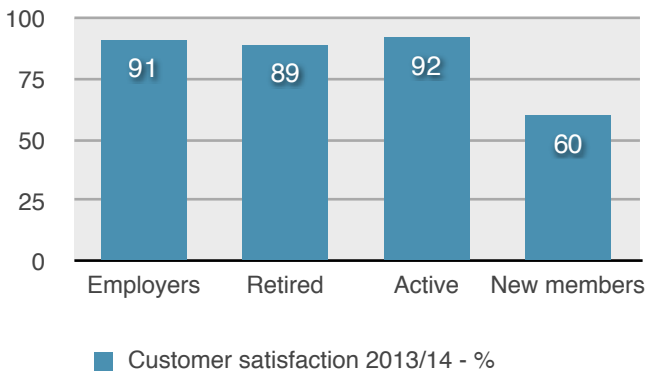


Surveys

Our overall customer satisfaction, measured by employers, retired, new and active scheme members, was 85%, marginally below the 86% target.

Satisfaction of employers, retired and active members is approximately 90%. However, new members satisfaction continues to be lower due largely to delays in receiving information about the pension scheme.





The Fund has implemented a number of improvements to ensure improved partnership working and data exchange including the new employer online system for data transfer. It is expected that these activities will improve the service for new scheme members.

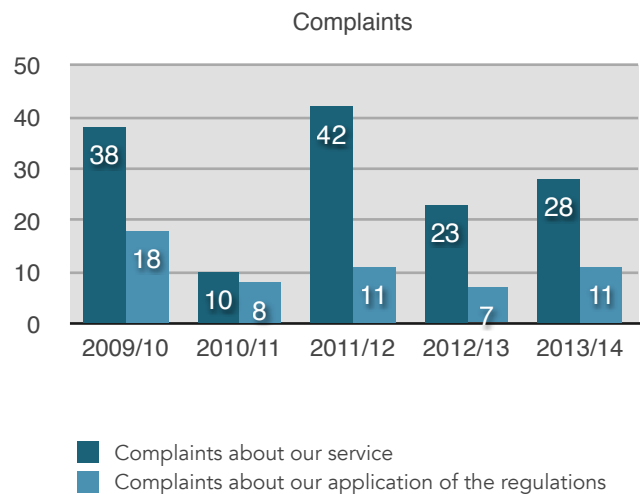
Complaints

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 our application of the regulations



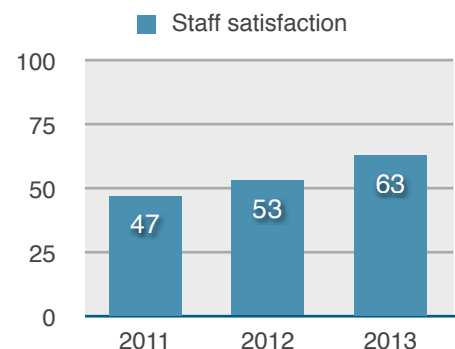
The graph shows the number of complaints in each of the categories. These represent less than 0.2% percentage of the procedures (over 19,000) we carried out in 2013/14.

Service plan objective 2 - Support and develop staff

| | Target | Actual |
|---|--------|--------|
| ✓ Level of sickness absence | 4% | 2.2% |
| ✓ Staff satisfaction with present job | 60% | 63% |
| ✓ Minimum number of days training per year for each member of staff | 2 days | 2 days |

The Fund recognises that staff are at the heart of our business and key to delivering our objectives. Over the last year the management team have reviewed development opportunities for staff and ensured that all staff had a minimum of two days training during the year. We have also involved staff in key service improvement projects. In addition, regular one to one meetings, team meetings and staff updates keep everyone informed of developments and provide opportunities to share opinions and make service improvement suggestions.

Key indicators for staff in 2013/14 are overall staff satisfaction, sickness absence levels and training hours completed. All targets were achieved. The sickness absence rate was low at 2.24% and overall job satisfaction rose 10% to 63%.

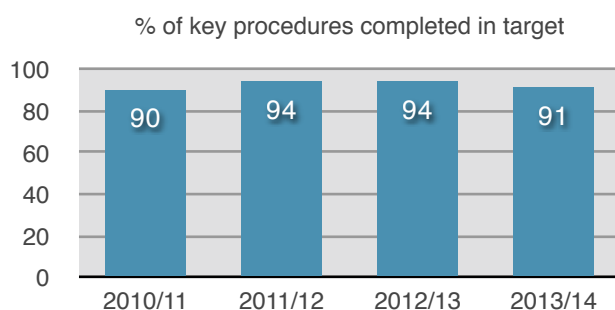


Service plan objective 3 - To continue to be a top performing Fund

| To continue to be a top performing fund | | Target | Actual |
|---|---|---------------------|-----------------|
| ✓ | Percentage of critical pensions administration work completed within standards | 90% | 91% |
| ✓ | Audit of annual financial statements | Unqualified opinion | Yes |
| ✓ | Data quality - compliance with best practice as defined by the Pensions Regulator | Fully compliant | Fully compliant |
| ⚠ | Employer contributions paid within 19 days of month end | 98% | 96% |

Pensions Administration

The dedicated in-house team provides pension administration services for the Funds. The time it takes to complete our procedures is monitored. Key procedures include processing of retirement and dependent benefits, providing information for new members, transfers and retirement quotes. Performance for these key procedures over the year 2013/14 showed 91% of the work completed was within target.



Data quality

The administration of pensions relies on good data. Along with our 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 the 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 | | |
| Fund-scheme specific measurement including date of joining; pensionable remuneration; date of leaving and reasons for leaving etc. | 98% | 98% |

The Pensions Administration Strategy

The Fund's Pensions Administration Strategy highlights the duties and performance standards for the Fund and participating employers.

As a Fund we rely on employers providing prompt information to ensure we can provide timely and accurate services to our members. We monitor employer performance regularly and update employers on their performance both individually and on a fund-wide basis at our employer events. During 2012/13, we met with our largest employers to discuss performance and have worked with them to improve, providing training and holding follow-up meetings to assess improvements where appropriate.

Employer performance for 2013/14 and 2012/13 for comparison is shown below.

| Case type | Target (working days) | 2012/13 | | | 2013/14 | | |
|------------------|-----------------------|-----------------|----------------------|-----------------|-----------------|----------------------|-----------------|
| | | Number received | Number within target | % within target | Number received | Number within target | % within target |
| New member | 20 | 2693 | 2386 | 89% | 4069 | 2812 | 69% |
| Leaver | 20 | 592 | 380 | 64% | 1006 | 384 | 38% |
| Retirement | 20 | 803 | 314 | 39% | 778 | 374 | 48% |
| Death in service | 10 | 37 | 7 | 19% | 42 | 23 | 55% |

In 2013/14, the proportion of retirement and death in service cases where we have received information from employers within target timescales increased from 2012/13. However information continues to be received later than target for a significant proportion of these cases.

In contrast the proportion of cases when we receive information on new members and leavers from employers within target timescales has worsened over the year. In both cases, this is due to efforts to rectify outstanding queries relating to member data. Of the 4,069 new members in 2013/14, 574 related to members who joined in the previous financial year (2012/13). 64% of these cases were received from employers late. Similarly, 457 of the 1,006 leavers processed in 2013/14 related to leavers in the prior financial year (2012/13) and 96% of these were late.

Efforts to ensure employers send details of membership changes promptly to the Fund are continuing, including further roll-out of monthly contribution submission to the Fund.

Employer contributions

The Pensions Act 1995 requires employers to pay pension contributions by the 19th of the month following the deduction from an employee's pay. This requirement is highlighted in the Pensions Administration Strategy and to all new employers on joining the Fund.

We monitor this requirement via our key performance indicators to ensure compliance with the Act. The target for 2013/14 was 98% of pension contributions to be paid in time. Actual performance was 96% and the dip in performance was largely due to a banking error that delayed a large payment by two days.

Of the 1,185 payments made to the Fund in 2013/14, 57 payments were later than the target of the 19th of the month. They are shown below:

| Employer | Number of late payments |
|--|-------------------------|
| Barony Housing Association | 1 |
| Broomhouse Centre Representative Council | 2 |
| Centre for the Moving Image | 1 |
| Children First | 1 |
| Children's Hearing Scotland | 2 |
| Compass Group | 1 |
| Dawn Construction | 2 |
| Edinburgh College | 6 |
| Edinburgh World Heritage | 1 |
| Edinburgh Leisure | 2 |
| Enjoy East Lothian | 1 |
| Festival City Theatres Trust | 2 |
| First Step | 1 |

| Employer | Number of late payments |
|---------------------------------|-------------------------|
| Granton Information Centre | 2 |
| Into Work | 2 |
| The Improvement Service | 1 |
| Keymoves | 1 |
| Police Scotland | 2 |
| Pilton Community Health Project | 4 |
| Royal Edinburgh Military Tattoo | 2 |
| Scotland's Learning Partnership | 1 |
| Scottish Fire & Rescue Service | 1 |
| Skanska | 3 |
| St Columba's Hospice | 1 |
| Stepping Out Project | 2 |
| Streetwork | 4 |
| Victim Support Scotland | 1 |
| West Lothian College | 1 |
| West Lothian Council | 1 |
| Waverley Care Trust | 3 |
| Young Scot Enterprise | 2 |

Statement of accounting policies and general notes

1 Basis of preparation

The Statement of Accounts summarises the transactions of the Funds for the 2013/14 financial year and their position at year-end as at 31 March 2014. The accounts have been prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2013/14 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 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) Income from unquoted private equity and infrastructure investments

Income from the above sources is recognised when it is notified by the manager. Distributions are split into capital and income elements with the latter being included under investment income in the Fund Account.

v) Property related income

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

During the year the accounting policy was changed and rental income is now reported gross with the operational costs of the properties included in investment management expenses (see note 11 to the accounts of Lothian Pension Fund). There is no impact on the net increase in fund during the year (see note 24 to the accounts of Lothian Pension Fund).

Contingent rents based on the future amount of a factor that changes other than with the passage of time, such as turnover rents, are only recognised when contractually due.

vi) Movement in the net market value of investments

Changes in the net market value of investments (including investment properties) are recognised as income and comprise all realised and unrealised profits/losses during the year.

Fund account - expense items

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

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. 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 on an accruals basis.

Fees of the external investment managers and custodian are agreed in the respective mandates governing their appointments. Broadly, these are based on the market value of the investments under their management and therefore increase or reduce as the value of these investments change. For some investment managers, an element of their fee is performance related. The amount of any performance related fees paid is disclosed in the note to the accounts on investment management expenses provided for each Fund.

The cost of administering the Local Government Pension Scheme in the UK has come under increasing scrutiny in recent years. As a result, the decision has been made to change the policy on accounting for investment management expenses. This means that investment management costs that are deducted from the value of an investment are now recognised as a cost in the Fund Account rather than as a reduction in the change in market value of investments. Investment transaction costs that are added to an investment purchase price or deducted from the proceeds of a sale are also now recognised as a cost in the Fund Account rather than as a reduction in the change in market value of investments. Both categories of expense are disclosed separately in the notes to the accounts of each of the Funds under investment management expenses.

The changes have no impact on net results for the year for any of the Funds, details for the prior year adjustments made can be found in the notes to the accounts (see note 24 to the accounts of Lothian Pension Fund and notes 19 to the accounts of both Lothian Buses Pension Fund and Scottish Homes Pension Fund).

Any indirect costs incurred through the bid-offer spread on some pooled investment vehicles are not treated as an expense. Such costs are accounted for as part of the acquisition costs or sale proceeds.

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

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

h) Operating lease

Lease payments under an operating lease are recognised as an expense on a straight-line basis over the term of the lease. In accordance with SIC 15, lease incentives are recognised as a reduction in the lease expense over the term of the lease on a straight-line basis.

Net assets statement

i) 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 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 2014 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.

j) Foreign currency transactions and balances

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

k) 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.

l) Cash and cash equivalents

Cash comprises cash in hand and demand deposits.

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

m) Financial liabilities

The Funds recognise financial liabilities at fair value as at the reporting date. A financial liability is recognised in the net assets statement on the date the 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.

n) Actuarial present value of promised retirement benefits

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

As permitted under 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.

o) Additional voluntary contributions

The Lothian Pension Fund and Lothian Buses Pension Fund provide an additional voluntary contributions (AVC) scheme for their members, the assets of which are invested separately from those of the Funds. The Funds have appointed Standard Life and Prudential as their AVC providers. AVCs are paid to the AVC providers by employers and are specifically for providing additional benefits for individual contributors. Each AVC contributor receives an annual statement showing the amount held in their account and the movements in the year.

In accordance with regulation 5(2)(b) of the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 1998, AVCs are not included in the pension fund financial statements. Details of contributions paid and the total value of funds invested are disclosed by way of note.

3 Accounting Standards that have been issued but not yet adopted

The Code requires the disclosure of information relating to the impact of an accounting change that will be required by a new standard that has been issued but not yet adopted. This applies to the adoption of the following new or amended standards within the 2014/15 Code:

- IFRS 13 Fair value measurement
- IAS 32 Financial instruments: Presentation
- Annual improvements to IFRSs 2009 - 2011 cycle

The Code requires implementation from 1 April 2014 and there is therefore no impact on the 2013/14 financial statements.

The IFRS and IAS improvements are generally minor, principally providing clarification. Overall, these new or amended standards are not expected to have a significant impact on the financial statements.

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 2014 was £527.2m (2013 £508.5m).

For the Lothian Buses Pension Fund, the value of unquoted private equity and infrastructure investments at 31 March 2014 was £11.3m (2013 £12.2m).

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 2014 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 2014 | Approx % increase in liabilities % | Approx monetary amount £m |
|---|---|------------------------------------|
| 0.5% decrease in discount rate | 9 | 516 |
| 1 year increase in member life expectancy | 3 | 168 |
| 0.5% increase in salary increase rate | 4 | 214 |
| 0.5% increase in pensions increase rate | 5 | 298 |

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 2014 | Approx % increase in liabilities % | Approx monetary amount £m |
|---|---|------------------------------------|
| 0.5% decrease in discount rate | 10 | 36 |
| 1 year increase in member life expectancy | 3 | 11 |
| 0.5% increase in salary increase rate | 4 | 14 |
| 0.5% increase in pensions increase rate | 5 | 22 |

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 2014 | Approx % increase in liabilities % | Approx monetary amount £m |
|---|---|------------------------------------|
| 0.5% decrease in discount rate | 7 | 9 |
| 1 year increase in member life expectancy | 3 | 4 |
| 0.5% increase in pensions increase rate | 7 | 9 |

b) Valuation of 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.

C) Quantifying the cost of investment fees deducted from capital

Uncertainties

Section g) above describes the accounting policy for investment management expenses in relation to expenses deducted from the capital value of investments. Quantification of these costs involves asking the relevant managers for information and only some of this information can be independently verified. In cases where the charges relate to an investment as a whole, an estimate needs to be made of the costs applicable to the holding owned by the relevant Fund.

Effect if actual results differ from assumptions

There is a risk that the cost of investment fees deducted from capital may be under or overstated. However, as the costs are included in the fund account by adjusting the change in market value of investments, any inaccuracy in the cost estimate will not change the reported net change in the fund for the year.

Lothian Pension Fund

Membership records

| Status | Membership at 31/03/2012 | Membership at 31/03/2013* | Membership at 31/03/2014 |
|--------------|--------------------------|---------------------------|--------------------------|
| Active | 28,337 | 28,869 | 30,622 |
| Deferred | 15,392 | 16,600 | 16,482 |
| Pensioners | 18,905 | 20,484 | 19,972 |
| Dependants | 3,720 | 4,064 | 3,770 |
| Total | 66,354 | 70,017 | 70,846 |

*Figures have been adjusted from 2012/3 annual report to include Councillor members

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 2014 the contribution rates were as follows:

| Full time equivalent pensionable pay (rate of pay on 31/3/2014) | Rate |
|---|-------------------------|
| Less than £20,382 | 5.5% |
| Between £20,383 and £26,489 | Between 5.6% and 6.0% |
| Between £26,490 and £33,254 | Between 6.1% and 6.5% |
| Between £33,255 and £46,876 | Between 6.6% and 7.5% |
| Between £46,877 and £52,810 | Between 7.6% and 8.0% |
| Between £52,811 and £70,711 | Between 8.1% and 9.0% |
| Between £70,712 and £106,974 | Between 9.1% and 10.0% |
| Between £106,975 and £245,412 | Between 10.1% and 11.2% |

Employers' contributions are set at the triennial actuarial valuation. The contribution rates for the year ended 31 March 2014 were based on the actuarial valuation as at 31 March 2011. This valuation resulted in a common contribution rate (i.e. the average of the employers contributions) of 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 2014/15, the rates for the four Council's as major employers ranged from 16.6% to 17.2% for service currently being accrued plus a fixed amount towards the past service deficit.

In December 2013, Lothian Pension Fund introduced a Contribution Stability Mechanism for contribution rates for some employers until March 2021. In developing this proposal, the Fund commissioned, from its Actuary, detailed financial modelling of liability and asset cashflows under a range of scenarios. Membership factors and salary growth assumptions were taken into account. Forecasts were made over the long-term horizon relevant to the Local Government Pension Scheme. Currently, total contributions received by the Lothian Pension Fund remain sufficient to pay pension benefits. The Fund, however, is expected to move to a cashflow negative position in the near future and when / if it does investment income will be used to pay pensions, rather than reinvesting. The Fund continues to regularly monitor its cashflows.

More information on funding can be found in the Actuarial Statement for 2013/14 at the end of this section.

Work has commenced on the triennial actuarial valuation at 31 March 2014. At the last valuation in 2011, the funding level calculated by the Fund's actuary was 96%.

Investment strategy

The Pensions Committee approved the Investment Strategy 2012-17 for Lothian Pension Fund in October 2012. The general thrust of the strategy is to reduce the Fund's investment risk in the long term by focusing on capital preservation, durable investment income generation and a reduction in the absolute volatility of the Fund.

The investment strategy is set at the broad asset class level of Equities, Index-Linked gilts and Alternatives, which are the key determinants of investment risk and return. The Equities category includes listed and unlisted equities; Index-Linked Assets includes index-linked gilts, bonds and gold; Alternatives include property, infrastructure, timber and fixed income assets, such as corporate bonds.

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

| | Interim benchmark at 31 March 2014 | Strategy for 2012-2017 | Asset allocation limits minimum - maximum |
|--------------------|---------------------------------------|---------------------------|--|
| | % | % | % |
| Equities | 70 | 65 | 50 - 75 |
| Index-linked gilts | 5 | 7 | 0 - 20 |
| Alternatives | 24 | 28 | 20 - 35 |
| Cash | 1 | 0 | 0 - 10 |
| Total | 100 | 100 | n/a |

The objectives of the Fund were redefined in December 2012 and are:

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

The Fund is gradually implementing the strategy and will continue to do so over the next few years. Progress is dependent on finding attractive assets in the Alternatives category to provide the desired return and diversification.

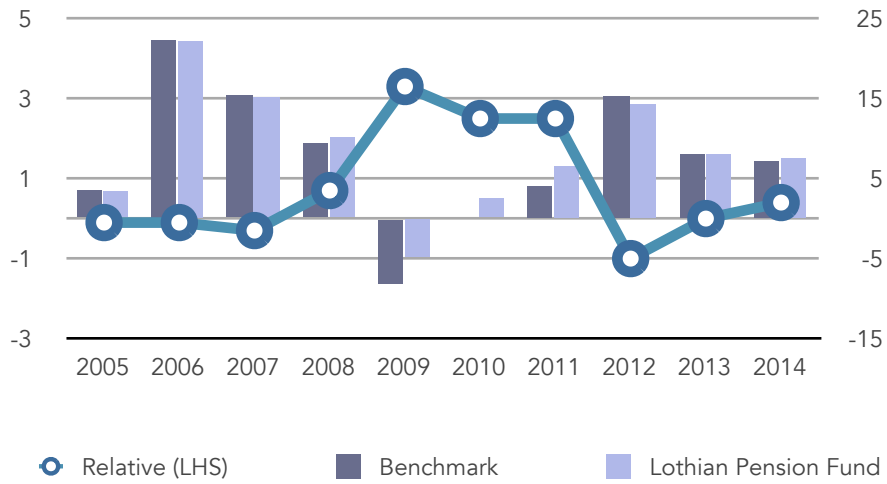
Investment performance

Annualised returns to 31 March 2014 (% per year)

| | 1 year | 3 years | 10 years |
|----------------------------|--------|---------|----------|
| Lothian Pension Fund | 6.8 | 7.6 | 8.3 |
| Benchmark | 5.2 | 7.2 | 7.4 |
| Retail Price Index (RPI) | 2.5 | 3.1 | 3.3 |
| Consumer Price Index (CPI) | 1.7 | 2.6 | 2.8 |
| National Average Earnings | 1.5 | 0.9 | 2.7 |

The absolute performance of Lothian Pension Fund over the 12-month period was +6.8% and the 3 year performance was +7.6% per annum. Over 10 years, the Fund returned +8.3% per annum, well ahead of measures of inflation, and national average earnings.

Annualised 3 yearly returns ending 31 March (% per year)



| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 |
|------------------|-------|-------|-------|------|-------|------|------|-------|------|------|
| Fund | 3.4 | 22.2 | 15.1 | 10.1 | (4.8) | 2.5 | 6.6 | 14.3 | 8.1 | 7.6 |
| Benchmark | 3.5 | 22.3 | 15.4 | 9.4 | (8.1) | 0.0 | 4.1 | 15.3 | 8.1 | 7.2 |
| Relative | (0.1) | (0.1) | (0.3) | 0.7 | 3.3 | 2.5 | 2.5 | (1.0) | 0.0 | 0.4 |

Lothian Pension Fund

Fund Account for year ended 31 March 2014

| 2012/13 Restated* £000 | | <i>Note</i> | 2013/14 £000 |
|-------------------------------|---|-------------|-----------------|
| Income | | | |
| 137,821 | Contributions from employers | 2 | 140,721 |
| 40,194 | Contributions from members | 3 | 41,363 |
| 4,484 | Transfers from other schemes | 4 | 4,280 |
| 182,499 | | | 186,364 |
| Less: expenditure | | | |
| 113,181 | Pension payments including increases | 5 | 120,434 |
| 33,176 | Lump sum retirement payments | 6 | 34,942 |
| 5,362 | Lump sum death benefits | 7 | 5,331 |
| 191 | Refunds to members leaving service | | 235 |
| 147 | Premiums to State Scheme | | 186 |
| 6,152 | Transfers to other schemes | 8 | 10,392 |
| 1,925 | Administrative expenses | 9 | 1,943 |
| 160,134 | | | 173,463 |
| 22,365 | Net additions from dealing with members | | 12,901 |
| Returns on investments | | | |
| 85,887 | Investment income | 10 | 124,526 |
| 431,875 | Change in market value of investments | 12a, 13b | 171,440 |
| (26,091) | Investment management expenses | 11 | (25,990) |
| 491,671 | Net returns on investments | | 269,976 |
| 514,036 | Net increase in the Fund during the year | | 282,877 |
| 3,580,623 | Net assets of the Fund at 1 April 2013 | | 4,094,659 |
| 4,094,659 | Net assets of the Fund at 31 March 2014 | 13a | 4,377,536 |

*The results for the year ended 31 March 2013 have been restated to reflect a change in the accounting policy on investment management expenses. This change has the effect of increasing the reported investment income by £1.203m; increasing the change in market value of investment by £15.316m and increasing investment management expenses by £16.519m. There is no change in the net returns on investment. See note 24 for details.

Lothian Pension Fund

Net Assets Statement as at 31 March 2014

| 31 March 2013 | | 31 March 2014 |
|----------------------------|--|---------------|
| £000 | <i>Note</i> | £000 |
| Investments | | |
| 4,086,938 | Assets | 4,349,645 |
| (25,042) | Liabilities | (6,335) |
| 4,061,896 | <i>12, 14</i> | 4,343,310 |
| Fixed assets | | |
| 157 | Computer systems | 397 |
| 157 | | 397 |
| Current assets | | |
| 4,355 | The City of Edinburgh Council | 7,819 |
| 34,616 | Cash balances | 31,734 |
| 10,299 | Debtors | 11,286 |
| 49,270 | | 50,839 |
| Current liabilities | | |
| (16,664) | Creditors | (17,010) |
| (16,664) | | (17,010) |
| 32,606 | Net current assets | 33,829 |
| 4,094,659 | Net assets of the Fund at 31 March 2014 | 4,377,536 |

The unaudited accounts were issued on 17 June 2014 and the audited accounts were authorised for issue on 23 September 2014.

JOHN BURNS FCMA CGMA
Pensions and Accounting Manager
23 September 2014

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 the balance sheet date

There have been no events since 31 March 2014, 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:-

| | 2012/13 £000 | 2013/14 £000 |
|-----------------------------|-----------------|-----------------|
| By category | | |
| Percentage of pay | 103,781 | 107,927 |
| Fixed deficit contribution | 24,711 | 24,756 |
| Strain costs | 8,929 | 7,870 |
| Cessation contribution | 400 | 168 |
| | 137,821 | 140,721 |
| By employer type | | |
| Administering Authority | 56,359 | 56,472 |
| Other Scheduled Bodies | 65,143 | 67,659 |
| Community Admission Bodies | 16,090 | 16,292 |
| Transferee Admission Bodies | 229 | 298 |
| | 137,821 | 140,721 |

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

| | 2012/13 £000 | 2013/14 £000 |
|-----------------------------|-----------------|-----------------|
| By employer type | | |
| Administering Authority | 15,694 | 16,172 |
| Other Scheduled Bodies | 19,047 | 19,433 |
| Community Admission Bodies | 5,394 | 5,686 |
| Transferee Admission Bodies | 59 | 72 |
| | 40,194 | 41,363 |

4 Transfers in from other pension schemes

| | 2012/13 £000 | 2013/14 £000 |
|----------------------|-----------------|-----------------|
| Group transfers | - | - |
| Individual transfers | 4,484 | 4,280 |
| | 4,484 | 4,280 |

| | | |
|--|---------|---------|
| 5 Pensions payable | 2012/13 | 2013/14 |
| By employer type | £000 | £000 |
| Administering Authority | 58,752 | 62,517 |
| Other Scheduled Bodies | 45,050 | 47,937 |
| Community Admission Bodies | 9,288 | 9,883 |
| Transferee Admission Bodies | 91 | 97 |
| | 113,181 | 120,434 |
| 6 Lump sum retirement benefits payable | 2012/13 | 2013/14 |
| By employer type | £000 | £000 |
| Administering Authority | 16,740 | 15,131 |
| Other Scheduled Bodies | 12,733 | 17,289 |
| Community Admission Bodies | 3,573 | 2,477 |
| Transferee Admission Bodies | 130 | 45 |
| | 33,176 | 34,942 |
| 7 Lump sum death benefits payable | 2012/13 | 2013/14 |
| By employer type | £000 | £000 |
| Administering Authority | 2,836 | 2,453 |
| Other Scheduled Bodies | 2,310 | 2,340 |
| Community Admission Bodies | 216 | 489 |
| Transferee Admission Bodies | - | 49 |
| | 5,362 | 5,331 |
| 8 Transfers out to other schemes | 2012/13 | 2013/14 |
| | £000 | £000 |
| Group transfers | - | 5,287 |
| Individual transfers | 6,152 | 5,105 |
| | 6,152 | 10,392 |
| <p>The group transfer was for 37 employees of the Edinburgh College of Art to the Universities Superannuation Scheme. The actuaries agreed the value on 19 April 2013 and it was paid on that day.</p> | | |
| 9 Administrative expenses | 2012/13 | 2013/14 |
| | £000 | £000 |
| Employee costs | 1,020 | 1,042 |
| The City of Edinburgh Council - pension payroll costs | 222 | 111 |
| The City of Edinburgh Council - other support costs | 276 | 262 |
| System costs | 183 | 197 |
| Actuarial fees | 23 | 75 |
| External audit fees | 41 | 43 |
| Legal fees | 87 | 64 |
| Printing and postage | 32 | 38 |
| Depreciation | 38 | 63 |
| Office costs | - | 40 |
| Sundry costs less sundry income | 3 | 8 |
| | 1,925 | 1,943 |

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. 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. Other costs are allocated on the basis of the number of members in each pension fund.

| 10 Investment income | 2012/13 £000 | 2013/14 £000 |
|---|-------------------------|-------------------------|
| Income from fixed interest securities | 11,146 | 10,911 |
| Dividends from equities | 49,976 | 84,814 |
| Unquoted private equity and infrastructure | 5,074 | 9,472 |
| Income from pooled investment vehicles | 579 | 960 |
| Gross rents from properties | 18,605 | 19,022 |
| Interest on cash deposits | 1,354 | 617 |
| Stock lending and sundries | 1,119 | 1,345 |
| | 87,853 | 127,141 |
| Irrecoverable withholding tax | (1,966) | (2,615) |
| | 85,887 | 124,526 |
| 11 Investment management expenses | 2012/13 £000 | 2013/14 £000 |
| External management fees - invoiced | 7,878 | 7,542 |
| External management fees - deducted from capital | 13,376 | 13,318 |
| Transaction costs | 2,030 | 2,805 |
| Property operational costs | 1,203 | 781 |
| Employee costs | 664 | 772 |
| Custody fees | 364 | 206 |
| Engagement and voting fees | 67 | 68 |
| Performance measurement fees | 45 | 56 |
| Investment consultancy fees | 66 | 40 |
| System costs | 132 | 141 |
| Legal fees | 134 | 109 |
| The City of Edinburgh Council - other support costs | 100 | 104 |
| Office costs | - | 16 |
| Sundry costs | 32 | 32 |
| | 26,091 | 25,990 |

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. 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 based on the value of the Funds as at the year end.

Following a change in accounting policy, the expenses for 2012/13 have been restated to account for costs that were deducted from capital and therefore impacted the change in market value of investments reported in the Fund Account. The related costs are included above as external management fees deducted from capital. Investment transaction costs that were previously added to the cost of purchases or deducted from the proceeds are now accounted for as expenses and shown above as transaction costs. In addition, operational costs on property that were previously netted against rental income are now reported separately.

Any indirect costs incurred through the bid-offer spread on some pooled investment vehicles are reflected in the cost of investment acquisitions or in the proceeds of investment sales (see note 12a - Reconciliation of movements in investments and derivatives).

The external investment management fees above include £3.056m in respect of performance-related fees (2012/13 £3.504m).

| | 31 March 2013 £000 | 31 March 2014 £000 |
|---|--------------------------|--------------------------|
| 12 Net investment assets | | |
| Fixed interest securities | 326,829 | 318,215 |
| Equities | 2,718,320 | 2,866,444 |
| Pooled investment vehicles | 582,535 | 598,687 |
| Properties | 251,480 | 270,753 |
| Derivatives | | |
| Futures | 1,067 | 304 |
| Forward foreign exchange | 3,262 | 9,977 |
| | 4,329 | 10,281 |
| Cash deposits | | |
| Margin balances | 1,769 | 894 |
| Deposits | 187,608 | 257,749 |
| | 189,377 | 258,643 |
| Other investment assets | | |
| Due from broker | 3,029 | 12,553 |
| Dividends and other income due | 11,039 | 14,067 |
| | 14,068 | 26,620 |
| Total investment assets | 4,086,938 | 4,349,643 |
| Investment liabilities | | |
| Derivatives | | |
| Futures | (622) | (91) |
| Forward foreign exchange | (20,844) | (268) |
| | (21,466) | (359) |
| Other financial liabilities - due to broker | (3,576) | (5,974) |
| Total investment liabilities | (25,042) | (6,333) |
| Net investment assets | 4,061,896 | 4,343,310 |

12a Reconciliation of movement in investments and derivatives

| | Market value at 1 April 2013 £000 | Purchases at cost and derivative payments £000 | Sale proceeds and derivative receipts £000 | Change in market value £000 | Market value at 31 March 2014 £000 |
|--------------------------------------|---|--|--|---|--|
| Fixed interest | 326,829 | 142,683 | (136,047) | (15,250) | 318,215 |
| Equities | 2,718,320 | 1,826,082 | (1,796,521) | 118,563 | 2,866,444 |
| Pooled investment vehicles | 582,535 | 65,326 | (68,717) | 19,543 | 598,687 |
| Property | 251,480 | 9,160 | (15,822) | 25,935 | 270,753 |
| Derivatives - futures | 445 | 1,007,496 | (1,007,306) | (422) | 213 |
| Derivatives - fwd foreign exchange | (17,582) | 30,266 | (33,753) | 30,778 | 9,709 |
| | 3,862,027 | 3,081,013 | (3,058,166) | 179,147 | 4,064,021 |
| Other financial assets / liabilities | | | | | |
| Margin balances | 1,769 | | | - | 894 |
| Cash deposits | 187,608 | | | (7,713) | 257,749 |
| Broker balances | (547) | | | 6 | 6,579 |
| Dividends due etc | 11,039 | | | - | 14,067 |
| | 199,869 | | | (7,707) | 279,289 |
| Net financial assets | 4,061,896 | | | 171,440 | 4,343,310 |

| | 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 | 1,221,629 | (446,344) | 295,664 | 2,718,320 |
| Pooled investment vehicles | 1,217,874 | 85,678 | (850,443) | 129,426 | 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 | 1,536,991 | (1,537,964) | 430,308 | 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 | | | 431,875 | 4,061,896 |

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.

Following a change in accounting policy, transaction costs are no longer included in the cost of purchases and sale proceeds. As a result, the figures for 2012/13 have been restated, information on transaction costs can now be found in note 11 on investment management expenses. Any indirect costs incurred through the bid-offer spread on some pooled investment vehicles are reflected in the cost of investment acquisitions and in the proceeds from sales and are therefore included in the tables above.

12b Analysis of investments (at market value)

| Area | 31 March 2013 £000 | 31 March 2014 £000 |
|---|-----------------------|-----------------------|
| Fixed interest securities | | |
| Public sector fixed interest quoted | UK 2,758 | 2,560 |
| Public sector index linked gilts quoted | UK 148,478 | 144,621 |
| Corporate quoted | UK 62,942 | 65,908 |
| Public sector quoted | Overseas 7,076 | 9,542 |
| Commercial quoted | Overseas 105,575 | 95,584 |
| | 326,829 | 318,215 |
| Equities | | |
| Quoted | UK 783,615 | 583,053 |
| Quoted | Overseas 1,934,705 | 2,283,391 |
| | 2,718,320 | 2,866,444 |
| Pooled investment vehicles | | |
| Managed funds - other | UK 17,977 | 16,187 |
| Managed funds - property | UK 56,053 | 55,319 |
| Private equity and infrastructure funds | UK 85,688 | 137,191 |
| Private equity and infrastructure funds | Overseas 422,817 | 389,990 |
| | 582,535 | 598,687 |
| Properties | | |
| Direct property | UK 251,480 | 270,753 |

Derivatives - futures

| Contract type | Contract expires | Economic exposure £000 | Market value at | | |
|-----------------------|------------------|---------------------------|-----------------------|-----------------------|------|
| | | | 31 March 2013 £000 | 31 March 2014 £000 | |
| Assets | | | | | |
| UK Fixed Income | < 1 year | 31,120 | 911 | 14,458 | 111 |
| Overseas Fixed Income | < 1 year | 26,232 | 156 | (28,605) | 193 |
| | | | 1,067 | | 304 |
| Liabilities | | | | | |
| UK fixed income | < 1 year | - | - | - | - |
| Overseas fixed income | < 1 year | (99,274) | (622) | 23,247 | (91) |
| | | | (622) | | (91) |
| Net asset | | | 445 | | 213 |

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 2014

| Contract settlement within | Currency bought | Currency sold | Local currency | | Asset value £000 | Liability value £000 |
|---|-----------------|---------------|----------------|--------------|---------------------|-------------------------|
| | | | bought £000 | sold £000 | | |
| Up to one month | AUD | CAD | 230 | (227) | 5 | - |
| Up to one month | AUD | GBP | 16,828 | (9,132) | 216 | - |
| Up to one month | CAD | GBP | 248 | (134) | 1 | - |
| Up to one month | CHF | JPY | 37 | (4,192) | 1 | - |
| Up to one month | EUR | GBP | 1,213 | (996) | 7 | - |
| Up to one month | EUR | SEK | 130 | (1,151) | 1 | - |
| Up to one month | GBP | AUD | 91,745 | (158,735) | 3,561 | - |
| Up to one month | GBP | EUR | 276,936 | (328,858) | 5,048 | - |
| Up to one month | GBP | USD | 42,589 | (69,328) | 1,002 | - |
| Up to one month | USD | EUR | 8,071 | (5,974) | - | (97) |
| Up to one month | USD | GBP | 5,835 | (3,543) | - | (43) |
| Up to one month | USD | JPY | 424 | (43,287) | 2 | - |
| Up to one month | USD | MXN | 11,557 | (152,484) | - | (70) |
| One to six months | USD | AUD | 2,300 | (2,615) | - | (58) |
| One to six months | USD | CHF | 18,845 | (16,410) | 133 | - |
| | | | | | 9,977 | (268) |
| Net forward currency contracts at 31 March 2014 | | | | | | 9,709 |

Prior year comparative

| | | |
|--|-------|----------|
| Open forward currency contracts at 31 March 2013 | 3,262 | (20,844) |
| Net forward currency contracts at 31 March 2013 | | (17,582) |

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

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

12c Investment managers and mandates

| Manager | Mandate | Market value at 31 March 2013 £000 | Percent of total 31 March 2013 % | Market value at 31 March 2014 £000 | Percent of total 31 March 2014 % |
|---|--------------------------|---------------------------------------|-------------------------------------|---------------------------------------|-------------------------------------|
| In-house | UK all cap equities | 525,587 | 13.0 | 100,415 | 2.3 |
| In-house | UK mid cap equities | 80,201 | 2.0 | 100,553 | 2.3 |
| Total UK equities | | 605,788 | 15.0 | 200,968 | 4.6 |
| In-house | European ex UK equities | 256,315 | 6.4 | 98,404 | 2.3 |
| In-house | US equities | 296,993 | 7.3 | 98,265 | 2.3 |
| Baillie Gifford | Pacific equities | 318,547 | 7.8 | 152,847 | 3.5 |
| Invesco | Pacific equities | 137,155 | 3.4 | 140,806 | 3.2 |
| Mondrian | Emerging markets | 111,524 | 2.7 | 92,455 | 2.1 |
| UBS | Emerging markets | 107,612 | 2.6 | 91,186 | 2.1 |
| Total regional overseas equities | | 1,228,146 | 30.2 | 673,963 | 15.5 |
| In-house | Global high div equities | 202,357 | 5.0 | 642,862 | 14.8 |
| In-house | Global low vol equities | - | - | 744,406 | 17.1 |
| Cantillon | Global equities | 220,072 | 5.4 | 238,423 | 5.5 |
| Lazard | Global equities | 261,099 | 6.4 | - | - |
| Harris | Global equities | 153,319 | 3.8 | 175,955 | 4.1 |
| Nordea | Global equities | - | - | 163,920 | 3.8 |
| Total global equities | | 836,847 | 20.6 | 1,965,566 | 45.3 |
| AG Bisset | Currency hedge | (19,098) | (0.5) | - | - |
| In-house | Currency hedge | - | - | 8,771 | 0.2 |
| Total currency overlay | | (19,098) | (0.5) | 8,771 | 0.2 |
| Total listed equities | | 2,651,683 | 65.3 | 2,849,268 | 65.6 |
| In-house | Private equity unq'ted | 200,947 | 4.9 | 190,787 | 4.4 |
| In-house | Private equity quoted | 47,327 | 1.2 | 51,480 | 1.2 |
| Total private equity | | 248,274 | 6.1 | 242,267 | 5.6 |
| Total equities | | 2,899,957 | 71.4 | 3,091,535 | 71.2 |

Investment managers and mandates (cont'd)

| Manager | Mandate | Market value at 31 March 2013 £000 | Percent of total 31 March 2013 % | Market value at 31 March 2014 £000 | Percent of total 31 March 2014 % |
|---------------------------------------|------------------------|---------------------------------------|-------------------------------------|---------------------------------------|-------------------------------------|
| In-house | Index linked gilts | 145,181 | 3.6 | 152,699 | 3.5 |
| In-house | Gold | 21,039 | 0.5 | 15,412 | 0.4 |
| Total inflation linked bonds and gold | | 166,220 | 4.1 | 168,111 | 3.9 |
| In-house | Property | 72,418 | 1.8 | 59,218 | 1.4 |
| Standard Life | Property | 289,511 | 7.1 | 322,037 | 7.4 |
| Total property | | 361,929 | 8.9 | 381,255 | 8.8 |
| In-house | Infrastructure unq'ted | 200,486 | 4.9 | 251,116 | 5.8 |
| In-house | Infrastructure quoted | 27,219 | 0.7 | 25,531 | 0.6 |
| In-house | Timber | 50,621 | 1.2 | 51,666 | 1.2 |
| Total other real assets | | 278,326 | 6.8 | 328,313 | 7.6 |
| In-house | Secured loans | 21,825 | 0.5 | 17,520 | 0.4 |
| Rogge | Corporate bonds | 189,578 | 4.7 | 184,569 | 4.2 |
| Total other bonds | | 211,403 | 5.2 | 202,089 | 4.6 |
| In-house | Cash | 143,935 | 3.6 | 171,892 | 3.9 |
| In-house | Transition | 126 | - | 115 | - |
| Total cash and sundries | | 144,061 | 3.6 | 172,007 | 3.9 |
| Net financial assets | | 4,061,896 | 100.0 | 4,343,310 | 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 2013 £000 | Percent of class 31 March 2013 % | Market value at 31 March 2014 £000 | Percent of class 31 March 2014 % |
|--|---------------------------------------|-------------------------------------|---------------------------------------|-------------------------------------|
| Fixed interest | | | | |
| UK Gov 1.125% Index Linked 22/11/37 | - | - | 19,450 | 6.1 |
| Pooled funds | | | | |
| Stafford Elm Inc | 38,482 | 6.6 | 35,169 | 5.9 |
| Macquarie European Infrastructure Fund | 33,134 | 5.7 | 33,204 | 5.5 |
| RREEF Pan European Infrastructure Fund | 31,477 | 5.4 | 30,638 | 5.1 |
| Carlyle Europe Real Estate III LP | 30,437 | 5.2 | 21,024 | 3.5 |
| Property | | | | |
| London, 119-125 Wardour St | 16,500 | 6.6 | 20,800 | 7.7 |
| Martlesham Heath, Retail Park | 19,050 | 7.6 | 20,500 | 7.6 |
| Sheffield, Bochum Parkway | 15,175 | 6.0 | 18,250 | 6.7 |
| London, 100 St John Street | 14,000 | 5.6 | 16,450 | 6.1 |
| Exeter, David Lloyd Leisure | 14,150 | 5.6 | 14,850 | 5.5 |
| Exeter, Bishops Court | 14,250 | 5.7 | 14,675 | 5.4 |

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 a securities lending arrangement with the Northern Trust Company. As at 31 March 2014, £120.9m (2013 £112.3m) of securities were released to third parties. Collateral valued at 107.4% (2013 107.2%) of the market value of the securities on loan was held at that date.

12f Property holdings

| | 2012/13 £000 | 2013/14 £000 |
|----------------------------|-----------------|-----------------|
| Opening balance | 246,915 | 251,480 |
| Additions | 27,216 | 9,160 |
| Disposals | (20,215) | (15,822) |
| Net change in market value | (2,436) | 25,935 |
| Closing balance | 251,480 | 270,753 |

As at 31 March 2014, 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. However, the Fund does have the responsibility of repairs and maintenance on any properties that are unlet.

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.

| | 31 March 2013 | | | 31 March 2014 | | |
|---------------------------|--|-------------------------------------|---|--|-------------------------------------|---|
| | 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 | | | | | | |
| Fixed interest | 326,829 | | | 318,215 | | |
| Equities | 2,718,320 | | | 2,866,444 | | |
| Pooled investments | 582,535 | | | 598,687 | | |
| Property leases | 11,544 | | | 10,706 | | |
| Derivative contracts | 4,329 | | | 10,281 | | |
| Margin balances | | 1,769 | | | 894 | |
| Cash | | 187,608 | | | 257,749 | |
| Other balances | | 14,068 | | | 26,620 | |
| | 3,643,557 | 203,445 | - | 3,804,333 | 285,263 | - |
| Other assets | | | | | | |
| City of Edinburgh Council | | 4,355 | | | 4,950 | |
| Cash | | 34,616 | | | 31,734 | |
| Debtors | | 10,299 | | | 14,155 | |
| | - | 49,270 | - | - | 50,839 | - |
| Assets total | 3,643,557 | 252,715 | - | 3,804,333 | 336,102 | - |

| | 31 March 2013 | | | 31 March 2014 | | |
|---|--|-------------------------------------|---|--|-------------------------------------|---|
| | 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 liabilities | | | | | | |
| Investment liabilities | | | | | | |
| Derivative contracts | (21,466) | | | (359) | | |
| Other investment balances | (3,576) | | | (5,974) | | |
| | (25,042) | - | - | (6,333) | - | - |
| Other liabilities | | | | | | |
| Creditors | | | (16,664) | | | (17,010) |
| Liabilities total | (25,042) | - | (16,664) | (6,333) | - | (17,010) |
| Net assets total | 3,618,515 | 252,715 | (16,664) | 3,798,000 | 336,102 | (17,010) |
| Total net financial instruments | | | 3,854,566 | | | 4,117,092 |
| Amounts not classified as financial instruments | | | 240,093 | | | 260,444 |
| Total net assets | | | 4,094,659 | | | 4,377,536 |

13b Net gains and losses on financial instruments

| | 2012/13 £000 | 2013/14 £000 |
|--|-----------------|-----------------|
| Designated as fair value through fund account | 432,648 | 153,378 |
| Loans and receivables | 1,567 | (7,707) |
| Financial liabilities at amortised cost | - | - |
| Total | 434,215 | 145,671 |
| Gains and losses on directly held freehold property | (2,340) | 25,769 |
| Change in market value of investments per fund account | 431,875 | 171,440 |

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.

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 2014 | | | |
|---|-----------------|-----------------|-----------------|---------------|
| | Level 1 £000 | Level 2 £000 | Level 3 £000 | Total £000 |
| Financial assets | | | | |
| Designated as fair value through fund account | 2,922,624 | 318,215 | 563,494 | 3,804,333 |
| Loans and receivables | 336,102 | | | 336,102 |
| Total financial assets | 3,258,726 | 318,215 | 563,494 | 4,140,435 |
| Financial liabilities | | | | |
| Designated as fair value through fund account | (6,333) | | | (6,333) |
| Financial liabilities at amortised cost | (17,010) | | | (17,010) |
| Total financial liabilities | (23,343) | - | - | (23,343) |
| Net financial assets | 3,235,383 | 318,215 | 563,494 | 4,117,092 |
| | 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 |

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.

Types of investment risk

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

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

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

The Fund manages these risks in a number of ways:

- assessing and establishing acceptable levels of market risk when setting overall investment strategy. Importantly, risk is considered relative to the liabilities of the Fund
- diversification of investments in terms of type of asset, investment styles, investment managers, geographical and industry sectors as well as individual securities
- taking stewardship responsibilities seriously and pursuing constructive engagement with the companies in which we invest
- monitoring market risk and market conditions to ensure risk remains within tolerable levels
- using equity futures contracts from time to time to manage market risk. 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 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 | 11.0% |
| Fixed Interest Gilts | 10.5% |
| Index-Linked Gilts | 8.5% |
| Infrastructure | 8.0% |
| Property | 13.0% |
| Cash | 1.5% |

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

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

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

| Asset type | Value at 31 March 2014 £m | % of fund % | Change + / - % | Value on increase £m | Value on decrease £m |
|-----------------------------------|------------------------------------|-------------------|----------------------|----------------------------|----------------------------|
| Equities - Developed Markets | 2,656 | 61.2 | 20.0 | 3,187 | 2,125 |
| Equities - Emerging Markets | 183 | 4.2 | 30.0 | 238 | 128 |
| Private Equity | 242 | 5.6 | 30.0 | 315 | 169 |
| Timber and Gold | 67 | 1.5 | 30.0 | 87 | 47 |
| Secured Loans | 18 | 0.4 | 10.0 | 20 | 16 |
| Corporate Bonds | 182 | 4.2 | 11.0 | 202 | 162 |
| Fixed Interest Gilts | 3 | 0.1 | 10.5 | 3 | 3 |
| Index-Linked Gilts | 153 | 3.5 | 8.5 | 166 | 140 |
| Infrastructure | 277 | 6.4 | 8.0 | 299 | 255 |
| Property | 381 | 8.8 | 13.0 | 431 | 331 |
| Cash and forward foreign exchange | 181 | 4.1 | 1.5 | 184 | 178 |
| Total [1] | 4,343 | 100.0 | 18.2 | 5,132 | 3,554 |
| Total [2] | | | 15.6 | 5,021 | 3,665 |
| Total [3] | | | 15.0 | 4,994 | 3,692 |

[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.

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 2014, cash deposits represented £289.5m, 6.6% of total net assets. This was held with the following institutions:

| | Moody's Credit Rating 31 March 2014 | Balances at 31 March 2013 £000 | Balances at 31 March 2014 £000 |
|--|--|--|--|
| Held for investment purposes | | | |
| Northern Trust Global Investment Limited - liquidity funds | <i>Aaa</i> | 75,949 | 45,480 |
| Northern Trust Company - cash deposits | <i>A1</i> | 17,758 | 80,765 |
| The City of Edinburgh Council - treasury management | <i>See below</i> | 93,901 | 131,504 |
| Total investment cash | | 187,608 | 257,749 |
| Held for other purposes | | | |
| The City of Edinburgh Council - treasury management | <i>See below</i> | 34,616 | 31,734 |
| Total cash | | 222,224 | 289,483 |

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:

| | Moody's Credit Rating 31 March 2014 | Balances at 31 March 2013 £000 | Balances at 31 March 2014 £000 |
|--------------------------------------|--|--|--|
| Money market funds | | | |
| Deutsche Bank AG, London | Aaa | 13,961 | 21,502 |
| Goldman Sachs | Aaa | 13,290 | 12,037 |
| Bank call accounts | | | |
| Bank of Scotland | A2 | 12,714 | 14,852 |
| Royal Bank of Scotland | Baa1 | 7,088 | 5,600 |
| Santander UK | A2 | 21 | 15,363 |
| Barclays Bank | A2 | 12,531 | 14,983 |
| Svenska Handelsbanken | Aaa3 | 18,117 | 23,089 |
| Clydesdale Bank | Baa2 | 12,502 | - |
| HSBC Bank | Aa3 | - | 22,274 |
| 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 | 4,893 | 7,431 |
| UK Pseudo-Sovereign risk instruments | | | |
| Other Local Authorities [1] | n/a | 23,590 | 18,679 |
| UK Government Treasury Bills | Aa1 | - | 7,428 |
| | | 128,517 | 163,238 |

[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 2014 would have been 'Aa1'). Of the £18.7m on deposit with local authorities, £11.6m 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.

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 2014, the Fund was due £10.0m and owed £0.3m on over-the-counter foreign currency derivatives.

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 2014, the Fund was due £304k (£213k 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 approximately 78%) 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 provided a statement describing the funding arrangements of the Fund. This can be found 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 £5,483m (2013 £4,946m). 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 2013 | 31 March 2014 |
|------------------------------------|------------------|------------------|
| | % p.a. | % p.a. |
| Inflation / pensions increase rate | 2.8 | 2.8 |
| Salary increase rate* | 5.1 | 5.1 |
| Discount rate | 4.5 | 4.3 |

*Salary increases were estimated at 1% p.a. nominal until 31 March 2015 reverting to the long term rate thereafter.

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 as at 31 March 2011) | 22.6 | 25.4 |

This assumption is the same as that adopted as at 31 March 2013.

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 2013 £000 | 31 March 2014 £000 |
|---|--------------------------|--------------------------|
| Contributions due - employers | 7,676 | 8,773 |
| Contributions due - members | 1,976 | 1,900 |
| Benefits paid in advance or recoverable | 155 | 16 |
| Pensions paid on behalf of employers | 16 | - |
| Sundry debtors | 361 | 325 |
| VAT | 13 | - |
| Prepayments | 102 | 272 |
| | 10,299 | 11,286 |

Analysis of debtors

| | | |
|--------------------------------|---------------|---------------|
| Administering Authority | 277 | 1,993 |
| Other Scheduled Bodies | 7,512 | 6,794 |
| Community Admission Bodies | 2,131 | 1,964 |
| Transferee Admission Bodies | 24 | 99 |
| Other Local Authorities | 7 | 9 |
| Central Government Bodies | 13 | - |
| Other entities and individuals | 335 | 427 |
| | 10,299 | 11,286 |

18 Creditors

| | 31 March 2013 £000 | 31 March 2014 £000 |
|--|--------------------------|--------------------------|
| Benefits payable | 3,919 | 4,662 |
| VAT and State Scheme premiums | 52 | 1,331 |
| Contributions in advance | 10,027 | 8,275 |
| Miscellaneous creditors and accrued expenses | 2,666 | 2,698 |
| Office - operating lease | - | 44 |
| | 16,664 | 17,010 |

Analysis of creditors

| | | |
|--------------------------------|---------------|---------------|
| Other Scheduled Bodies | 9,952 | 8,237 |
| Community Admission Bodies | 75 | 38 |
| Central Government Bodies | 52 | 1,331 |
| Other entities and individuals | 6,585 | 7,404 |
| | 16,664 | 17,010 |

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.

| | 2012/13 £000 | 2013/14 £000 |
|---|-----------------|-----------------|
| Total contributions during year for both pension funds | | |
| Standard Life | 395 | 450 |
| Prudential | 1,120 | 1,271 |
| | 1,515 | 1,721 |

| | 31 March 2013 £000 | 31 March 2014 £000 |
|---|--------------------------|--------------------------|
| Total value at year end for both pension funds | | |
| Standard Life | 5,968 | 6,253 |
| Prudential | 1,572 | 2,237 |
| | 7,540 | 8,490 |

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, based on the amount of central services consumed. This included the pension payroll service provided by the Council for part of 2013/14. 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 £56.5m to the Fund during the year (2013 £56.4m).

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 2013 £000 | 31 March 2014 £000 |
|--|--------------------------|--------------------------|
| | 4,355 | 7,819 |

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 2014, the fund had an average investment balance of £115.2m (2013 £93.5m). Interest earned was £603.7k (2013 £621.9k).

Year end balance on treasury management account

| | 31 March 2013 £000 | 31 March 2014 £000 |
|------------------------------|--------------------------|--------------------------|
| Held for investment purposes | 93,901 | 131,504 |
| Held for other purposes | 34,616 | 31,734 |
| | 128,517 | 163,238 |

Office accommodation- 144 Morrison Street, Edinburgh

Investment and Pensions Division of the Council has entered into an internal agreement with the Council for the provision of office accommodation at 144 Morrison Street in Edinburgh. The terms of the agreement are equivalent to those that would have been obtained had the accommodation been let on a commercial basis. In the accounts of the Fund the arrangement has been treated as a operational lease. The agreement was effective from November 2013. The Investment and Pensions Division is committed to making the following future payments.

| | 31 March 2013 £000 | 31 March 2014 £000 |
|--|--------------------------|--------------------------|
| Within one year | - | - |
| Between one and five years | - | 157 |
| After five years | - | 1,222 |
| | - | 1,379 |
| Recognised as an expense during the year | - | 33 |

The above expense has been allocated across the three Funds, Lothian Pension Fund's share is £30.7k.

Governance

As at 31 March 2014, 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 2013 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 2013 £000 | Accrued CETV as at 31 March 2014 £000 |
|-------------------|---|---|---|
| | | | |
| Alastair Maclean* | Director of Corporate Governance | 67 | 115 |
| Clare Scott | Investment and Pensions Service Manager | 89 | 126 |
| Struan Fairbairn | Legal and Risk Manager | 1 | 9 |
| John Burns | Pensions and Accounting Manager | 349 | 386 |
| Esmond Hamilton | Financial Controller | 101 | 119 |
| Bruce Miller | Investment Manager | 90 | 112 |

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

21 Contingent liabilities and contractual commitments

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

| | 31 March 2013 £000 | 31 March 2014 £000 |
|------------------------------------|--------------------------|--------------------------|
| Outstanding investment commitments | 164,316 | 109,692 |

As disclosed in note 20 on related party transactions the Investment and Pensions Division has a commitment to make future payments equivalent to rent in respect office accommodation at 144 Morrison Street. Details of the future payments are provided in that note.

The Fund has entered into an agreement with BT for the provision IT infrastructure at the new office accommodation of the Investment and Pensions Division of the Council. At 31 March 2014 there was an outstanding contractual commitment of £31k.

22 Contingent assets

There were no contingent assets at the year end.

23 Impairment losses

During the year the Fund recognised an increase in impairment losses in respect of specific benefit over payments for which reimbursement has been requested of £22.4k. This increased the impairment to £39.9k at the year end.

24 Prior year adjustment

The cost of administering the Local Government Pension Scheme in the UK has come under increasing scrutiny in recent years. As a result, the decision has been made to change the Fund's policy on accounting for investment management expenses. This means that investment management costs that are deducted from the value of an investment are now recognised as a cost in the Fund Account rather than as a reduction in the change in market value of investments. Investment transaction costs that are added to an investment purchase price or deducted from the proceeds of a sale are also now recognised as a cost in the Fund Account rather than as a reduction in the change in market value of investments. The final change is to recognise the operating costs of investments in property as an expense rather than netting those cost against rental income.

As a result of the above changes the results for the year ended 31 March 2013 have been restated. The change has the effect of increasing the reported investment income by £1.203m; increasing the change in market value of investments by £15.316m and increasing investment management expenses by £16.519m. The changes are reported in the Fund Account but there is no change to the net increase in the Fund for the year ended 31 March 2013 of £514.036m. The adjustments can be summarised as follows:

| | 2012/13 Fund Account as restated £000 | Changes made £000 |
|---------------------------------------|--|-------------------------|
| Fund Account 2012/13 | | |
| Investment income | 85,887 | 1,203 |
| Change in market value of investments | 431,875 | 15,316 |
| Investment management expenses | (26,091) | (16,519) |

List of active employers at 31 March 2014

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

Scheduled Bodies **SB**

Community Admitted Bodies CAB

Transferee Admitted Bodies TAB

Lothian Pension Fund Actuarial Statement for 2013/14

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 2013/14.

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 | % 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 request from the City of Edinburgh Council, Administering Authority to the Fund.

Experience over the period since April 2011

Experience has been poorer than expected since the 2011 valuation (excluding the effect of any membership movements). Real bond yields have fallen considerably, leading to an increase in liabilities. This has been partially offset by stronger than expected asset returns meaning that the funding level is likely to have fallen since the 2011 valuation.

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

19 May 2014
Hymans Robertson LLP
20 Waterloo Street Glasgow G2 6DB

Lothian Buses Pension Fund

Membership records

| Status | Membership at 31/03/2012 | Membership at 31/03/2013 | Membership at 31/03/2014 |
|--------------|--------------------------------|--------------------------------|--------------------------------|
| Active | 1,407 | 1,335 | 1,268 |
| Deferred | 1,179 | 1,163 | 1,146 |
| Pensioners | 1,122 | 1,163 | 1,191 |
| Dependants | 303 | 310 | 320 |
| Total | 4,011 | 3,971 | 3,925 |

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 2014 the contribution rates were as follows:

| Full time equivalent pensionable pay (rate of pay on 31/3/2014) | Rate |
|---|-------------------------|
| Less than £20,382 | 5.5% |
| Between £20,383 and £26,489 | Between 5.6% and 6.0% |
| Between £26,490 and £33,254 | Between 6.1% and 6.5% |
| Between £33,255 and £46,876 | Between 6.6% and 7.5% |
| Between £46,877 and £52,810 | Between 7.6% and 8.0% |
| Between £52,811 and £70,711 | Between 8.1% and 9.0% |
| Between £70,712 and £106,974 | Between 9.1% and 10.0% |
| Between £106,975 and £245,412 | Between 10.1% and 11.2% |

Employers' contributions are set at the triennial actuarial valuation. The contribution rates for the year ended 31 March 2014 were based on the actuarial valuation at 31 March 2011. For the nine months to 31 December 2013 the rate was 19.9% of pensionable pay and 20.5% for the three months to 31 March 2014 for service currently being accrued.

At the last valuation in 2011, the funding level on an ongoing basis was calculated by the Fund's actuary to be 112%. At 31 March 2013, the actuary provided an updated estimate of 103%. As the Fund is closed to new members and the liabilities are expected to mature further over time, the funding basis will be reviewed during the 2014 actuarial valuation.

On the more prudent 'gilts basis', the funding levels were 87% and 80% at 31 March 2011 and 31 March 2013 respectively. More information on funding can be found in the Actuarial Statement for 2013/14.

Work has commenced on the triennial actuarial valuation at 31 March 2014.

Investment strategy

The Pensions Committee approved the Investment Strategy 2012-17 for Lothian Buses Pension Fund in October 2012. The general thrust of the strategy is to reduce the Fund's investment risk in the long term by focusing on capital preservation, durable investment income generation and a reduction in the absolute volatility of the Fund.

The investment strategy is set at the broad asset class level of Equities, Index-Linked gilts and Alternatives, which are the key determinants of investment risk and return. The Equities category includes listed and unlisted equities; Index-Linked Assets includes index-linked gilts; Alternatives include property, infrastructure, timber and fixed income assets, such as corporate bonds. The long term strategy for 2012-17 is set out in the table below along with the current interim strategy allocation and the asset allocation limits under normal financial conditions.

| | Interim benchmark at 31 March 2014 % | Strategy for 2012 - 2017 % | Asset allocation limits minimum – maximum % |
|--------------------|--|----------------------------------|---|
| Equities | 62.5 | 55.0 | 45 – 65 |
| Index linked gilts | 10.0 | 15.0 | 10 - 30 |
| Alternatives | 27.5 | 30.0 | 10 – 35 |
| Cash | - | - | 0 - 10 |
| Total | 100.0 | 100.0 | |

Investment performance

The objectives of the Fund were redefined in December 2012 and are:

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

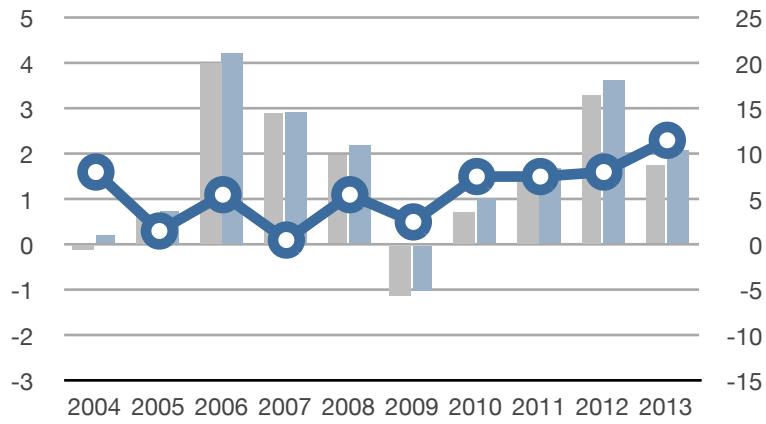
The Fund is gradually implementing the strategy and will continue to do so over the next few years. It is dependent on finding attractive assets in the Alternatives category to provide the desired diversification and an adequate return.

Annualised returns to 31 March 2014 (% per year)

| | 1 Year | 3 Years | 10 Years |
|----------------------------|--------|---------|----------|
| Lothian Buses Pension Fund | 8.9 | 10.0 | 9.9 |
| Benchmark | 5.1 | 7.7 | 8.4 |
| Retail Price Index (RPI) | 2.5 | 3.1 | 3.3 |
| Consumer Price Index (CPI) | 1.7 | 2.6 | 2.8 |
| National Average Earnings | 1.5 | 0.9 | 2.7 |

The absolute performance of Lothian Buses Pension Fund over the 12 month period was +8.9% and 3 year performance was +10.0% per annum. Over 10 years, the Fund returned +9.9% per annum, well ahead of measures of inflation and national average earnings.

Annualised 3 yearly returns ending 31 March (% per year)



○ Relative (LHS)
 ■ Benchmark
 ■ Lothian Buses Pension Fund

| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 |
|------------------|------|------|------|------|-------|------|------|------|------|------|
| Fund | 3.7 | 21.1 | 14.6 | 10.9 | (5.1) | 5.1 | 8.4 | 18.1 | 10.4 | 10.0 |
| Benchmark | 3.4 | 20 | 14.5 | 9.8 | (5.6) | 3.6 | 6.9 | 16.5 | 8.7 | 7.7 |
| Relative | 0.3 | 1.1 | 0.1 | 1.1 | 0.5 | 1.5 | 1.5 | 1.6 | 2.3 | 2.3 |

Lothian Buses Pension Fund

Fund Account for year ended 31 March 2014

| 2012/13 Restated* £000 | | Note | 2013/14 £000 |
|-------------------------------|--|--------|-----------------|
| Income | | | |
| 7,147 | Contributions from employer | 2 | 7,126 |
| 2,261 | Contributions from members | | 2,222 |
| - | Transfers from other schemes | | - |
| 9,408 | | | 9,348 |
| Less: expenditure | | | |
| 7,015 | Pension payments including increases | | 7,358 |
| 2,136 | Lump sum retirement payments | | 1,819 |
| 237 | Lump sum death benefits | | 213 |
| 114 | Transfers to other schemes | 3 | 218 |
| 110 | Administrative expenses | 4 | 110 |
| 9,612 | | | 9,718 |
| (204) | Net withdrawals from dealing with members | | (370) |
| Returns on investments | | | |
| 5,913 | Investment income | 5 | 6,156 |
| 36,459 | Change in market value of investments | 7a, 8b | 22,411 |
| (1,706) | Investment management expenses | 6 | (2,982) |
| 40,666 | Net returns on investments | | 25,585 |
| 40,462 | Net increase in the Fund during the year | | 25,215 |
| 271,448 | Net assets of the Fund at 1 April 2013 | | 311,910 |
| 311,910 | Net assets of the Fund at 31 March 2014 | 8a, 8c | 337,125 |

*The results for the year ended 31 March 2013 have been restated to reflect a change in the accounting policy on investment management expenses. This change has the effect of increasing the reported change in market value of investment by £659k and increasing investment management expenses by £659k. There is no change in the net returns on investment. See note 19 for details.

Lothian Buses Pension Fund

Net Assets Statement as at 31 March 2014

| 31 March 2013 | | Note | 31 March 2014 |
|----------------------------|--|--------|---------------|
| £000 | | | £000 |
| Investments | | | |
| 309,255 | Assets | | 337,279 |
| (490) | Liabilities | | (1,934) |
| 308,765 | | 7, 9 | 335,345 |
| Current assets | | | |
| 459 | The City of Edinburgh Council | 15 | 422 |
| 1,913 | Cash balances | 9, 15 | 1,523 |
| 894 | Debtors | 12 | 912 |
| 3,266 | | | 2,857 |
| Current liabilities | | | |
| (121) | Creditors | 13 | (1,077) |
| 3,145 | Net current assets | | 1,780 |
| 311,910 | Net assets of the Fund at 31 March 2014 | 8a, 8c | 337,125 |

The unaudited accounts were issued on 17 June 2014 and the audited accounts were authorised for issue on 23 September 2014.

JOHN BURNS FCMA CGMA
Pensions and Accounting Manager
23 September 2014

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 2014, and up to the date when these accounts were authorised, that require any adjustments to these accounts.

2 Contributions from employer

| | 2012/13 | 2013/14 |
|--------------------------------|--------------|--------------|
| | £000 | £000 |
| Lothian Buses Plc | | |
| Normal (ongoing contributions) | 7,147 | 7,126 |
| Deficit funding | - | - |
| Pension strain | - | - |
| Total | 7,147 | 7,126 |

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).

From 2012/13 onwards, no deficit funding was required (as stated in the actuarial valuation of 31 March 2011). For the nine months to 31 December 2013 the rate was 19.9% of pensionable pay and 20.5% for the three months to 31 March 2014 for service currently being accrued.

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. There were no strain costs during 2013/14.

3 Transfers out to other pension schemes

| | 2012/13 | 2013/14 |
|----------------------|------------|------------|
| | £000 | £000 |
| Group transfers | - | - |
| Individual transfers | 114 | 218 |
| | 114 | 218 |

4 Administrative expenses

| | 2012/13 | 2013/14 |
|---|------------|------------|
| | £000 | £000 |
| Employee costs | 58 | 59 |
| The City of Edinburgh Council - pension payroll costs | 13 | 7 |
| The City of Edinburgh Council - other support costs | 16 | 15 |
| System costs | 10 | 11 |
| Actuarial fees | 7 | 9 |
| External Audit fees | 2 | 2 |
| Legal fees | - | - |
| Printing and postage | 2 | 2 |
| Depreciation | 2 | 3 |
| Office costs | - | 2 |
| Sundry costs less sundry income | - | - |
| | 110 | 110 |

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. 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. Other costs were allocated based on the number of members of each Fund.

| 5 Investment income | 2012/13 | 2013/14 |
|--|---------|---------|
| | £000 | £000 |
| Fixed income | - | 7 |
| Dividends from equities | 4,054 | 4,610 |
| Income from pooled investment vehicles | 1,802 | 1,451 |
| Interest on cash deposits | 31 | 46 |
| Securities lending and sundries | 96 | 140 |
| | 5,983 | 6,254 |
| Irrecoverable withholding tax | (70) | (98) |
| | 5,913 | 6,156 |

| 6 Investment management expenses | 2012/13 | 2013/14 |
|---|---------|---------|
| | £000 | £000 |
| External management fees - invoiced | 892 | 2,021 |
| External management fees - deducted from capital | 576 | 568 |
| Transaction costs | 89 | 268 |
| Employee costs | 51 | 59 |
| Custody fees | 51 | 21 |
| Engagement and voting fees | 5 | 5 |
| Performance measurement fees | 3 | 11 |
| Investment consultancy fees | 15 | 3 |
| System costs | 10 | 11 |
| Legal fees | 4 | 3 |
| The City of Edinburgh Council - other support costs | 8 | 8 |
| Office costs | - | 1 |
| Sundry costs | 2 | 3 |
| | 1,706 | 2,982 |

Following a change in accounting policy, the expenses for 2012/13 have been restated to account for costs that were deducted from capital and therefore impacted the change in market value of investments reported in the Fund Account. The related costs are included above as external management fees deducted from capital. Investment transaction costs that were previously added to the cost of purchases or deducted from the proceeds are now accounted for as expenses and shown above as transaction costs.

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

The external investment management fees for 2013/14 above include £1.428m in respect of performance-related fees (2012/13 £0.460m).

| 7 Net investment assets | 31 March 2013 £000 | 31 March 2014 £000 |
|---|--------------------------|--------------------------|
| Investment assets | | |
| Fixed interest | - | 6,511 |
| Equities | 214,633 | 221,274 |
| Pooled investment vehicles | 80,844 | 87,978 |
| Deposits | 11,850 | 19,521 |
| Other investment assets | | |
| Due from broker | 1,104 | 1,084 |
| Dividends and other income due | 824 | 911 |
| | 1,928 | 1,995 |
| Total investment assets | 309,255 | 337,279 |
| Investment liabilities | | |
| Other financial liabilities - due to broker | (490) | (1,934) |
| Total investment liabilities | (490) | (1,934) |
| Net investment assets | 308,765 | 335,345 |

7a Reconciliation of movement in investments

| | Market value at 1 April 2013 £000 | Purchases at cost £000 | Sales proceeds £000 | Change in market value £000 | Market value at 31 March 2014 £000 |
|--|---|------------------------------|---------------------------|---|--|
| Fixed interest | - | 6,414 | - | 97 | 6,511 |
| Equities | 214,633 | 127,533 | (142,769) | 21,877 | 221,274 |
| Pooled investment vehicles | 80,844 | 7,228 | (934) | 840 | 87,978 |
| | 295,477 | 141,175 | (143,703) | 22,814 | 315,763 |
| Other financial assets / (liabilities) | | | | | |
| Cash deposits | 11,850 | | | (405) | 19,521 |
| Broker balances | 614 | | | 2 | (850) |
| Dividends due | 824 | | | - | 911 |
| | 13,288 | | | (403) | 19,582 |
| Net financial assets | 308,765 | | | 22,411 | 335,345 |

| | 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 | 43,346 | (27,410) | 29,068 | 214,633 |
| Pooled investment vehicles | 93,708 | 5,615 | (25,617) | 7,138 | 80,844 |
| | 263,337 | 48,961 | (53,027) | 36,206 | 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 | | | 36,459 | 308,765 |

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.

Following a change in accounting policy, transaction costs are no longer included in the cost of purchases and sale proceeds. As a result, the figures for 2012/13 have been restated, information on transaction costs can now be found in note 6 on investment management expenses. Any indirect costs incurred through the bid-offer spread on some pooled investment vehicles are reflected in the cost of investment acquisitions and in the proceeds from sales and are therefore included in the tables above.

7b Analysis of investments (at market value)

| | Market value at 31 March 2013 £000 | Market value at 31 March 2014 £000 |
|-----------------------------------|---------------------------------------|---------------------------------------|
| Fixed income | | |
| UK index linked | - | 6,511 |
| Equities | | |
| UK quoted | 32,742 | 42,178 |
| Overseas quoted | 181,891 | 179,096 |
| | 214,633 | 221,274 |
| Pooled investment vehicles | | |
| UK | | |
| Managed funds - property | 22,931 | 29,327 |
| Managed funds - index linked | 23,133 | 23,338 |
| Managed funds - other bonds | 22,550 | 24,039 |
| Infrastructure and timber | 1,334 | 1,703 |
| Overseas | | |
| Infrastructure and timber | 10,896 | 9,571 |
| | 80,844 | 87,978 |

7c Investment managers and mandates

| Manager | Mandate | Market value at 31 March 2013 £000 | % of total funds | Market value at 31 March 2014 £000 | % of total funds |
|-----------------|-------------------------------------|---------------------------------------|------------------|---------------------------------------|------------------|
| Baillie Gifford | Global equities | 191,885 | 62.2 | 107,901 | 32.2 |
| In-house | Global high div equities | 15,516 | 5.0 | 107,435 | 32.0 |
| In-house | Private equity quoted | 6,370 | 2.1 | 3,761 | 1.1 |
| | Total global equities | 213,771 | 69.3 | 219,097 | 65.3 |
| Baillie Gifford | Index linked gilts | 23,133 | 7.5 | 23,338 | 7.0 |
| In-house | Index linked gilts | - | - | 14,106 | 4.2 |
| | Total index linked gilts | 23,133 | 7.5 | 37,444 | 11.2 |
| Baillie Gifford | Bonds | 22,550 | 7.3 | 24,039 | 7.2 |
| In-house | Secured loans | 1,552 | 0.5 | 1,421 | 0.4 |
| | Total other bonds | 24,102 | 7.8 | 25,460 | 7.6 |
| Standard Life | Property managed fund | 22,931 | 7.4 | 29,327 | 8.7 |
| In-house | Infrastructure unquoted | 8,484 | 2.7 | 8,627 | 2.6 |
| In-house | Infrastructure quoted | 5,427 | 1.8 | 5,739 | 1.7 |
| In-house | Timber | 2,897 | 0.9 | 2,647 | 0.8 |
| In-house | Alternatives cash | 859 | 0.3 | - | - |
| | Total alternative investment | 17,667 | 5.7 | 17,013 | 5.1 |

7c Investment managers and mandates (cont'd)

| Manager | Mandate | Market value at 31 March 2013 | % of total funds | Market value at 31 March 2014 | % of total funds |
|----------------------|------------|-------------------------------|------------------|-------------------------------|------------------|
| | | £000 | % | £000 | % |
| In-house | Cash | 7,161 | 2.3 | 6,886 | 2.1 |
| In-house | Transition | - | - | 118 | - |
| | | 7,161 | 2.3 | 7,004 | 2.1 |
| Net financial assets | | 308,765 | 100.0 | 335,345 | 100.0 |

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

| | Market value at 31 March 2013 | % of net assets of the Fund | Market value at 31 March 2014 | % of net assets of the Fund |
|--|-------------------------------|-----------------------------|-------------------------------|-----------------------------|
| | £000 | % | £000 | % |
| Standard Life Property Fund | 22,931 | 7.4 | 29,327 | 8.7 |
| Baillie Gifford Inv Grade Bond Fund | 22,551 | 7.2 | 24,039 | 7.1 |
| Baillie Gifford Index Linked Gilt Fund | 23,132 | 7.4 | 23,338 | 6.9 |

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

| Class | Market value at 31 March 2013 | Percent of class 31 March 2013 | Market value at 31 March 2014 | Percent of class 31 March 2014 |
|--|-------------------------------|--------------------------------|-------------------------------|--------------------------------|
| | £000 | % | £000 | % |
| UK Gov 1.125%Index Linked 22/11/37 | - | - | 1,226 | 18.8 |
| UK Gov 2%Index Linked 26/01/35 | - | - | 1,179 | 18.1 |
| UK Gov 1.25%Index Linked 22/11/32 | - | - | 1,170 | 18.0 |
| UK Gov 0.75%Index Linked 22/03/34 | - | - | 988 | 15.2 |
| UK Gov 0.625%Index Linked 22/03/40 | - | - | 987 | 15.2 |
| UK Gov 4.125%Index Linked 22/07/30 | - | - | 961 | 14.8 |
| Standard Life Property Fund | 22,931 | 28.4 | 29,327 | 33.3 |
| Baillie Gifford Inv Grade Bond Fund | 22,551 | 27.9 | 24,039 | 27.3 |
| Baillie Gifford Index Linked Gilt Fund | 23,132 | 28.6 | 23,338 | 26.5 |

7f Securities lending

During the year Lothian Buses Pension Fund participated in a securities lending arrangement with the Northern Trust Company. As at 31 March 2014, £14.1m (2013 £9.2m) of securities were released to third parties. Collateral valued at 105.2% (2013 106.8%) of the market value of the securities on loan was held at that date.

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.

| | 31 March 2013 | | | 31 March 2014 | | |
|---------------------------------|---|-------------------------------------|---|---|-------------------------------------|---|
| | 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 | | | | | | |
| Fixed interest | - | | | 6,511 | | |
| Equities | 214,633 | | | 221,274 | | |
| Pooled investments | 80,844 | | | 87,978 | | |
| Cash | | 11,850 | | | 19,521 | |
| Other investment balances | | 1,928 | | | 1,995 | |
| | 295,477 | 13,778 | - | 315,763 | 21,516 | - |
| Other assets | | | | | | |
| The City of Edinburgh Council | | 459 | | | 422 | |
| Cash | | 1,913 | | | 1,523 | |
| Debtors | | 894 | | | 912 | |
| | - | 3,266 | - | - | 2,857 | - |
| Assets total | 295,477 | 17,044 | - | 315,763 | 24,373 | - |
| Financial liabilities | | | | | | |
| Investment liabilities | | | | | | |
| Other investment balances | (490) | | | (1,934) | | |
| | (490) | - | - | (1,934) | - | - |
| Other liabilities | | | | | | |
| Creditors | | | (121) | | | (1,077) |
| | - | - | (121) | - | - | (1,077) |
| Liabilities total | (490) | - | (121) | (1,934) | - | (1,077) |
| Net asset total | 294,987 | 17,044 | (121) | 313,829 | 24,373 | (1,077) |
| Total net financial instruments | | | 311,910 | | | 337,125 |

8b Net gains and losses on financial instruments

| | 2012/13 £000 | 2013/14 £000 |
|---|-----------------|-----------------|
| Designated as fair value through fund account | 36,206 | 22,814 |
| Loans and receivables | 253 | (403) |
| Financial liabilities at amortised cost | - | - |
| Total | 36,459 | 22,411 |

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.

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 2014 | | | |
|---|-----------------|-----------------|-----------------|----------------|
| | Level 1 £000 | Level 2 £000 | Level 3 £000 | Total £000 |
| Financial assets | | | | |
| Designated as fair value through fund account | 304,489 | | 11,274 | 315,763 |
| Loans and receivables | 24,373 | | | 24,373 |
| Total financial assets | 328,862 | - | 11,274 | 340,136 |
| Financial liabilities | | | | |
| Designated as fair value through fund account | (1,934) | | | (1,934) |
| Financial liabilities at amortised cost | (1,077) | | | (1,077) |
| Total financial liabilities | (3,011) | - | - | (3,011) |
| Net financial assets | 325,851 | - | 11,274 | 337,125 |
| | 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 |

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. 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, investment styles, investment managers, geographical and industry sectors as well as individual securities
- taking stewardship responsibilities seriously and pursuing constructive engagement with the companies in which the Fund invests
- 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:

| Asset type | Potential price movement (+ or -) |
|------------------------------|-----------------------------------|
| Equities - developed markets | 20.0% |
| Private equity | 30.0% |
| Timber | 30.0% |
| Secured loans | 10.0% |
| Corporate bonds | 11.0% |
| Index-linked gilts | 8.5% |
| Infrastructure | 8.0% |
| Property | 13.0% |
| Cash | 1.5% |

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

Asset classes do not always move in line with each other. The extent to which assets move together is known as their "correlation". A lower correlation means that there is less risk of assets losing value at the same time. The overall Fund benefits from "diversification" because it invests in different asset classes, which don't all move in line with each other. Consequently, the aggregate risk at the Fund level is less than the total risk from all the individual assets in which the Fund invests. The following table shows the risks at the asset class level and the overall Fund level, with and without allowance for correlation.

| Asset type | Value at 31 March 2014 £000 | % of fund % | Potential Change + / - % | Value on increase £000 | Value on decrease £000 |
|------------------------------|--------------------------------|----------------|-----------------------------|---------------------------|---------------------------|
| Equities - developed markets | 215,335 | 64.2 | 20.0 | 258,402 | 172,268 |
| Private equity | 3,761 | 1.1 | 30.0 | 4,889 | 2,633 |
| Timber | 2,647 | 0.8 | 30.0 | 3,441 | 1,853 |
| Secured loans | 1,421 | 0.4 | 10.0 | 1,563 | 1,279 |
| Corporate bonds | 24,039 | 7.2 | 11.0 | 26,683 | 21,395 |
| Index-linked gilts | 37,444 | 11.2 | 8.5 | 40,627 | 34,261 |
| Infrastructure | 14,366 | 4.3 | 8.0 | 15,515 | 13,217 |
| Property | 29,327 | 8.7 | 13.0 | 33,140 | 25,514 |
| Cash | 7,005 | 2.1 | 1.5 | 7,110 | 6,900 |
| Total [1] | 335,345 | 100.0 | 16.7 | 391,370 | 279,320 |
| Total [2] | | | 14.4 | 383,635 | 287,055 |
| Total [3] | | | 13.6 | 380,952 | 289,738 |

[1] No allowance for correlations between assets

[2] Including allowance correlations for between assets

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

The value on increase/decrease columns illustrate the effect of the volatility. 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 [2] assets is lower than the total of the risks to the individual assets[1].

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 2014, cash deposits represented £21.0m, 6.2% of total net assets. This was held with the following institutions:

| | Moody's Credit Rating at 31 March 2014 | Balances at 31 March 2013 £000 | Balances at 31 March 2014 £000 |
|--|--|--|--|
| Held for investment purposes | | | |
| Northern Trust Global Investment Limited - liquidity funds | Aaa | 10,207 | 11,452 |
| Northern Trust Company - cash deposits | A1 | 947 | 5,591 |
| The City of Edinburgh Council - treasury management | See below | 696 | 2,478 |
| Total investment cash | | 11,850 | 19,521 |

Held for other purposes

| | | | |
|---|-----------|--------|--------|
| The City of Edinburgh Council - treasury management | See below | 1,913 | 1,523 |
| Total cash | | 13,763 | 21,044 |

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 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 2014 | Balances at 31 March 2013 £000 | Balances at 31 March 2014 £000 |
|---------------------------|---|--|--|
| Money market funds | | | |
| Deutsche Bank AG, London | Aaa | 284 | 527 |
| Goldman Sachs | Aaa | 270 | 295 |
| Bank call accounts | | | |
| Bank of Scotland | A2 | 258 | 364 |
| Royal Bank of Scotland | Baa1 | 144 | 137 |
| Santander UK | A2 | - | 377 |
| Barclays Bank | A2 | 255 | 367 |
| Svenska Handelsbanken | Aaa3 | 368 | 566 |
| Clydesdale Bank | A2 | 254 | - |
| HSBC Bank | Aa3 | - | 546 |

| (Cont'd) | Moody's Credit Rating at 31 March 2014 | Balances at 31 March 2013 £000 | Balances at 31 March 2014 £000 |
|---|---|--|--|
| Bank certificates of deposit | | | |
| Standard Chartered | A1 | 100 | - |
| Floating Rate Note | | | |
| Rabobank | Aa2 | 100 | - |
| Building Society fixed term deposits | | | |
| Nationwide Building Society | A2 | 99 | 182 |
| UK pseudo-sovereign risk instruments | | | |
| Other Local Authorities [1] | n/a | 477 | 458 |
| UK Government Treasury Bills | Aa1 | - | 182 |
| | | 2,609 | 4,001 |

[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 2014 would have been 'Aa1'). Of the £458k on deposit with local authorities at 31 March 2014, £274k 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.

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 approximately 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 £358m (2013 £321m).

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 2013 % p.a. | 31 March 2014 % p.a. |
|------------------------------------|----------------------------|----------------------------|
| Inflation / pensions increase rate | 2.8 | 2.8 |
| Salary increase rate | 5.1 | 5.1 |
| Discount rate | 4.5 | 4.3 |

*Salary increases were estimated at 1% p.a. nominal until 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 2013.

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 2013 £000 | 31 March 2014 £000 |
|-------------------------------------|--------------------------|--------------------------|
| Contributions due - employers | 650 | 654 |
| Contributions due - employees | 202 | 199 |
| Pensions paid on behalf of employer | 28 | 38 |
| Sundry debtors | 14 | 21 |
| | 894 | 912 |
| Analysis of debtors | | |
| Administering Authority | 1 | 1 |
| Lothian Buses plc | 880 | 890 |
| Other entities and individuals | 13 | 21 |
| | 894 | 912 |

13 Creditors

| | 31 March 2013 £000 | 31 March 2014 £000 |
|--|--------------------------|--------------------------|
| Benefits payable | 121 | 91 |
| Miscellaneous creditors and accrued expenses | - | 986 |
| | 121 | 1,077 |
| Analysis of creditors | | |
| Other entities and Individuals | 121 | 1,077 |
| | 121 | 1,077 |

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.

Total contributions during year for both pension funds

| | 2012/13 £000 | 2013/14 £000 |
|---------------|-----------------|-----------------|
| Standard Life | 395 | 450 |
| Prudential | 1,120 | 1,271 |
| | 1,515 | 1,721 |

Total value at year end for both pension funds

| | 31 March 2013 £000 | 31 March 2014 £000 |
|---------------|--------------------------|--------------------------|
| Standard Life | 5,968 | 6,253 |
| Prudential | 1,572 | 2,237 |
| | 7,540 | 8,490 |

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, based on the amount of central services consumed. This included the pension payroll service provided by the Council for part of 2013/14. 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 Council is paid a cash sum leaving a working balance in the account to cover the next month's pension payroll costs and other expected costs.

Year end balance on holding account

| | 31 March 2013 £000 | 31 March 2014 £000 |
|--|--------------------------|--------------------------|
| | 459 | 422 |

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 2014, the Fund had an average investment balance of £6.6m (2013 £3.3m), interest earned was £34.9k (2013 £22.0k).

| Year end balance on treasury management account | 31 March | 31 March |
|---|----------|----------|
| | 2013 | 2014 |
| | £000 | £000 |
| Held for investment purposes | 696 | 2,478 |
| Held for other purposes | 1,913 | 1,523 |
| | 2,609 | 4,001 |

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

Office accommodation- 144 Morrison Street, Edinburgh

Investment and Pensions Division of the Council has entered into an internal agreement with the Council for the provision of office accommodation at 144 Morrison Street in Edinburgh. The terms of the agreement are equivalent to those that would have been obtained had the accommodation been let on a commercial basis. In the accounts of the Fund the arrangement has been treated as a operational lease. The agreement was effective from November 2013. The Investment and Pensions Division is committed to making the following future payments.

| | 31 March | 31 March |
|--|----------|----------|
| | 2013 | 2014 |
| | £000 | £000 |
| Within one year | - | - |
| Between one and five years | - | 157 |
| After five years | - | 1,222 |
| | - | 1,379 |
| Recognised as an expense during the year | - | 33 |

The above expense has been allocated across the three Funds, Lothian Buses Pension Fund's share is £1.9k.

Key management personnel

During the period from 1 April 2013 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:

| Name | Position held | Accrued | Accrued |
|-------------------|---|--------------------------|--------------------------|
| | | CETV as at 31 March 2013 | CETV as at 31 March 2014 |
| | | £000 | £000 |
| Alastair Maclean* | Director of Corporate Governance | 67 | 115 |
| Clare Scott | Investment and Pensions Service Manager | 89 | 126 |
| Struan Fairbairn | Legal and Risk Manager | 1 | 9 |
| John Burns | Pensions and Accounting Manager | 349 | 386 |
| Esmond Hamilton | Financial Controller | 101 | 119 |
| Bruce Miller | Investment Manager | 90 | 112 |

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

16 Contingent liabilities and contractual commitments

The Fund has commitments relating to outstanding call payments due on unquoted funds held in the infrastructure and timber 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 2013 £000 | 31 March 2014 £000 |
|------------------------------------|--------------------------|--------------------------|
| Outstanding investment commitments | 3,041 | 466 |

17 Contingent assets

There were no contingent assets at the year end.

18 Impairment losses

No impairment losses have been identified during the year.

19 Prior year adjustment

The cost of administering the Local Government Pension Scheme in the UK has come under increasing scrutiny in recent years. As a result, the decision has been made to change the Fund's policy on accounting for investment management expenses. This means that investment management costs that are deducted from the value of an investment are now recognised as a cost in the Fund Account rather than as a reduction in the change in market value of investments. Investment transaction costs that are added to an investment purchase price or deducted from the proceeds of a sale are also now recognised as a cost in the Fund Account rather than as a reduction in the change in market value of investments.

As a result of the above changes the results for the year ended 31 March 2013 have been restated. The change has the effect of increasing the change in market value of investments by £659k and increasing investment management expenses by £659k. The changes are reported in the Fund Account but there is no change to the net increase in the Fund for the year ended 31 March 2013 of £40.462m. The adjustments can be summarised as follows:

| | 2012/13 Fund Accounts as restated £000 | Changes made £000 |
|---------------------------------------|--|-------------------------|
| Fund Account 2012/13 | | |
| Change in market value of investments | 36,459 | 659 |
| Investment management expenses | (1,706) | (659) |

Lothian Buses Pension Fund

Actuarial Statement for 2013/14

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 2013/14.

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 Fund;
- to minimise the degree of short-term change in the employer's contribution rate;
- 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 the employer manage its 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 contributions for the period 1 January 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, 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 request from the City of Edinburgh Council, Administering authority to the Fund.

Experience over the period since April 2011

Experience has been poorer than expected since the 2011 valuation (excluding the effect of any membership movements). Real bond yields have fallen considerably, leading to an increase in liabilities. This has been partially offset by stronger than expected asset returns meaning that the funding level is likely to have fallen since the 2011 valuation.

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

19 May 2014
Hymans Robertson LLP 20 Waterloo Street Glasgow
G2 6DB

Scottish Homes Pension Fund

Membership records

| Status | Membership at 31/03/2012 | Membership at 31/03/2013 | Membership at 31/03/2014 |
|--------------|--------------------------|--------------------------|--------------------------|
| Active | - | - | - |
| Deferred | 650 | 626 | 595 |
| Pensioners | 999 | 978 | 956 |
| Dependants | 303 | 308 | 298 |
| Total | 1,952 | 1,912 | 1,849 |

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 2014, of £771,000, was based on the actuarial valuation as at 31 March 2011.

The Fund's actuary has estimated the funding level to be 90.5% at 31 March 2014. The position has improved from 86.2% at the date of the last actuarial valuation, 31 March 2011. Work has commenced on the triennial actuarial valuation at 31 March 2014 where the actuary will recalculate the funding level based on up-to-date membership of the Fund. More information on funding can be found in the Actuarial Statement for 2013/14 at the end of this section.

Investment strategy

The funding agreement with the Scottish Government and the investment strategy are designed to reduce investment risk as the Fund is closed to new members and the liabilities will mature over the time. They allow for acceleration in the sale of equities and property and purchase of bonds if the actual funding level improves to the target funding level.

The Pensions Committee approved the Investment Strategy 2012-17 for Scottish Homes Pension Fund in October 2012. Over 2013/14, the actual funding level moved closer to the target funding level prescribed in the funding agreement. Hence the move to the long term strategy was accelerated and the current strategy allocation is now in line with the 2012-17 investment strategy, as shown in the table below. The table also shows the asset allocation limits under normal financial conditions.

| | Strategic Allocation 31 March 2014 % | Long term Strategy 2012 - 2017 % | Permitted ranges % |
|--------------|--|--|-----------------------|
| Equities | 30 | 30 | 20-35 |
| Bonds | 65 | 65 | 60-75 |
| Property | 5 | 5 | 0-10 |
| Cash | 0 | 0 | 0-5 |
| Total | 100 | 100 | |

The objectives of the Fund were redefined in December 2012 and are:

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

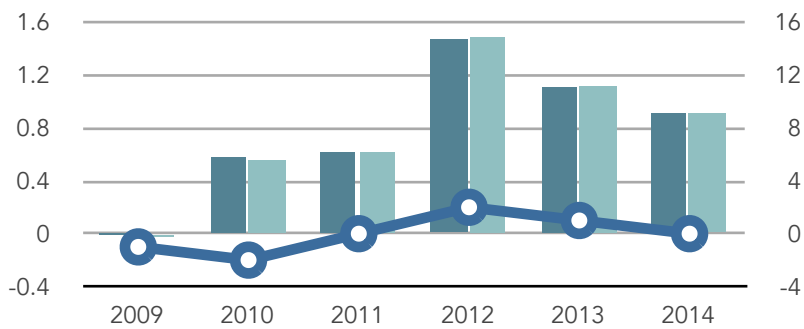
Investment performance

The absolute performance of Scottish Homes Pension Fund over the 12-month period was +2.1% and 3 year performance was +9.1% per annum. With a large allocation to bonds, the fund's performance over 2013/14 was affected by weak bond markets. Since inception in July 2005, the Fund has returned +8.0% per annum, well ahead of measures of inflation, and national average earnings.

Annualised returns to 31 March 2014 (% per year)

| | 1 year | 3 years | Since inception (July 2005) |
|-----------------------------|--------|---------|--------------------------------|
| Scottish Homes Pension Fund | 2.1 | 9.1 | 8.0 |
| Benchmark | 2.1 | 9.1 | 8.0 |
| Retail Price Index (RPI) | 2.5 | 3.1 | 3.3 |
| Consumer Price Index (CPI) | 1.7 | 2.6 | 2.8 |
| National Average Earnings | 1.5 | 0.9 | 2.3 |

Annualised 3 yearly returns ending 31 March (% per year)



○ Relative (LHS)
 ■ Benchmark
 ■ Scottish Homes Pension Fund

| | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 |
|------------------|-------|-------|------|------|------|------|
| Fund | (0.2) | 5.6 | 6.2 | 14.9 | 11.2 | 9.1 |
| Benchmark | (0.1) | 5.8 | 6.2 | 14.7 | 11.1 | 9.1 |
| Relative | (0.1) | (0.2) | - | 0.2 | 0.1 | - |

Scottish Homes Pension Fund

Fund Account for year ended 31 March 2014

| 2012/13 Restated* £000 | <i>Note</i> | 2013/14 £000 |
|-------------------------------|--|-----------------|
| Income | | |
| 794 | 2 | 791 |
| - | | - |
| 794 | | 791 |
| Less: expenditure | | |
| 7,070 | | 7,083 |
| 488 | | 329 |
| 2 | | 15 |
| 82 | 3 | 9 |
| 61 | 4 | 57 |
| 7,703 | | 7,493 |
| (6,909) | Net withdrawals from dealing with members | (6,702) |
| Returns on investments | | |
| 333 | 5 | 339 |
| 15,511 | 7a, 8b | 2,742 |
| (236) | 6 | (191) |
| 15,608 | Net returns on investments | 2,890 |
| 8,699 | Net (decrease) / increase in the Fund during the year | (3,812) |
| 131,418 | Net assets of the Fund at 1 April 2013 | 140,117 |
| 140,117 | Net assets of the Fund at 31 March 2014 | 136,305 |

*The results for the year ended 31 March 2013 have been restated to reflect a change in the accounting policy on investment management expenses. This change has the effect of increasing the change in market value of investment by £91k and increasing investment management expenses by £91k. There is no change in the net returns on investment. See note 19 for details.

Scottish Homes Pension Fund

Net Assets Statement as at 31 March 2014

| 31 March 2013 | | 31 March 2014 |
|----------------------------|--|---------------|
| £000 | <i>Note</i> | £000 |
| Investments | | |
| 138,006 | Assets | 133,761 |
| | - Liabilities | - |
| 138,006 | 7, 9 | 133,761 |
| Current assets | | |
| | - The City of Edinburgh Council | 175 |
| 2,514 | Cash balances | 2,383 |
| 55 | Debtors | 48 |
| 2,569 | | 2,606 |
| Current liabilities | | |
| (442) | The City of Edinburgh Council | - |
| (16) | Creditors | (62) |
| (458) | | (62) |
| 2,111 | Net current assets | 2,544 |
| 140,117 | Net assets of the Fund at 31 March 2014 | 136,305 |

The unaudited accounts were issued on 17 June 2014 and the audited accounts were authorised for issue on 23 September 2014.

JOHN BURNS FCMA CGMA
Pensions and Accounting Manager
23 September 2014

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 2014, and up to the date when these accounts were authorised, that require any adjustments to these accounts.

2 Contributions

| | 2012/13 | 2013/14 |
|--------------------------------------|---------|---------|
| | £000 | £000 |
| Deficit funding | 671 | 671 |
| Administration expenses contribution | 100 | 100 |
| Strain costs | 23 | 20 |
| | 794 | 791 |

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

| | 2012/13 | 2013/14 |
|----------------------|---------|---------|
| | £000 | £000 |
| Group transfers | - | - |
| Individual transfers | 82 | 9 |
| | 82 | 9 |

4 Administrative expenses

| | 2012/13 | 2013/14 |
|---|---------|---------|
| | £000 | £000 |
| Employee costs | 27 | 27 |
| The City of Edinburgh Council - pension payroll costs | 12 | 6 |
| The City of Edinburgh Council - other support costs | 8 | 7 |
| System costs | 5 | 5 |
| Actuarial fees | 6 | 7 |
| External audit fees | 1 | 1 |
| Printing and postage | 1 | 1 |
| Depreciation | 1 | 2 |
| Office costs | - | 1 |
| Sundry costs less sundry income | - | - |
| | 61 | 57 |

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. 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.

| 5 Investment income | 2012/13 | 2013/14 |
|---|------------|------------|
| | £000 | £000 |
| Property pooled investment income | 316 | 326 |
| Interest on cash deposits | 16 | 13 |
| Sundries | 1 | - |
| | 333 | 339 |
| Irrecoverable withholding tax | - | - |
| | 333 | 339 |
| 6 Investment management expenses | | |
| | 2012/13 | 2013/14 |
| | £000 | £000 |
| External management fees - invoiced | 68 | 72 |
| External management fees - deducted from capital | 91 | 61 |
| Transaction costs | 13 | 2 |
| Employee costs | 23 | 24 |
| Engagement and voting fees | 2 | 2 |
| Performance measurement fees | 2 | 2 |
| Investment consultancy fees | 13 | 1 |
| The City of Edinburgh Council - other support costs | 3 | 3 |
| Custodian fees | 15 | 18 |
| System costs | 5 | 4 |
| Legal fees | - | - |
| Office costs | - | 1 |
| Sundry costs | 1 | 1 |
| | 236 | 191 |

Following a change in accounting policy, the expenses for 2012/13 have been restated to account for costs that were deducted from capital and therefore impacted the change in market value of investments reported in the Fund Account. The related costs are included above as external management fees deducted from capital. Investment transaction costs that were previously added to the cost of purchases or deducted from the proceeds are now accounted for as expenses and shown above as transaction costs.

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

The Fund has not incurred any performance-related investment management fees in 2013/14 or 2012/13.

| 7 Net investment assets | 31 March | 31 March |
|----------------------------|----------------|----------------|
| | 2013 | 2014 |
| | £000 | £000 |
| Pooled investment vehicles | 138,006 | 133,761 |
| Net investment assets | 138,006 | 133,761 |

7a Reconciliation of movement in investments

| | Value at 1 April 2013 £000 | Purchases at cost £000 | Sales proceeds £000 | Change in market value £000 | Value at 31 March 2014 £000 |
|----------------------------|-------------------------------------|------------------------------|---------------------------|---|--------------------------------------|
| Pooled investment vehicles | 138,006 | 21,435 | (28,422) | 2,742 | 133,761 |

| | 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 | 4,785 | (12,176) | 15,511 | 138,006 |

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.

Following a change in accounting policy, transaction costs are no longer included in the cost of purchases and sale proceeds. As a result, the figures for 2012/13 have been restated, information on transaction costs can now be found in note 6 on investment management expenses. Any indirect costs incurred through the bid-offer spread on some pooled investment vehicles are reflected in the cost of investment acquisitions and in the proceeds from sales and are therefore included in the tables above.

7b Analysis of Investments (at market value)

| | 2012/13 £000 | 2013/14 £000 |
|-----------------------------|-----------------|-----------------|
| Pooled investment vehicles | | |
| UK managed funds - property | 11,352 | 6,960 |
| UK managed funds - other | 126,654 | 126,801 |
| | 138,006 | 133,761 |

7c Investment managers and mandates

| Manager | Mandate | Market value at 31 March 2013 £000 | % of total funds % | Market value at 31 March 2014 £000 | % of total funds % |
|---------------|---------------------------|--|-----------------------------|--|-----------------------------|
| State Street | UK equity | 12,351 | 8.9 | 8,777 | 6.6 |
| State Street | N American equities | 18,253 | 13.2 | 12,596 | 9.4 |
| State Street | European equities | 11,408 | 8.3 | 8,171 | 6.1 |
| State Street | Pacific (ex Jpn) equities | 4,661 | 3.4 | 3,225 | 2.4 |
| State Street | Japanese equities | 6,581 | 4.8 | 4,149 | 3.1 |
| State Street | Emerging mkts equities | 4,362 | 3.2 | 3,048 | 2.3 |
| | Total overseas equities | 45,265 | 32.9 | 31,189 | 23.3 |
| State Street | UK fixed interest | 12,540 | 9.1 | 17,336 | 13.0 |
| State Street | UK index-linked | 56,498 | 40.9 | 69,499 | 51.9 |
| | Total fixed interest | 69,038 | 50.0 | 86,835 | 64.9 |
| Schroders | Property | 7,509 | 5.4 | 6,960 | 5.2 |
| Standard Life | Property | 3,843 | 2.8 | - | - |
| | Total property | 11,352 | 8.2 | 6,960 | 5.2 |
| | Net financial assets | 138,006 | 100.0 | 133,761 | 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.

| | 31 March 2013 | | | 31 March 2014 | | |
|---------------------------------|---|-------------------------------|---|---|-------------------------------|---|
| | 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 | | | | | | |
| Pooled investments | 138,006 | | | 133,761 | | |
| | 138,006 | | | 133,761 | | |
| Other assets | | | | | | |
| The City of Edinburgh Council | | - | | | 175 | |
| Cash | | 2,514 | | | 2,383 | |
| Debtors | | 55 | | | 48 | |
| | | 2,569 | | | 2,606 | |
| Assets total | 138,006 | 2,569 | | 133,761 | 2,606 | |
| Financial liabilities | | | | | | |
| Other liabilities | | | | | | |
| The City of Edinburgh Council | | | (442) | | | - |
| Creditors | | | (16) | | | (62) |
| | | - | (458) | | - | (62) |
| Liabilities total | | - | (458) | | - | (62) |
| Net assets total | 138,006 | 2,569 | (458) | 133,761 | 2,606 | (62) |
| Total net financial instruments | | | 140,117 | | | 136,305 |

8b Net gains and losses on financial instruments

| | 2012/13 £000 | 2013/14 £000 |
|---|-----------------|-----------------|
| Designated as fair value through fund account | 15,511 | 2,742 |
| Loans and receivables | - | - |
| Financial liabilities at amortised cost | - | - |
| Total | 15,511 | 2,742 |

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.

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 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 2014 | | | |
|---|-----------------|-----------------|-----------------|---------------|
| | Level 1 £000 | Level 2 £000 | Level 3 £000 | Total £000 |
| Financial assets | | | | |
| Designated as fair value through fund account | 133,761 | | | 133,761 |
| Loans and receivables | 2,606 | | | 2,606 |
| Total financial assets | 136,367 | - | - | 136,367 |
| Financial liabilities | | | | |
| Designated as fair value through fund account | - | | | - |
| Financial liabilities at amortised cost | (62) | | | (62) |
| Total financial liabilities | (62) | - | - | (62) |
| Net financial assets | 136,305 | - | - | 136,305 |
| | | | | |
| | 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 |

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.

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
- 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 the Fund invests
- 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 | 10.5% |
| Index-linked gilts | 8.5% |
| Property | 13.0% |

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

Asset classes don't always move in line with each other. The extent to which assets move together is known as their "correlation". A lower correlation means that there is less risk of assets losing value at the same time. The overall Fund benefits from "diversification" because it invests in numerous different asset classes, which don't all move in line with each other. Consequently, the aggregate risk at the Fund level is less than the total risk from all the individual assets in which the Fund invests.

The following table shows the risks at the asset class level and the overall Fund level.

| Asset type | Value at 31 March 2014 £000 | % of fund % | Change + / - % | Value on increase £000 | Value on decrease £000 |
|------------------------------|--------------------------------|-------------|----------------|---------------------------|---------------------------|
| Equities - Developed Markets | 36,918 | 27.6 | 20.0 | 44,302 | 29,534 |
| Equities - Emerging Markets | 3,049 | 2.2 | 30.0 | 3,964 | 2,134 |
| Fixed Interest Gilts | 17,336 | 13.0 | 10.5 | 19,156 | 15,516 |
| Index-Linked Gilts | 69,498 | 52.0 | 8.5 | 75,405 | 63,591 |
| Property | 6,960 | 5.2 | 13.0 | 7,865 | 6,055 |
| Total [1] | 133,761 | 100.0 | 12.7 | 150,692 | 116,830 |
| Total [2] | | | 9.5 | 146,468 | 121,054 |
| Total [3] | | | 7.4 | 143,659 | 123,863 |

[1] No allowance for correlations between assets

[2] Including allowance for correlations between assets

[3] Including allowance for correlations between assets and liabilities

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

It can be seen that the risk to the overall Fund assets [2] is lower than the total of the risks to the individual assets [1].

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.

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 2014 cash deposits represented £2.4m, 1.7% of total net assets. This was held as follows:

| | Moody's Credit Rating at 31 March 2014 | Balances at 31 March 2013 £000 | Balances at 31 March 2014 £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 | 2,514 | 2,383 |
| Total cash | | 2,514 | 2,383 |

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.

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 2014 was held with the following institutions:

| | Moody's credit rating at 31 March 2014 | Balances at 31 March 2013 £000 | Balances at 31 March 2014 £000 |
|---|---|--|--|
| Money market funds | | | |
| Deutsche Bank AG, London | Aaa | 273 | 314 |
| Goldman Sachs | Aaa | 260 | 175 |
| Bank call accounts | | | |
| Bank of Scotland | A2 | 249 | 217 |
| Royal Bank of Scotland | Baa1 | 139 | 82 |
| Santander UK | A2 | - | 225 |
| Barclays Bank | A2 | 245 | 219 |
| Svenska Handelsbanken | Aaa3 | 355 | 337 |
| HSBC Bank | Aa3 | - | 325 |
| Bank near-call accounts | | | |
| Clydesdale Bank (15 Day Notice) | Baa2 | 245 | - |
| Bank certificates of deposit | | | |
| Standard Chartered | A1 | 96 | - |
| Floating Rate Note | | | |
| Rabobank | Aa2 | 96 | - |
| Building society fixed term deposits | | | |
| Nationwide Building Society | A2 | 96 | 108 |
| UK pseudo-sovereign risk instruments | | | |
| Other Local Authorities [1] | n/a | 460 | 273 |
| UK Government Treasury Bills | Aa1 | - | 108 |
| | | 2,514 | 2,383 |

[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 2014 would have been 'Aa1'). Of the £273k above, £119k 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.

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 approximately 94%) 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 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 £138m (2013 £136m). 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 2013 % p.a. | 31 March 2014 % p.a. |
|------------------------------------|----------------------------|----------------------------|
| Inflation / pensions increase rate | 2.8 | 2.6 |
| Discount rate | 4.5 | 4.1 |

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 aged 45 as at 31 March 2011) | 23.0 | 25.7 |

This assumption is the same as at 31 March 2013.

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 2013 £000 | 31 March 2014 £000 |
|----------------|--------------------------|--------------------------|
| Sundry debtors | 55 | 48 |
| | 55 | 48 |

Analysis of debtors

| | | |
|--------------------------------|----|----|
| Administering Authority | 1 | 1 |
| Scottish Government | 29 | 20 |
| Other entities and individuals | 25 | 27 |
| | 55 | 48 |

13 Creditors

| | 31 March 2013 £000 | 31 March 2014 £000 |
|--|--------------------------|--------------------------|
| Benefits payable | 16 | 39 |
| Miscellaneous creditors and accrued expenses | - | 23 |
| | 16 | 62 |

Analysis of creditors

| | | |
|--------------------------------|----|----|
| Other entities and individuals | 16 | 62 |
| | 16 | 62 |

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, which 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 Council 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 2013 | 31 March 2014 |
|------------------|------------------|
| £000 | £000 |
| (442) | 175 |

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 2014, the Fund had an average investment balance of £2.3m (2013 £2.5m). Interest earned was £12.3k (2013 £16.5k).

Year end balance on treasury management account

Held for investment purposes
Held for other purposes

| 31 March 2013 | 31 March 2014 |
|------------------|------------------|
| £000 | £000 |
| - | - |
| 2,514 | 2,383 |
| 2,514 | 2,383 |

Office accommodation- 144 Morrison Street, Edinburgh

Investment and Pensions Division of the Council has entered into an internal agreement with the Council for the provision of office accommodation at 144 Morrison Street in Edinburgh. The terms of the agreement are equivalent to those that would have been obtained had the accommodation been let on a commercial basis. In the accounts of the Fund the arrangement has been treated as a operational lease. The agreement was effective from November 2013. The Investment and Pensions Division is committed to making the following future payments.

Within one year
Between one and five
years
After five years

Recognised as an expense during the year

| 31 March 2013 | 31 March 2014 |
|------------------|------------------|
| £000 | £000 |
| - | - |
| - | 157 |
| - | 1,222 |
| - | 1,379 |
| - | 33 |

The above expense has been allocated across the three Funds. Scottish Homes Pension Fund's share is £0.8k.

Key management personnel

During the period from 1 April 2013 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:

| Name | Position held | Accrued CETV as at 31 March 2013 | Accrued CETV as at 31 March 2014 |
|-------------------|---|----------------------------------|----------------------------------|
| | | £000 | £000 |
| Alastair Maclean* | Director of Corporate Governance | 67 | 115 |
| Clare Scott | Investment and Pensions Service Manager | 89 | 126 |
| Struan Fairbairn | Legal and Risk Manager | 1 | 9 |
| John Burns | Pensions and Accounting Manager | 349 | 386 |
| Esmond Hamilton | Financial Controller | 101 | 119 |
| Bruce Miller | Investment Manager | 90 | 112 |

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

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.

19 Prior year adjustment

The cost of administering the Local Government Pension Scheme in the UK has come under increasing scrutiny in recent years. As a result, the decision has been made to change the Fund's policy on accounting for investment management expenses. This means that investment management costs that are deducted from the value of an investment are now recognised as a cost in the Fund Account rather than as a reduction in the change in market value of investments. Investment transaction costs that are added to an investment purchase price or deducted from the proceeds of a sale are also now recognised as a cost in the Fund Account rather than as a reduction in the change in market value of investments.

As a result of the above changes the results for the year ended 31 March 2013 have been restated. The change has the effect of increasing the change in market value of investments by £91k and increasing investment management expenses by £91k. The changes are reported in the Fund Account but there is no change to the net increase in the Fund for the year ended 31 March 2013 of £8.699m. The adjustments can be summarised as follows:

| | 2012/13 Fund Accounts as restated | Changes made |
|---------------------------------------|-----------------------------------|--------------|
| | £000 | £000 |
| Fund Account 2012/13 | | |
| Change in market value of investments | 15,511 | 91 |
| Investment management expenses | (236) | (91) |

Scottish Homes Pension Fund Actuarial Statement for 2013/14

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 2013/14.

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 from 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:

| Financial assumptions | 31 March 2011 | |
|--|----------------|-------------|
| | % 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% | - |

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 2014. It showed that the funding level (excluding the effect of any membership movements) had risen from 86% to 91%.

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

19 May 2014

Hymans Robertson LLP 20 Waterloo Street Glasgow G2 6DB

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 2013/14 (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 2014).

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.

The Statement of Accounts presents a true and fair view of the financial position of the Pension Funds as at 31 March 2014, and their income and expenditure for the year ended 31 March 2014.

JOHN BURNS, FCMA CGMA
Pensions and Accounting Manager
23 September 2014

Independent Auditor's Report

Independent auditor's report to the members of City of Edinburgh Council as administering body for Lothian Pension Funds and the Accounts Commission for Scotland

I certify that I have audited the financial statements of Lothian Pension Funds for the year ended 31 March 2014 under Part VII of the Local Government (Scotland) Act 1973. The financial statements comprise the fund accounts, the net assets statements and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union, and as interpreted and adapted by the Code of Practice on Local Authority Accounting in the United Kingdom 2013/14 (the 2013/14 Code).

This report is made solely to the parties to whom it is addressed in accordance with Part VII of the Local Government (Scotland) Act 1973 and for no other purpose. In accordance with paragraph 125 of the Code of Audit Practice approved by the Accounts Commission for Scotland, I do not undertake to have responsibilities to members or officers, in their individual capacities, or to third parties.

Respective responsibilities of the Pensions and Accounting Manager and auditor

As explained more fully in the Statement of Responsibilities, the Pensions and Accounting Manager is responsible for the preparation of financial statements and for being satisfied that they give a true and fair view. My responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) as required by the Code of Audit Practice approved by the Accounts Commission for Scotland. Those standards require me to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the funds' circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Pensions and Accounting Manager; and the overall presentation of the financial statements. In addition, I read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my report.

Opinion on financial statements

In my opinion the financial statements:

- give a true and fair view in accordance with applicable law and the 2013/14 Code of the financial transactions of the funds during the year ended 31 March 2014, and of the amount and disposition at that date of their assets and liabilities;
- have been properly prepared in accordance with IFRSs as adopted by the European Union, as interpreted and adapted by the 2013/14 Code; and
- have been prepared in accordance with the requirements of the Local Government (Scotland) Act 1973 and the Local Government in Scotland Act 2003.

Opinion on other prescribed matters

In my opinion the information given in the sections titled Review of the Year, About the Funds, and Investment and Financial Performance for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which I am required to report by exception

I am required to report to you if, in my opinion:

- adequate accounting records have not been kept; or
- the financial statements are not in agreement with the accounting records; or
- I have not received all the information and explanations I require for my audit; or
- the Governance Compliance Statement does not comply with guidance from the Scottish Ministers, or
- the Annual Governance Statement does not comply with Delivering Good Governance in Local Government.

I have nothing to report in respect of these matters.

DAVID MCCONNELL
Assistant Director of Audit
Audit Scotland
4th Floor, South Suite
The Athenaeum Building
8 Nelson Mandela Place
Glasgow, G2 1BT

23 September 2014

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 and accounts to the various stakeholders. It enables the Council and Lothian Pension Funds to monitor the achievement of their objectives and consider whether those objectives have led to the delivery of appropriate, cost-effective services.

The Council's Local Code of Corporate Governance is supported by evidence of compliance which is regularly reviewed and considered by the Governance, Risk & Best Value Committee. The Council has implemented arrangements for monitoring each element of the framework and providing evidence of compliance. The Governance Manager has reviewed the arrangements and is satisfied that the Code continues to be adequate and effective. The framework meets the principles of effective governance.

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;
- The preparation of regular financial reports which indicate actual expenditure against the forecasts; and
- Consideration of external and internal audit reports by the Governance, Risk and Best Value (GRBV) 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 Strategic plan, Community plan (SOA 4) and Service plans;
- identifying the objectives of the Funds in the 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 Pensions Committee, senior officers and stakeholders, including the Consultative Panel and Independent Professional Observer;
- describing the role of the Council and committees in committee terms of reference and delegated functions, procedural standing orders and the scheme of delegation;
- Financial Rules and Regulations (or equivalent) that specify the controls over budgeting, income, expenditure and financial performance;
- the Council's Monitoring Officer reports on any non-compliance with laws and regulations of which he is made aware;
- Governance, Risk and Best Value Committee whose core functions comply with CIPFA standards and has an audit remit, and the Pensions Audit Sub-Committee in respect of the Lothian Pension Funds;
- 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;
- a Code of conduct for staff and Standards Commission code for elected members; and
- Member/Officer Protocol;
- 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' Statement 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; and
- 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 controls, which is based on an ongoing process to identify and prioritise risks to the achievement of the Group's objectives.

A review of all aspects of governance, internal controls and financial management was initiated by the Director of Corporate Governance in September 2011. The Corporate Management Team agreed a range of actions to further develop and enhance corporate oversight including procurement, the internal control framework, policies and procedures along with a further focus on governance, risk and assurance. This approach was agreed by Council on 23 August 2012.

Good progress has been made to implement a range of improvements and a full overview was provided to the Governance, Risk and Best Value Committee on 14 November 2013.

The Director of Corporate Governance commissioned a further independent assessment over the robustness of the systems of internal control. The results of the assessment were received in March 2013. Of a total of 56 combined recommendations, 12 of these served to mitigate weaknesses exposing the Council, either individually or collectively, to a combination or risk of significant loss or error. As of 30 April 2014, 2 remain outstanding both relating to procurement and purchasing processes.

In addition to the specific measures put in place to strengthen elements of the Council's financial control framework, following Council's approval of the adoption of a co-sourced model, risk management and internal audit functions are in place and working well. A full overview was considered by the Governance, Risk and Best Value Committee on 30 January and 22 May 2014.

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

Review of effectiveness

The Local Code of Governance details the Council's arrangements for monitoring each element of the framework and providing evidence of compliance. The Council's Governance manager has reviewed the effectiveness of the Code and reported the result to the Governance, Risk and Best Value Committee in June 2014.

The Internal Audit Section operates in accordance with CIPFA's Code of Practice for Internal Audit. The Section undertakes an annual work programme based on agreed audit strategy and formal assessments of risk that are reviewed regularly. During the year, the Chief Internal Auditor reports to the Head of Legal, Risk and Compliance but had free access to the Chief Executive, all directors and elected members along with reporting directly to the Governance, Risk and Best Value Committee.

The Chief Internal Auditor and Council's Governance Manager have provided an assurance statement on the effectiveness of the system of internal control, which was informed by:

- service directors' certified assurances;
- Council officers' management activities;
- Internal Audit review work;
- Audit Scotland's review work leading to its Annual Audit Report;
- risk management procedures;
- reports by external, statutory inspection agencies; and
- assurances provided by the Chief Executives / Directors of Finance group companies.

In compliance with standard accounting practice, the Head of Finance has provided the Chief Executive with a statement of the effectiveness of the Council's internal financial control system for the year ended 31st March 2014. It is the Head of Finance's opinion that reasonable assurance can be placed upon its effectiveness.

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 2014. It is the Pension and Accounting Manager's opinion that reasonable assurance can be placed upon its effectiveness.

For the Council, each service director has reviewed the arrangements in his / her service areas and reported on their assessment of the effectiveness of control arrangements, together with any potential areas requiring improvement, to the Chief Executive. Where improvement actions are identified, an action plan will be developed and subject to regular monitoring. In reviewing the overall governance framework, the Council has also considered any relevant third party reviews and recommendations.

These reviews have identified actions that will be taken to continue improvement in the following activities:

By the Council:

- policy review and development arrangements of the Council Committees;
- the control framework of the Council's legacy property services;
- the control framework within the Council's shared repairs service;
- the robustness of internal control systems;
- the delegation of authority to officers below Directors;
- the processes to ensure compliance with policies and procedures;
- the processes to ensure compliance with health and safety legislation, regulations and guidance;
- the mitigation of risks during a time of change of structures and service delivery;
- the procurement activities of the Council;
- the awareness and understanding of the employee code of conduct, anti bribery policy and procedure, disciplinary and grievance procedures, ICT acceptable use policy, fraud prevention policy and whistleblowing policy;
- the processes to ensure income is timeously received by the Council;
- the implementation of action plans agreed with external inspection agencies;
- the implementation of actions identified by service directors;
- the planning for and implementation of health and social care integration;
- the management and oversight of major programmes and projects by the Corporate Programme Office; and
- the delivery of internal improvement plans.

Certification

It is our opinion that in light of foregoing, reasonable assurance can be placed upon the adequacy and effectiveness of the systems of governance of the Funds. The annual review demonstrates sufficient evidence that the Code is operated effectively and the Council complies with the Local Code of Corporate Governance in all significant respects.

SUE BRUCE

Chief Executive

23 September 2014

ALASTAIR MACLEAN

Director of Corporate Governance

23 September 2014

COUNCILLOR ALASDAIR RANKIN

Convener of Pensions Committee

23 September 2014

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 | <p>The City of Edinburgh Council acts as administering authority and delegates all pension scheme matters to a committee of seven members (Pensions Committee) made up as follows:</p> <ul style="list-style-type: none"> - Five City of Edinburgh elected members - Two external members from Lothian Pension Funds' Consultative Panel (one each from the employer and member representatives). |
| | That representatives of participating LGPS employers, admitted bodies and scheme members (including pensioner and deferred members) are members of either the main or secondary committee established to underpin the work of the main committee. | Yes | <p>The Pensions Committee includes two external places for pension fund stakeholders i.e. one each from the employer and member representatives taken from the Lothian Pension Funds' Consultative Panel. Two members of the Consultative Panel also attend the Pensions Audit Sub-Committee.</p> <p>Fund members and employers are also represented by a Lothian Pension Funds' Consultative Panel. Membership includes six employer representatives and six member representatives.</p> <p>All members of the Consultative Panel are invited to attend the meeting of the Pensions Committee and receive the relevant papers prior to those meetings.</p> |
| | That where a secondary committee or panel has been established, the structure ensures effective communication across both levels. | Yes | <p>The Pensions Audit Sub-Committee consisting of three members of the Pensions Committee, report to the Pensions Committee on their findings and recommendations.</p> <p>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.</p> |

| Principle | | Full Compliance | Comments |
|--|--|-----------------|---|
| Structure (cont'd) | 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 | <p>Membership of the Lothian Pension Funds' Consultative Panel consists of the Convener of the Pensions Committee, the two external members of the Pensions Committee and ten other representatives.</p> <p>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.</p> |
| Representation | That all key stakeholders are afforded the opportunity to be represented within the main or secondary committee structure. These include employing authorities (including non-scheme employers, e.g. admitted bodies) and scheme members (including deferred and pensioner scheme members) | Yes | <p>The Lothian Pension Funds' Consultative Panel consists of a mix of representatives:</p> <ul style="list-style-type: none"> - six employer representatives from non-administering authority employers (of which two places are reserved for Lothian Buses plc and Scottish Government) - six member representatives including one pensioner representative, three members (active or deferred) appointed by the Trade Union Consultative Committee and two members (active or deferred) appointed through an alternative route. |
| | Where appropriate, independent professional observers, and expert advisors (on an ad-hoc basis). | Yes | <p>An Independent Professional Observer was appointed in March 2013 to help Committee scrutinise advice.</p> <p>Three independent investment advisers sit on the Investment Strategy Panel.</p> <p>A separate specialist Pension Audit Sub-Committee consisting of three members (including at least two elected members from the City of Edinburgh Council) undertake the audit scrutiny of the pension funds.</p> |
| | That where lay members sit on a main or secondary committee, they are treated equally in terms of access to papers and meetings, training and are given full opportunity to contribute to the decision making process, with or without voting rights. | Yes | <p>The 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.</p> |
| Selection and Role of Lay Members | 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 | <p>A comprehensive training programme including induction is in place. Members of the Pensions Committee are expected to attend three days training each year and Lothian Pension Funds' Consultative Panel members one day's training each year. The members confirm that they have read and will abide by a Code of Conduct (specifically tailored for the Committee and Panel) prior to their appointment to the Lothian Pension Funds' Pensions Committee and Consultative Panel.</p> |

| Principle | | Full Compliance | Comments |
|---|---|-----------------|---|
| Selection and Role of Lay Members (cont'd) | That at the start of any meeting, committee members are invited to declare any financial or pecuniary interest related to specific matters on the agenda. | Yes | <p>The declaration of members' interests is a standard item on the agenda of the Pensions Committee and Pensions Audit Sub-Committee.</p> <p>A Code of Conduct also applies to all members of the Pension Committee and to the Lothian Pension Funds' Consultative Panel.</p> |
| Voting | The policy of individual administering authorities on voting rights is clear and transparent, including the justification for not extending voting rights to each body or group represented on main LGPS committees. | Yes | Five of the seven places 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 one each of the employer and member representatives 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 Code of Conduct also applies to all members of the Pension Committee and to the Lothian Pension Funds' Consultative Panel which addresses these matters. This Code is under continual review in order that it remains up to date and that it contains an appropriate level of detail. |
| | 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 development obligations. |
| | 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. |

| Principle | | Full Compliance | Comments |
|------------------------------------|--|-----------------|--|
| Meetings frequency (cont'd) | 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 | <p>The Lothian Pension Funds' Consultative Panel attends all the Pensions Committee meetings. Further meetings are held if necessary.</p> <p>The Pensions Audit Sub-Committee is held before the Pensions Committee at least three times with further meetings held if necessary.</p> <p>The Investment Strategy Panel meets quarterly or more frequently as required.</p> |
| | 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 | <p>The Pensions Committee deals with all matters relating to both the administration and investment of the Funds.</p> <p>A separate specialist Pension Audit Sub-Committee consisting of three members (including at least two elected members from the City of Edinburgh Council) undertake the audit scrutiny of the pension funds.</p> |

| Principle | | Full Compliance | Comments |
|------------------|--|-----------------|---|
| 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 | <p>The City of Edinburgh Council is responsible for the appointment of members to the Pensions Committee.</p> <p>However on an annual basis:</p> <ul style="list-style-type: none"> - 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. <p>Membership of the Consultative Panel is rotated every three years.</p> <p>The Funds publish governance documents and communicates regularly with employers and scheme members. Two members of the Consultative Panel are recruited by self nomination.</p> |

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 (not taking into account of our controls) faced by the Fund change over time and ongoing management of risk is crucial.

The Funds also have a compliance policy and each manager is responsible for ensuring compliance within their area of responsibility. Risk management has been strengthened by the appointment of the Legal and Risk Manager in March 2013.

The most significant risks at 31 March 2013 were as follows:

| Description | Before controls | | | After controls |
|---|-----------------|------------|------------|-----------------------------|
| | Impact | Likelihood | Risk score | Risk score at 31 March 2013 |
| 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 |

As at 31 March 2014, the most significant risks (taking account of controls), as assessed by the Investment and Pensions Service Management Team, were as follows:

| Description | After controls | | | |
|--|----------------|------------|------------|-------------|
| | Impact | Likelihood | Risk score | Risk target |
| Business continuity issues (associated with our office move) | 7 | 5 | 35 | 18 |
| The collapse of an employer body member, leading to pressure on other employers | 4 | 8 | 32 | 21 |
| Recruitment and retention of appropriate key staff | 5 | 6 | 30 | 16 |
| Adverse movement against non-invest assumptions leading to pressure on employer contributions | 5 | 5 | 25 | 20 |
| Acting out-with proper authority/delegations (associated with updating our internal sub-delegation/signature policies) | 6 | 4 | 24 | 4 |

Additional information

Key documents online

You can find further information on what we do and how we do it, on our website at www.lpf.org.uk/policy

[Actuarial Valuation reports](#)

[Consultative Panel constitution and operation guidance](#)

[Annual Report and Accounts](#)

[Statement of Investment Principles](#)

[Communications strategy](#)

[Funding Strategy Statement](#)

[Service Plan](#)

[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: | Dedicated in-house resource |

Comments and suggestions

We appreciate your comments and suggestions on this report. Please let us know which sections you found useful and if you have any suggestions for items to be included in the future. Please email your comments to pensions@lpf.org.uk

Accessibility

You can get this document on tape, in Braille, large print and various computer formats if you ask us. Please contact the Interpretation and Translation Service (ITS) on 0131 242 8181 and quote reference number 00819. The ITS can also give information on community language translations.

Contact details

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

Address: Lothian Pension Fund, Atria One, 144 Morrison Street, Edinburgh EH3 8EX
Telephone: 0131 529 4638 **Fax:** 0131 529 6229
Email: pensions@lpf.org.uk **Web:** www.lpf.org.uk

Lothian Pension Fund
Atria One
144 Morrison Street
Edinburgh
EH3 8EX

Pensions Audit Sub Committee

2.30 p.m., Monday, 22 September 2014

Review of Investment Operations

| | |
|-------------------|-----|
| Item number | 5.3 |
| Report number | |
| Executive/routine | |
| Wards | All |

Executive summary

This report summarises the key matters in relation to the investment controls and development of the in-house investment operations. These are:

- **Investment controls and consultant's recommendations:** the Fund has made significant progress in reviewing and implementing the recommendations of the external consultant following their review of the in-house investment operations in December 2013.
- **Financial Conduct Authority (FCA) Authorisation:** the Fund is making progress in seeking authorisation from the Financial Conduct Authority (FCA) in order to strengthen internal controls and facilitate further development of the in-house investment function.

Links

Coalition pledges

Council outcomes

CO26 –The Council engages with stakeholders and works in partnership to improve services and deliver on agreed objectives.

Single Outcome Agreement

Report

Review of Investment Operations

Investment Controls

Following the review of the Fund's in-house function by external consultants, the recommendations have been considered and action prioritised in order to improve controls. Importantly, the Fund has sought to apply a cost/benefit analysis to determine whether, and when, it would be most appropriate to implement particular recommendations (e.g. some being more appropriate to circumstances which may arise in the future, but would not be justified in the context of the current activities of the in-house investment team).

As reported to Committee in March 2014, the review concluded that the Fund's existing systems and controls are generally sufficient for the Fund's current investment activity.

The recommended improvements have been considered by the Fund and progress made in a number of areas. The key recommendations of the report are outlined below with an update provided on each:

- **Dedicated front office systems:** a dedicated front office portfolio management system (in relation to reviewing, managing and confirming portfolio/stock details, trades etc.) would be required in the event of increased investment activity.

Update: There has been no increased level of activity and hence this has not been pursued further at this stage. The need for such a system will be kept under review.

- **Operational due diligence on custodian and external investment managers:** the Fund currently carries out regular reviews of underlying investments and periodic reviews of the custodian and external managers. The consultant recommended more detailed and regular operational review of providers' systems and alignment with the Fund's requirements.

Update: Some, albeit limited discussions have been held with providers so far. With the completion of the Fund's accounts for 2013/14 and the appointment of a replacement Finance Manager for the Fund, this action will be progressed.

- **Staff remuneration and retention:** the review identified that the Fund does not externally benchmark salaries and that the notice period provisions in staff contracts were not in line with market practice for the relevant roles. The consultant also noted that the Fund adheres to wider Council Human Resource (HR) policies and procedures but ideally special arrangements should be made for key staff to mitigate this risk.

Update: Options to manage this risk have been considered in some detail and recommendations are provided separately on the agenda.

There has also been progress on a number of other improvements, including:

- An audit of the currency trading of the Fund which will be reported to Pensions Audit Sub-Committee on 22 September 2014;
- Changing the sign-off for alternative investments to formally recognise that decisions are made by the relevant internal investment committee, rather than solely the Investment & Pensions Service Manager;
- Various procedural changes relating to instructions and authorisations between the investment managers and administrators.

An update on all the recommendations has been provided to the Convener of the Pensions Committee, the Convener of the Pensions Audit Sub-Committee, the Independent Professional Observer and the Investment Strategy Panel.

FCA Authorisation

The critical matter to determine for the application for FCA authorisation is the extent of regulatory permissions that the Fund is looking to obtain. This determines what the Fund can do in the regulated environment, the complexity of the level of regulation that will apply to it and also the resource/cost burden of maintaining this entity. We are in the process of refining the Business Plan, which is required for the application.

Initially, the Fund will be looking to limit the scope of permissions to those relating to advising on and dealing in investments (e.g. we will not be seeking permissions that relate to the custody of assets or operating collective vehicles etc.) and so we will be subject to a lower level of regulation. Consequentially the capital requirements and resource/cost burden of managing and administering the vehicle will be kept to a relative minimum. It is worth noting that there is scope to vary the FCA permissions at a later date if required in the future.

Work is underway to establish what would be required, internally, to set up the vehicle which would apply for the FCA authorisation and to consider the accounting, tax and employment implications. It is likely that the vehicle would be a UK limited company, to ensure that the Fund/Council's exposure to liability in relation to the activities of the entity are limited to the extent of its regulatory capital. These discussions are ongoing. Critically, the vehicle will be wholly owned by the City of Edinburgh Council in its capacity as administering authority of the pensions funds, so all costs and returns will flow to and from the pension funds (with statutorily ring-fenced finances). Assurance from external legal and financial advisors on particular aspects of the structure (including on the tax and employment implications) is likely to be sought.

Separately, work is underway to determine the current regulatory position of the in-house investment team, as this will feed into the Business Plan.

Further work will involve producing a Compliance Manual suitable for an FCA authorised entity and in ensuring staff that will FCA authorised undertake the necessary training and, if appropriate, qualifications. The majority of the investment team have previously held approved person status and so it is not anticipated that this process would be overly onerous.

It is expected that the application to the FCA will be submitted within the next six months and the FCA will then have between 6-12 months to consider this and come to a decision. Initial indications from the FCA are that the previous backlog of applications is now being cleared. Therefore they may not require the full 12 months for the Fund's application which is likely to be a relatively straightforward application by comparison with others.

Recommendations

- 1.1 It is recommend that Committee notes the progress made in relation to implementing the recommendations of the external consultant and in seeking FCA authorisation and highlights any points it would like to raise at the Pensions Committee on 23 September 2014.

Measures of success

- 2.1 That the Fund continues to develop efficiencies for the benefit of its members, employer bodies and the taxpayer, while mitigating any risk associated with the necessary arrangements, and seeks to continue to improve its service provision and adapt the operations to the wider structural changes facing public sector pension funds.

Financial impact

- 3.1 There is no direct financial impact associated with the update of progress in relation to the matters set out in this report. Costs associated with implementing investment operation improvements and seeking and maintaining FCA authorisation are contained within the agreed budget for 2014-17. Improved operations should reduce financial risks.

Risk, policy, compliance and governance impact

- 4.1 The review of operations highlighted areas for the improvement of governance and risk and these are being implemented.

Equalities impact

- 5.1 None.

Sustainability impact

- 6.1 None.

Consultation and engagement

- 7.1 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.

Alastair Maclean

Director of Corporate Governance

Contact: Struan Fairbairn, Legal and Risk Manager

E-mail: Struan.Fairbairn@edinburgh.gov.uk | Tel: 0131 529 4689

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

Pensions Audit Sub Committee

2.30p.m, Monday, 22 September 2014

Pension Fund Investment Staffing

| | |
|--------------------------|-----|
| Item number | 5.4 |
| Report number | |
| Executive/routine | |
| Wards | All |

Executive summary

The risk of the lack of remuneration benchmarking and short notice periods for investment staff has been highlighted by an external consultant's inspection of the pension fund operations. This report highlights the issue and potential options to manage the risk.

The options involve different risks and implications for the investment strategy and budget for the pension funds.

Pensions Committee is asked to agree to employ pension fund investment staff via a special purpose vehicle separate to the Council. As a phase 1 pilot, 6 posts of grade 10 or above (11 staff members) would be transferred. Consultation with staff would then progress and requisite approval for the establishment of the special purpose vehicle would then be sought.

Links

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Single Outcome Agreement

Pension Fund Staffing

Recommendations

- 1.1 Pensions Committee is asked to agree to employ certain pension fund investment staff via a special purpose vehicle separate to the Council, consult with staff and request requisite approval for the establishment of the special purpose vehicle.

Background

- 2.1 Lothian Pension Fund has, for many years, in-sourced investment management for part of the Fund. Aside from lower cost, the advantages of internal investment management include the fact that investment staff are more clearly aligned to the pension fund, they are not distracted by non-investment issues (such as marketing, advertising, client service and business development). Independent analysis of local government pension fund schemes shows that funds which are internally managed outperform in the long term.
- 2.2 Over recent years, the internal team has been expanded, which has facilitated further in-sourcing investment functions as well as the development of innovative and low cost investment strategies to meet the significant funding challenges faced by the pension funds.
- 2.3 The team currently manages over £3bn (63% of the pension funds). The costs of managing the pension funds are deducted from the funds. The budget for 2014/15 is £13.6million, which includes £9.5million for external investment management costs.

Main report

- 3.1 The Director of Corporate Governance requested a review of investment governance arrangements of the pension funds and in December 2013, an external consultant was appointed to review the investment operations particularly relating to the internally managed investments. The review considered governance and organisational structure, team size and adequacy, compliance processes and controls and investment systems by comparison to industry best practice in the private sector, but also in the context of the structure of a local government pension fund.

3.2 The review concluded that the existing systems and controls are generally sufficient for the Fund's current investment activity. However, the consultant highlighted a key risk associated with staff remuneration and retention which had also been identified as a risk internally as follows:

Staff remuneration and retention: the review identified that the Fund does not externally benchmark salaries and that the notice period provisions in staff contracts were not in line with market practice for the relevant roles. The consultant also noted that the Fund adheres to wider Council Human Resource (HR) policies and procedures but ideally special arrangements should be made for key staff to mitigate this risk.

3.3 It is well recognised in the investment industry that stability of employees with a well defined objective is a key indicator of success and turnover of staff is a recipe for poor outcomes. Not only could significant change prompt an expensive contingency plan, it could jeopardise the strategy.

3.4 Since the consultant reported their findings, analysis has been undertaken on the impact of loss of investment staff and advice sought from the Council's Organisation Development regarding remuneration benchmarking and staff retention.

3.5 A contingency plan is also being put in place to ensure that, if the risk materialised, the operational risks could be closed quickly. Indicative costs of such a contingency are significant with additional fees of £8-10million per annum plus one-off transaction costs. These are central scenario estimates. In addition workforce and succession planning strategies are being reassessed to help mitigate the risk of people potentially leaving the service in future.

3.6 Insight into the investment management industry indicates that the risk of staff departures is considered to be meaningful. As outlined above, the potential implications for the pension funds are significant.

3.7 Pension fund staff are Council employees and are subject to the Local Government terms and conditions of service negotiated and implemented in October 2010 in response to the Single Status agenda. Hence changes to the terms and conditions are not straightforward.

3.8 Options to manage/mitigate this risk are as follows:

- Option 1: Tolerate the risk and enact the contingency plan in the event of the risk materialising. Prompt and immediate action would be required to implement the contingency and reduce operational risks. However, some risks will inevitably remain.
- Option 2: Introduce different terms and conditions for affected staff. While this would help to manage the risk to the pension fund, it could increase the risk that the Council is exposed to further equal pay claims.
- Option 3: Close down the risk and out-source the investment management service. This would have major strategic and financial implications for the

pension fund, similar to those resulting from enactment of the contingency plan.

- Option 4: Employ staff via a special purpose vehicle separate to the Council.

- 3.9 The options involve different risks and implications for the investment strategy and budget for the pension funds. The preferred option is Option 4. Not only would this enable the current investment and funding strategies to be implemented to achieve the pension funds' objectives, it would allow for opportunities to further develop strategies and reduce costs. Staff will simply move into a special purpose vehicle and there would be no changes to the fund.
- 3.10 The special purpose vehicle would be wholly owned by the Council and there should be a formal and transparent procedure for developing policy on remuneration. .
- 3.11 It is proposed that the board of the special purpose vehicle consist of the Director of Corporate Governance, Head of Finance and Head of Organisation Development and Investment & Pensions Service Manager. They would be responsible for the setting of remuneration and terms and conditions of employment. However, the Investment & Pensions Service Manager would not be involved in any decision as to their own remuneration or terms and conditions.
- 3.12 This does not necessarily imply that salaries will be higher in the special purpose vehicle. The arrangement will allow the Board to consider benchmarking information and decide on appropriate terms and conditions in the future.
- 3.13 As a phase 1 pilot, 6 posts of grade 10 or above (11 staff members) would be transferred. The posts are the Investment & Pensions Service Manager, Investment Manager, Pensions & Accounting Manager, Legal & Risk Manager, Financial Controller and Portfolio Manager. They are all directly involved in the internal investment management function. Additional consideration could be given to the transfer of other roles and this would be the subject to consultation with trades unions and staff.
- 3.14 Pensions Committee is asked to agree to employ pension fund investment staff via a special purpose vehicle separate to the Council.
- 3.15 The next steps would be that requisite approval for the special purpose vehicle would be sought and consultation with staff and trades unions would be undertaken.

Measures of success

- 4.1 The investments of the pension funds are measured using performance indicators relative to market benchmarks.

Financial impact

- 5.1 The investments of the pension funds are critical in determining the contribution rates payable by the City of Edinburgh Council and other employers in the pension funds.

Risk, policy, compliance and governance impact

- 6.1 The risk of the lack of remuneration benchmarking and short notice periods for investment staff has been highlighted by an external consultant's inspection of the pension fund operations. This report highlights the issue and potential options to manage the risk.
- 6.2 The transfer of certain staff to a special purpose vehicle could impact on staff morale, both for those directly affected and others in the Fund not transferring to the special purpose vehicle. This risk will need to be managed accordingly. Communication will be particularly important in the lead up to the transfer.

Equalities impact

- 7.1 There is no equalities impact as a result of this report. Options to address the risks highlighted in this report could have an impact on equalities. Full equalities impact assessment would need to be undertaken as options are explored further.

Sustainability impact

- 8.1 Sustainable investing of pension fund monies is heavily reliant on a stable team. This report highlights the risk of loss of personnel and consequences, as potential options to mitigate this risk.

Consultation and engagement

- 9.1 The Consultative Panel for the Lothian Pension Funds, comprising employer and member representatives, is integral to the governance of the Funds. They attend meetings of the Pensions Committee.
- 9.2 Consultation and engagement with associated staff will be important as the options for change are developed.

Background reading / external references

None.

Alastair Maclean

Director of Corporate Governance

Contact: Clare Scott, Investment & Pensions Service Manager

E-mail: clare.scott@edinburgh.gov.uk | Tel: 0131 469 3865

Links

Coalition pledges

Council outcomes CO26 –The Council engages with stakeholders and works in partnership to improve services and deliver on agreed objectives.

Single Outcome Agreement Appendices

Pensions Audit Sub Committee

2.30p.m., Monday, 22 September 2014

Audit of Foreign Exchange Transaction Costs

| | |
|--------------------------|-----|
| Item number | 5.5 |
| Report number | |
| Executive/routine | |
| Wards | All |

Executive summary

This report considers the audit of foreign exchange (FX) transaction costs for the period 1 April 2013 to 31 March 2014. The company carrying out the audit considers the overall costs to be satisfactory and in line with typical market ranges.

In addition the audit report includes recommendations on possible future actions to further improve the control of costs. The internal team has consulted with its independent investment adviser to determine the appropriate approach to trade as efficiently as possible.

Links

Coalition pledges

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Single Outcome Agreement

Audit of Foreign Exchange Transaction Costs

Recommendations

- 1.1 That the Committee notes the contents of this report and highlights any points it would like to raise at the Pensions Committee on 23 September 2014.

Background

- 2.1 Over half of the Funds' investments are in overseas markets and as a result significant FX transactions are an inevitable part of the investment process.
- 2.2 A review of the Fund's FX trading was undertaken by Mercer Limited in 2012, covering transactions executed during the 2011 calendar year.
- 2.3 As part of the comprehensive review of investment operations which the Fund commissioned in late 2013, coverage of "FX trading arrangements and aspects of the service from the Fund's global custodian" was specified. In February 2014, the "Operational Gap Analysis" report by Mercer Limited concluded that "Lothian Pension Fund do(es) not undertake Transaction Cost Analysis (TCA) of their trades with brokers, and only review FX execution costs infrequently. Market practice is to undertake regular analysis of broker performance and foreign exchange trading, and challenge execution results against market indicators.We also recommend this TCA is extended to FX and results challenged with external managers and Northern Trust. TCA results can be summarised and reported to the Audit Committee."

Main report

- 3.1 Following competitive procurement, the Fund engaged Mercer Limited to analyse foreign currency exchange execution by its investment managers and global custodian, Northern Trust. The review covered transactions executed between 1 April 2013 and 31 March 2014.
- 3.2 The full report by the consultants is shown at Appendix 1.
- 3.3 The report's conclusion is that "overall costs (are considered) to be satisfactory and in line with typical market ranges".

- 3.4 Whilst the conclusion is reassuring and consistent with expectations, the methodology of the quantitative analysis produces results that are approximate. The transaction data does not include the time it was undertaken. This is a common issue in the industry. Without a full set of time-stamped data, Mercer evaluated individual trades against the mid-price for the day as well as the daily high-low range. As a result, the findings are imprecise.
- 3.5 This is exemplified by the estimated cost of the currency transactions in the Fund's Transition account. Mercer's methodology indicates an excess monetary cost of £558,000 for a very large transaction (in the context of total excess monetary cost of £607,000 for the year for the Fund). In reality, the £558,000 solely reflects the imprecise measurement methodology - there was no excess monetary cost as the transactions were completed at the WM/Reuters 4pm benchmark, not at the mid-price of the day.
- 3.6 Nevertheless, some recommendations for potential improvement in the trading arrangements were made, specifically regarding:
- a. "proactive trading" of larger trades through direct market dealing rather than a standing instruction with the custodian;
 - b. any "out of day range trades" to be queried with the custodian;
 - c. periodic verification of trade rates on currency overlays.
- 3.7 The internal team has considered the recommendations and consulted with its independent investment advisor Gordon Bagot, who is an expert on foreign exchange pricing having been a pioneer in creating greater transparency in the foreign exchange markets.
- 3.8 The Fund has now adopted a more proactive trading approach for all trades to ensure the greatest transparency of execution possible. Mercer has confirmed that the new arrangements are sensible, cost effective and may allow for more precise analysis of costs in the future. In addition, the out-of-day range trades have been queried with the custodian and comfort has been gained. All currency overlay trades are already checked on the day of the transaction.

Measures of success

- 4.1 The measure of success is for the independent assessor to confirm the overall cost of FX transactions is satisfactory and in line with typical market ranges. This has been attained.

Financial impact

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

Risk, policy, compliance and governance impact

- 6.1 The purpose of the audit is to minimise the risk of the Funds incurring excessive FX transaction costs. The regular assessment of the Funds' operating costs is an important element of good governance.

Equalities impact

- 7.1 There are no equalities implications as result of this report.

Sustainability impact

- 8.1 There are no sustainability implications as result of this report.

Consultation and engagement

- 9.1 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

Alastair Maclean

Director of Corporate Governance

Contact: Esmond Hamilton, Financial Controller

E-mail: Esmond.hamilton@edinburgh.gov.uk | Tel: 0131 469 3521

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 Foreign Exchange Transaction Cost Analysis for Lothian Pension Fund by Mercer, dated July 2014

FOREIGN EXCHANGE TRANSACTION COST ANALYSIS

LOTHIAN PENSION FUND

JULY 2014

1

Introduction

1.1. Scope

The City of Edinburgh Council as administering authority for the Lothian Pension Fund (the Fund) has engaged Mercer to analyse foreign currency exchange (FX) execution by its investment managers and custodian, Northern Trust (Northern). This review covers transactions executed between 1 April 2013 and 31 March 2014. Mercer has previously undertaken a similar review in 2012 for the Fund, covering transactions executed during the 2011 calendar year.

1.2. Background

Investment managers have three main reasons for exchanging foreign currencies: 1) asset sales/purchases, 2) income repatriation, and 3) exposure management (using currency to express their investment views or to maintain a hedge).

- Asset transactions – When buying an asset in one country, the manager will need that country’s currency to settle the purchase. Investment managers will use the excess currencies supplied by securities sales to buy the required currency to settle purchases.
- Income repatriation – FX transactions also arise when income, such as dividend or interest payments, are repatriated. The manager may bring all cash flows back to the base currency (e.g. £) or use the cash flow to make a purchase in another country. In either case, FX trades takes place.
- Exposure management – The motivations associated with maintaining a hedge can be materially different from the immediate considerations surrounding an individual asset transaction. Accordingly, the trading characteristics of individual components taken out of context can appear sub-optimal. For example, many hedges will require a “contract roll” to extend the existing exposure. Typically, a roll will involve the purchase (sale) of a forward and the simultaneous sale (purchase) of a spot contract. Either side of this paired transaction may show extreme cost (or gain) in isolation; whereas the complete pair may show a fairly neutral cost result.

FX is priced and dealt on a (bid-offer) basis. The difference between the bid and offer price is known as the spread, which is the market cost of trading. Execution outside the prevailing bid-offer range suggests that the Fund is paying an excess cost. There are many reasons why excess expense may be incurred; however, one should be aware of the magnitude and drivers of costs that result from pricing outside the bid-offer spread, in order to assess the reasonableness of the Fund’s expenses.

A bid-offer market means those trading FX using a bank intermediary cannot easily identify or measure the potential excess cost or benefit on a given deal. As a result, the only way to assess whether a particular FX transaction is in line with the market is to review the posted bid-offer spreads across market makers on the day in question. Preferably such analysis will be done using time-stamped trade information. In the absence of time-stamped trade information, trade cost analysis can use the high offer and low bid of a trading day as a proxy (the day-range methodology).

1.3. Sources

Northern did not provide time-stamped transaction data (i.e., the actual time of day when each trade was executed). Time-stamped data benchmarking evaluates execution performance within the intra-day trading ranges of the currencies traded, the price at which each trade was executed, and the volume of each trade executed. In the absence of time-stamped data, we base our analysis on intra-day market price ranges (the highest and lowest execution of the day). Based on these prices, we calculate the day's midpoint from the high offer and low bid. We then compare the actual execution price against the midpoint and the daily range.

***Note:** Northern do provide the Fund with time stamped information for trades that are instructed via standing instruction only. Whilst this information is beneficial for verification of rates, the day-range analysis methodology is required given the lack of a complete data set. Mercer are aware of other Northern clients who receive similar data. Generally, the availability of time stamps from other custodians is very limited.*

Our analysis is based on foreign exchange transaction data supplied by Northern, containing all transactions executed by Northern, and the Fund's investment managers over the period from (1 April 2013) to 31 March 2014. Mercer has run reasonability checks on the data, but we cannot verify the data's accuracy or completeness. ***The analysis undertaken places reliance on the accuracy and completeness of the data provided by Northern.***

We have utilised Bloomberg data as the primary benchmarking source.

1.4. Methodology

Mercer utilises in-house software to compute all trade costs, classify transactions, and generate summary analyses. As Northern did not provide time-stamped trade data, our analysis evaluates individual trades against the mid-price for the day as well as the daily high-low range, and then uses statistical principles to aggregate those individual results into meaningful cumulative results. A fundamental assumption underlying our analysis methodology is that foreign currency trades are normally distributed around the mid-price for the day. "Mid-price" is defined as the average of the recorded high and low prices.

Mercer analyses trades according to trade size, direction (buys and sells), currency pairs, and execution method or contract types. The Fund's data has sufficient observations to draw statistically significant conclusions for all commonly used ways of assessing the data. The cost/benefit figures in this report have been adjusted for estimated prevailing bid/ask spreads. Typically, Mercer will evaluate a transaction price relative to the mid-point of the day's trading range with an "imputed spread" adjustment, which varies based upon the currency pair in question. Actively traded currency pairs typically have narrow bid/ask spreads; illiquid or restricted currencies may have wider spreads.

2

Executive Summary

2.1. Findings

Table 2.1 below provides the overall results of our benchmark analysis, for all managers excluding the Fund's Currency Overlay. Given the highly specialised nature of the Overlay mandate, the results are discussed separately in Section 5.

Table 2.1: All Trades excluding currency overlay

| | |
|--|---------------|
| Value of FX traded, £ | 2,206,471,472 |
| Number of FX trades | 3,679 |
| Excess benefit/(cost) on FX trading, £ | (607,149) |
| Excess benefit/(cost), bps | (2.75) |

In Mercer's review in 2012, the trade results excluding the dedicated FX managers produced a 2.3bps excess cost against benchmark. The results above for 2013/14 show a very similar result with an excess cost of 2.75 bps. Whilst a monetary cost, Mercer believe the result is within market expectation. Mercer considers the overall costs to be satisfactory and in line with typical market ranges.

By far the largest driver of excess monetary cost was observed on the LPF Transition account, accounting for over £558,000 of excess cost on £700m of trade volume. In particular, Mercer observed a single, very large GBPUSD trade on the account on which an estimated £330,000 of excess cost was estimated. However, it should be noted that the trades in the transition account were executed against the WM/Reuters 4pm benchmark, against which there were no excess costs observed, and therefore the £558,000 of excess cost can be attributed to daily market movements. Table 2.2 below shows a comparison of cost impact for 74 of the 77 trades on the account (WM data was not available for 3 trades) against both benchmarks, and clearly evidences market movements were the largest source of cost for the account.

Table 2.2: Transition Account trades

| Manager | Volume, £ | Trades | Day mid-point impact, £ | 4pm Impact, £ |
|------------------------|-------------|--------|-------------------------|---------------|
| LPF Transition Account | 698,976,853 | 74 | (550,795) | 38,238 |

Showing an improvement from the 2012 review, we observed 112 trades executed outside the day's prevalent trading range, representing less than 1% of all trade value (135 trades in 2012). Of the 112, 14 were "market" sized trades, 9 of which were on the Harris portfolio (£6.1m

principal, £17,900 cost). We suspect the results of these Harris trades may be due to a timezone issue, and given Harris' wider, satisfactory results, do not believe there is an immediate cause for concern and details have been provided to Fund staff for further investigation.

Currency Overlay

Table 2.3a below shows the six trades executed by Northern benchmarked against the prevailing 12pm WM/Reuters rate plus the applicable forward points and a small fixed basis point spread. As the near-neutral cost results show, we can confirm Northern traded in line with their instruction and applied the appropriate benchmark rate and spreads. However, the Fund should note that Mercer believe best practice for currency hedge trades is to verify execution as and when the overlay "rolls" to promptly identify any issues, especially given the manual nature of Northern's hedging calculation.

Table 2.3a: Currency overlay trades - benchmark rate available

| | |
|--|-------------|
| Value of FX traded, £ | 673,053,002 |
| Number of FX trades | 6 |
| Excess benefit/(cost) on FX trading, £ | 33,477 |
| Excess benefit/(cost), bps | 0.49 |

Table 2.3b: Currency overlay trades – trading day mid-point benchmark

| | |
|--|-------------|
| Value of FX traded, £ | 320,369,697 |
| Number of FX trades | 8 |
| Excess benefit/(cost) on FX trading, £ | (108,834) |
| Excess benefit/(cost), bps | (3.4) |

The results above in Table 2.3b show the remaining 8 currency hedge trades benchmarked against the mid-point of the trading day. The results appear satisfactory; however the very limited sample size reduces the ability to draw meaningful conclusions. However going forward, we understand all trades will be executed against the 12pm WM/Reuters rate.

Northern had reported a further 10 currency overlay trades to Mercer with value £322m, which were predominantly GBPAUD trades. However, upon querying the execution results of these trades, Northern stated they were in fact trade novations from their take-on of the currency hedge. As such, the trade date was reported as the date of novation rather than the original execution date, thereby giving incorrect results.

2.2. Recommendations

- The excess costs were driven by trading on the LPF Transition Account. However, as noted below, Mercer understands the trading for the accounts were undertaken using the prevailing WM/Reuters 4pm rates (against which the results were favourable). As such, the costs can be attributed to market movements. However, we believe very large trades (e.g. over £5m) could be traded more “proactively”. We understand the Fund does not have access to an FX trading platform such as FX All or FX Connect, but as a potential interim solution could trade directly with the Northern trading desk using indicative quotes from Bloomberg as a guide. In Mercer’s experience, clients have often reported more favourable transaction rates simply by dealing direct with an FX desk compared to deferring to a standing instruction arrangement. Nevertheless, the Fund’s current trading procedure of utilising the WM/Reuters 4pm rate is transparent and costs easily verifiable.
- The Fund currently have an arrangement in place with Northern whereby all standing instructions are priced at the WM/Reuters 4pm rate plus small fixed basis point spread. Mercer believes this is reasonable, but as observed above, would recommend managers are encouraged to proactively seek favourable quotes in the market when dealing larger trades.
- Mercer also considered potential solutions to improve FX efficiency. Given the results observed from the Fund’s trading, which appear slightly atypical to Mercer’s experience (i.e. more favourable results for smaller trades), we do not believe there is a firm basis for immediate implementation of any new solution. However, the Fund could further consult with Northern with respect to any solution that could be easily implemented, albeit such discussions would not be deemed high priority.
- Although showing a significant improvement from the 2012 review, the Fund may also wish to query the out of day range trades. At a minimum, investors can expect in-day range execution or a clear reasoning if there is a reporting issue. Mercer has provided further to the Fund staff.
- Analysis of the currency overlay was very limited due to constraints with trade data. Given the size and potential impact of the currency overlay trades, Mercer recommend the Fund perform a simple verification of the trade rates each month/quarter as reported by Northern, ensuring any errors are immediately spotted and can be rectified more efficiently. A simple “eyeball” comparison to Bloomberg or Reuters should be sufficient to identify incorrect or misreported trade rates. Northern provide this data to the Fund therefore a simple check should be straightforward.
 - For the limited trade information provided to Mercer, we can confirm the trades executed in September 2013 and January 2014 were priced in line with the time stamp and spreads agreed.

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Mercer Limited
Quartermile One, 15 Lauriston Place
Edinburgh EH3 9EP
+44 (0)131 226 4884

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Pensions Audit Sub-Committee

2.30 p.m., Monday, 22 September 2014

Pensions Administration Data Quality

| | |
|--------------------------|-----|
| Item number | 5.6 |
| Report number | |
| Executive/routine | |
| Wards | All |

Executive summary

The purpose of this report is to inform the Pensions Audit Sub-Committee of the ongoing work to enhance the quality of pension administration membership record data.

Aside from poorer service for members and additional costs in areas such as error correction and compensation claims from members, poor record-keeping could potentially necessitate more conservative actuarial assumptions as well as causing reputational damage. Lothian Pension Fund, therefore, places a high importance on the quality of its pension administration data. The information demands of accurate record-keeping are also expected to increase with the introduction of a scheme based on career average revalued earnings (CARE) in 2015.

The Fund continues with its efforts to improve the flow of data from employers through regular reporting and meetings to discuss issues and improvements. Criteria for passing on the Fund's costs associated with poor record keeping and/or poor service from employers have also been developed and consultation with employers will follow in the coming months.

Links

Coalition pledges

Council outcomes

CO26 –The Council engages with stakeholders and works in partnership to improve services and deliver on agreed objectives.

Single Outcome Agreement

Pensions administration data quality

Recommendations

- 1.1 Pensions Audit Sub-Committee is requested to note the report and highlight any points it would like to raise at the Pensions Committee on 23 September 2014.

Background

- 2.1 At its meeting on 20 September 2013, Pensions Audit Sub-Committee noted the report by the Director of Corporate Governance on the ongoing work to enhance the quality of pensions administration membership record data. This report also emphasised the importance of good record-keeping, given the serious negative implications of inaccurate and missing information. An update on progress is now provided on an annual basis.
- 2.2 As stated in the Lothian Pension Funds Annual Report 2014 Unaudited, the Funds are fully compliant with best practice as defined by The Pensions Regulator's "Guidance on record-keeping".
- 2.3 As Committee is aware, Lothian Pension Fund introduced a new employer on-line system in 2013/14. This portal facilitates secure electronic data transfer of member payroll information from employers to the Funds, serving to increasing efficiency and reducing the risk of manual errors.

Main report

- 3.1 A range of initiatives have been adopted by Lothian Pension Fund to improve and update its membership records. A summary of progress to-date is provided as follows:

Employer on-line data transfer portal

- 3.2 All the Fund's employers now utilise the electronic portal to transmit and receive forms and documents.
- 3.3 Following liaison with the system supplier, the portal was refined to fully incorporate monthly reconciliation of pension contribution payments by employers to member individual records. As advised previously, this presented an opportunity to reduce historic reliance on year-end validation and potentially achieve transformational improvement in data quality. Specifically, it allows the employer and the Fund to identify missing new member and leaver information as well as mismatches of member working hours on a monthly basis.

- 3.4 The work necessary to effectively introduce monthly contribution returns, however, should not be underestimated. Inevitably, a large number of initial data queries are identified and investigation of such, often going back many years, is time-consuming for employers and pension administration staff. Also, in certain instances, data extract reporting from employer payroll systems needs to be refined to suitably align with the portal. Otherwise some degree of data manipulation is required. Typically, this issue relates to Councils where one employee may hold multiple posts. A unique pensions identifier reference number is already embedded in the portal to address this complication.
- 3.5 Accordingly, a phased roll-out of monthly contribution returns by employers has been targeted by the Fund. This has been designed to facilitate “quick wins” where possible and also prioritise the largest employers.
- 3.6 Sixty-two employers are currently submitting monthly contribution returns. Of the Fund’s largest employers, Lothian Buses, Scottish Water, Heriot Watt University and Midlothian Council have been submitting data since April 2013.
- 3.7 Meetings have been held with West Lothian Council, Police Scotland, Napier University, Edinburgh Leisure and the City of Edinburgh Council to clarify the detailed requirements and support employers through the process changes.
- 3.8 West Lothian Council (WLC) has sent its contribution data from April 2014. Its April return upload was split by individual post which means that a check can be done for all missing records and mismatch of hours. Unfortunately, significant data manipulation was required by its payroll team in order to produce this report and this has been deemed unsustainable. WLC, however, is procuring a new payroll system and has provided assurance that this should readily enable monthly contribution reporting. Implementation of this new payroll system is scheduled for April 2015.
- 3.9 Police Scotland and Edinburgh Leisure have been submitting monthly contribution data from April 2014. The Fund is currently awaiting replies to missing new starts and leavers queries as well as part-time hours mismatches to ensure all records are up to date.
- 3.10 Napier University and City of Edinburgh Council are currently working on extract reports from their payroll systems. Both employers use the iTrent payroll system. As this system is also used by Midlothian Council, which already sends monthly data to the Fund, it is expected that there should be few problems with these employers developing reports for upload to the portal. Indeed, good initial progress has been made by the City of Edinburgh Council and it is expected that the data extract should be finalised very shortly.

Pensions Administration Strategy and employer liaison

- 3.11 Since 2010, the Fund has set out standards for provision of data from employers in an agreed Pensions Administration Strategy. Following consultation with employers, this was reviewed in September 2013. Annual reports are issued to each employer outlining their own performance against standards and comparing this to other employers of a similar size. Fund-wide performance is reported each year in the Annual Report.
- 3.12 Annual performance reports have been issued to employers for 2013/14 year. As a whole, performance against standards remains poor. This can in part be attributed to data cleansing exercises carried out at year end and as part of the work to prepare employers for the introduction of the employer on-line system monthly contribution returns. However, data provided outside of these particular exercises still shows significant room for improvement.
- 3.13 Employers generally have acknowledged the need to develop and improve internal processes in order to improve performance in future. Key issues that have been highlighted are delays in information being provided from line managers and HR departments to payroll staff resulting in late notifications of retirements and early leavers. Employers have also highlighted that service standards cannot be achieved for certain types of members, for example early notification of retirements on ill health grounds is impractical and this is recognised by the Fund.
- 3.14 As in previous years, senior officers from the Fund are in the process of holding annual meetings with employers and these meetings will include discussion of the performance to highlight the key areas where improvement is required. . Priority is being given to 13 employers where two or more contribution payment have been paid late, employer performance (as per the Pensions Administration Strategy) is below average and/or year-end data was received two or more weeks late.
- 3.15 The Fund will be seeking improvement plans, setting out key priorities including setting priorities to resolve current data queries and also to ensure timely provision of data in the future. Fund officers are offering to meet with employers on a regular basis to identify any problems with the quality and provision of data to ensure that any issues are resolved quickly.
- 3.16 Regulation 38A of the LPPS (administration) (Scotland) Regulations 2008 give the Fund power to recover costs arising for poor performance by an employer from that employer. In addition regulation 39 (1) allows the Fund to charge employers interest for late payment of scheme contributions and agreed performance levels are outlined in the Pensions Administration Strategy (PAS) produced under regulation 60(A).

- 3.17 Committee will recall that the PAS includes the scope for the Fund to levy charges to cover any resultant costs if an employer's performance continues to fall below acceptable tolerances. This provision ensures that the administrative costs of the Fund are borne equitably by all the employers.
- 3.18 The Fund has considered the criteria for passing on its costs of poor performance to employers and they consist of any of the following:
- contributions received later than the regulatory standard;
 - not regularly addressing membership data queries;
 - consistent and repeatedly failing to meet service standards for new starts, leavers, retirements and deaths as per the PAS and no clear commitment to improve: and
 - not submitting monthly contributions via PensionsWEB or no clear commitment to implement before 1 April 2016.
- 3.19 It will be proposed that this is put in place with effect from 1 April 2015. The Fund will consult with employers over the coming months on this proposal.

Mortality screening and address tracing

- 3.20 Utilising the Glasgow City Council framework agreement, Lothian Pension Fund awarded a contract on 1 July 2014 to Tracesmart Limited for the provision of mortality screening and address tracing services. The contract is for one year, with the potential to extend by a further two years. Mortality screening will be undertaken for approximately 27,900 pensioner records and 15,400 deferred records on an initial and monthly ongoing basis. A validation against The Pensions Regulator's Common Data requirements will also be supplied. Address tracing is also being commissioned in respect of approximately 2,900 currently untraced deferred members.
- 3.21 Matching our records to the General Registrars Office for Scotland, Disclosure of Death Information (Scottish GRO) and also the National Fraud Initiative (NFI) are covered separately on the agenda in the report "Fraud Prevention Pension Payments".
- 3.22 On an initial trial basis, Lothian Pension Fund has also utilised the "FindMyLostPension.com" service. By reference to National Insurance numbers, this website is used by funds and members of the general public to find lost or forgotten pension pots. Additionally, cross referencing among pension schemes helps to identify gone-away deferred members that are active members elsewhere (not only across statutory pension schemes but commercial pension scheme too).

Other data quality actions - "Club Vita"

- 3.23 All the Lothian Pension Funds now participate in "Club Vita", which is a specialist company proving longevity monitoring and experience analyses. Various data quality assurance checks are undertaken on an annual basis. In this respect, it is particularly important for data to be clean in a number of key areas for example 'lifetime' dates such as dates of birth and death, and information which may

distinguish between those with significantly different life expectancies ('longevity predictors'), such as pension amounts or postcodes.

- 3.24 As at the last annual report in November 2013, data quality compared very favourably with the "VitaBank" of other funds. Lothian Pension Fund was stated to have data "amongst the best for deferred pensioners with correct and complete postcodes and reliable salary at retirement / exit for pensioners". The smaller Lothian Buses Pension Fund was similarly praised "...amongst the best for actives with correct and complete postcodes, and deferred pensioners with correct and complete postcodes".
- 3.25 Within a peer group of the LGPS, the Lothian Pension Fund data was "amongst the best for actives with correct and complete postcodes, and deferred pensioners with correct and complete postcodes". This comment was echoed for Lothian Buses Pension Fund, supplemented by "and reliable pensions for pensioners and dependants".

Other data quality actions - Member self-service

- 3.26 The Fund's member self service web-link enables secure on-line amendment to the individual's address record and also encourages contact with the Fund should the member wish to query salary or service details.

Actuarial Valuation 2014 – Data quality assessment

- 3.27 Data for the Lothian Buses Pension Fund and Scottish Homes Pension Fund has been analysed by the Actuary for the purposes of the triennial actuarial valuation. In respect of Lothian Buses Pension Fund the actuary commented that "The data was of good quality and we believe that it is fit for the purpose of the valuation. We were able to reconcile the employee contributions provided in your accounts to within 0.2%. The comparison to the pensions paid in your accounts and from the data was within 0.4%." For the Scottish Homes Pension Fund "In general, the data was of good quality and we believe that it is fit for the purpose of the valuation. The comparison to the pensions paid in your accounts and from the data was within 1.9%." At the time of writing, the data quality assessment for Lothian Pension Fund is awaited.

Future developments

- 3.28 Lothian Pension Fund has registered for the Government's Scheme Reconciliation Service. This will allow pension scheme administrators and trustees to reconcile the membership and Guaranteed Minimum Pension (GMP) data held on scheme records against HM Revenue & Customs' (HMRC) records in advance of the ending of contracting-out in April 2016. The service provides a list of contracted out periods and GMP data for members who have left contracted-out employment. This includes early leavers, pensioners, widows, widowers and surviving civil partners.
- 3.29 Following the introduction of the new LGPS in 2015, it is intended to undertake a business appraisal of Lothian Pension Fund seeking accreditation by the Pensions Administration Standards Association (PASA).

Measures of success

- 4.1 Data quality performance standards are measured against best practice guidance and included in the Lothian Pension Funds' Annual Report.

Financial impact

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

Risk, policy, compliance and governance impact

- 6.1 There are no adverse risk, policy, compliance or governance impacts arising from this report.

Equalities impact

- 7.1 There are no adverse equalities impacts arising from this report.

Sustainability impact

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

Consultation and engagement

- 9.1 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.

Alastair Maclean

Director of Corporate Governance

John Burns, Pensions & Accounting Manager

E-mail: john.burns@edinburgh.gov.uk | Tel: 0131 469 3711

Links

Coalition pledges

Council outcomes CO26 –The Council engages with stakeholders and works in partnership to improve services and deliver on agreed objectives.

Single Outcome Agreement

Appendices

Pensions Audit Sub Committee

2.30 p.m., Monday, 22 September 2014

Prevention of Fraudulent Pension Payments

| | |
|--------------------------|-----|
| Item number | 5.7 |
| Report number | |
| Executive/routine | |
| Wards | All |

Executive summary

The purpose of this report is to allow the Pensions Audit Sub-Committee to understand and scrutinise the work undertaken by Lothian Pension Fund to prevent fraud. The report provides details of our participation in fraud prevention initiatives as an integral part of the control environment and the overall management of risk.

Matching of records with the General Registrars Office on a quarterly basis is highlighting that un-notified deaths are now dealt with quicker than they would have been previously.

The Fund continues to exercise discretion as to whether to approve transfers in pensions liberation and is about to implement a new approach to checking the existence of pensioners living overseas.

Links

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Council outcomes

CO26 –The Council engages with stakeholders and works in partnership to improve services and deliver on agreed objectives.

Single Outcome Agreement

Prevention of Fraudulent Pension Payments

Recommendations

- 1.1 The Pensions Audit Sub Committee is requested to note the work undertaken by Lothian Pension Fund to prevent pension payment fraud and to highlight any points it would like to raise at the Pensions Committee on 23 September.

Background

- 2.1 At its meeting on 20 September 2013, Pensions Audit Sub-Committee noted the report by the Director of Corporate Governance on ongoing fraud prevention measures by Lothian Pension Fund. An update on progress is now provided on an annual basis.

Main report

- 3.1 The pension's administration team deliver services to members using a browser based pension software system. The software stores and controls all aspects of the membership database, document management and benefit calculations. Access is restricted to authorised individuals by user identification and password protection. In addition, the Fund's compliance policy includes the restriction that members of staff should not be involved in the computation or checking benefits payable to a member who is a connected person.

The operation of internal controls also gives comfort that the risk of fraud is mitigated or minimised. Procedural controls include:

- obtaining the originals of relevant certificates;
- where a beneficiary of a death grant is a child and the payment is being made to a parent/guardian on his/her behalf, evidence that the parent/legal guardian is capable and has the appropriate capacity to act in the best interests of the child;
- authorisation of payments in line with the Council's Scheme of Delegation.

- 3.2 The Fund mainly relies on relatives to inform us of the death of a pensioner member. If a payslip or bank credit is returned undelivered, the pension is

suspended pending investigation. To further mitigate the risk of not being informed of a member's death, the following procedures and checks are in place:

- **The National Fraud Initiative (NFI)** - The NFI is a well established data matching exercise led by Audit Scotland, which is carried out every two years. It is designed to help organisations identify causes of fraud and detect and correct any consequential overpayments from the public purse. The matching exercises undertaken include a comparison of public sector records to death records and other pension related outcomes, for example, when retirees have returned to work but not reported circumstances that require their pension to be reduced. Costs are met through the annual audit fee. Investigations from NFI 2012/13 identified 6 cases where Lothian Pension Fund was not aware of the death of a pensioner. The total value of the overpayments amount to £9,026.46. All overpayments are being pursued.
- **Matching our records to the General Registrars Office for Scotland, Disclosure of Death Information** - Since December 2012 Lothian Pension Fund has worked with General Registrars Office for Scotland who offer a quarterly mortality screening service. The fee charged by General Registrars Office for Scotland for providing this service amounts to around £480 each quarter. Undertaking this exercise regularly highlights cases promptly. 28 deaths unnotified to the Fund were highlighted by GRO before being identified through NFI 2012/13.
- To further reduce risk, the Fund intends to access the "Tell us Once (TUO)" project. TUO is a national application of registering a birth and death funded by the UK Government. It facilitates a single point of contact for customers to register a birth and death and notifies the relevant service areas (local and national) of each birth and death registration as soon as they have been reported. Presently, pension services are not yet available through TUO but are anticipated in a future release. Thereafter, it is likely that Local Government Association will set up a UK wide Local Government Pension Scheme database.

3.3 **Pensions Liberation** - The Pension Regulator, HM Revenue & Customs, the Financial Conduct Authority and the Serious Fraud Office have all combined to warn pension funds and the public of the dangers associated with those seeking to encourage members to liberate their pensions, commonly with enticements of receiving an early cash-lump sum and/or tapping into 'enhanced' investment performance. The Fund is required to exercise discretion as to whether to approve transfers. While the Pension Regulator has issued guidance in terms of identifying potential cases of liberation fraud, it places the onus on the pension

funds themselves to have sufficient procedures in place to identify any suspicious practices and properly exercise their discretion as to whether or not to approve a transfer. Therefore, we have a procedure which involves additional levels of diligence/enquiry of the member itself and the proposed transferee scheme. This is to ensure that any decisions to approve these types of transfer can be as informed as possible, are clearly documented and also to assert that we are sending a clear external message that these transfers are not being approved as a matter of course. Since September 2013 we have identified 104 potential liberation fraud cases (72 low risk cases and 32 high risk cases). Out of these 104 potential cases, the transfer payment for 11 cases has been refused. Each refused case has been referred to one of the regulatory bodies (The Pensions Regulator, HMRC or Financial Conduct Authority) and/or to Action Fraud, the UK's national fraud and internet crime reporting centre.

- 3.4 **Western Union Business Solutions** – Lothian Pension Fund has been working with Western Union to provide an international payment service to our overseas pensioners (around 140). International payments service is expected to be transferred to Western Union in the coming months. One of the main reasons for using Western Union is to use their “Existence” service. Under this arrangement, Western Union will use their network of agents to verify that overseas pensioners are alive by means of a face to face meeting at which the member is required to produce a valid form of identification such as a passport or driving licence. They will undertake an existence check in the month following the transfer of service, and every following year thereafter. At present, overseas pensioners are written to annually by Lothian Pension Fund and asked to provide written confirmation from a “responsible person” that they are alive. The face to face check is seen as a more effective means of mitigating the risks of pensions being paid to deceased overseas pensioners. At present, the recovery of any such resulting overpayments is both difficult and costly.

Measures of success

- 4.1 Lothian Pension Fund is committed to deter and ultimately prevent fraud. Suitable controls are in place and subjected to regular scrutiny. Should any fraud be detected, however, immediate action is taken to prevent future losses.

Financial impact

- 5.1 The Lothian Pension Fund budget includes expenditure for fraud prevention. Direct costs are detailed in paragraph 3.2. Staff resource is met within the existing budget for pension administration employee costs.

Risk, policy, compliance and governance impact

6.1 There are no adverse risk, policy, compliance or governance impacts arising from this report

Equalities impact

7.1 There are no adverse equalities impacts arising from this report.

Sustainability impact

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

Consultation and engagement

9.1 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.

Alastair McLean

Director of Corporate Governance

Contact: Carole Thomson, Pensions Operations and Development Manager

E-mail: carole.thomson@edinburgh.gov.uk | Tel: 0131 529 4662

Links

Coalition pledges

Council outcomes CO26 –The Council engages with stakeholders and works in partnership to improve services and deliver on agreed objectives.

Single Outcome Agreement

Appendices

Pensions Audit Sub-Committee

2.30 p.m., Monday, 22 September 2014

Irrecoverable overpayment of pensions

| | |
|--------------------------|-----|
| Item number | 5.8 |
| Report number | |
| Executive/routine | |
| Wards | All |

Executive summary

This report advises Pensions Audit-Sub Committee of pension overpayments, during the period 1 September 2013 to 31 August 2014, which have been deemed irrecoverable by the Director of Corporate Governance, in accordance with the Council's "Scheme of Delegation to Officers".

Links

Coalition pledges

Council outcomes

CO26 –The Council engages with stakeholders and works in partnership to improve services and deliver on agreed objectives.

Single Outcome Agreement

Irrecoverable overpayment of pensions

Recommendations

- 1.1 Pensions Audit Sub-Committee is requested to:
- note that the total value of pension overpayments written off between 1 September 2013 and 31 August 2014 is £2,287.64, and;
 - highlight any points they would like to raise at the Pensions Committee on 23 September 2014.

Background

- 2.1 Delegated authority has been granted to the Director of Corporate Governance, in certain circumstances, to write-off pension overpayments up to £3,000. Any overpayments above this limit require approval of the Pensions Committee.
- 2.2 At its meeting on 20 September 2013, Pensions Audit Sub-Committee noted that the total value of pension overpayments written off between 1 April 2013 and 31 August 2013 was £5,491.50.

Main report

- 3.1 Pension regulations determine the calculation and payment of pension benefits to scheme members. During the course of administration overpayments of pension may occur upon the death of a pensioner, where pensioners return to work when receiving a pension (this only affects people who retired on the grounds of efficiency and received compensatory added years when they retired) or where a mistake occurs.
- 3.2 Attempts are made to recover overpayments over £250 however, on occasions, it is not in the best interest to seek recovery of an overpaid pension. Depending on the circumstances of the particular case, in line with delegated functions certain officers in the Investment & Pensions division may write off the whole or part of an overpayment up to £3,000. The most likely circumstances would be if recovery would cause undue hardship to the member's family, if there are insufficient funds to repay the overpayment or it is uneconomical to pursue.
- 3.3 Any overpayments over £3,000 are referred to the Pensions Committee. Pensions Committee will be asked to write off one overpayment at their meeting on 23 September 2014.

3.3 The value of pension overpayment write offs between 1 September 2013 and 31 August 2014 is shown below. The total value is £2,287.64.

| | Date of Death | Amount Written Off | Reason for write off |
|----------|----------------------|---------------------------|---|
| Member A | 25/02/2013 | £250.40 | Every effort was made to recover the overpayment. |
| Member B | 30/12/2012 | £122.56 | The total overpayment amounted to £794.33 of which £671.77 has been recovered. The outstanding amount was written off because there are no further funds in the Estate. |
| Member C | 05/12/2012 | £858.65 | No funds in the Estate. |
| Member D | 23/05/2012 | £1,056.03 | No funds in the Estate. |

3.4 Any overpayment of pension is charged to the respective fund, namely the Lothian Pension Fund, the Lothian Buses Pension Fund or the Scottish Homes Pension Fund.

Measures of success

4.1 Not applicable.

Financial impact

5.1 As the expenditure has already been reflected in the relevant financial statements of the Lothian Pension Funds, there is no additional financial impact arising from the overpayment of pensions.

Risk, policy, compliance and governance impact

6.1 There are no adverse risk, policy, compliance or governance impacts arising from this report.

Equalities impact

7.1 There are no adverse equalities impacts arising from this report.

Sustainability impact

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

Consultation and engagement

9.1 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.

Alastair Maclean

Director of Corporate Governance

John Burns, Pensions & Accounting Manager

E-mail: john.burns@edinburgh.gov.uk | Tel: 0131 469 3711

Links

Coalition pledges

Council outcomes CO26 –The Council engages with stakeholders and works in partnership to improve services and deliver on agreed objectives.

Single Outcome Agreement

Appendices

Pensions Committee

2.30 p.m., Monday, 22 September 2014

Risk Management

| | |
|-------------------|-----|
| Item number | 5.9 |
| Report number | |
| Executive/routine | |
| Wards | All |

Executive summary

The pension funds' risk management procedures require us to:

- (i) maintain a detailed operational risk register which sets out all the risks identified and assessed by the officers on an ongoing basis, the degree of risk associated in each case and our action to mitigate these risks (the "**Operational Risk Register**"); and
- (ii) produce a summary report of the risk register for the Pensions Committee and the Pensions Audit Sub-Committee which highlights the material risks facing the pension funds and identifies any new risks/concerns and the progress being made over time by the officers in mitigating the relevant risks (the "**Quarterly Risk Overview**").

The Operational Risk Register has been issued to the conveners of the Pensions Committee and the Pensions Audit-Sub-Committee.

The Quarterly Risk Overview, as at 20 September 2014, is set out in the appendix to this report.

Links

Coalition pledges

Council outcomes

CO26 –The Council engages with stakeholders and works in partnership to improve services and deliver on agreed objectives.

Single Outcome Agreement

Report

Risk Management

Recommendations

- 1.1 We recommend the Committee notes the Quarterly Risk Overview and highlights any points it wishes to raise at the Pensions Committee on 23 September 2014.

Measures of success

- 2.1 Improved visibility of the risks facing the pension funds and progress in analysing/mitigating these risks. Regular, focused and relevant risk updates to the Pensions Committee and Pensions Audit Sub-Committee should increase general awareness and allow productive analysis/feedback by the Pensions Committee/Audit Sub-Committee members on these fundamental issues.
- 2.2 Ultimately, risk management should lead to less third party exposure, an improved financial position and have a positive impact on the reputation of the pension funds.

Financial impact

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

Risk, policy, compliance and governance impact

- 4.1 Please see the Quarterly Risk Overview appended to this report.

Equalities impact

- 5.1 None.

Sustainability impact

- 6.1 None.

Consultation and engagement

- 7.1 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.

Alastair Maclean

Director of Corporate Governance

Contact: Struan Fairbairn, Legal and Risk Manager

E-mail: Struan.Fairbairn@edinburgh.gov.uk | Tel: 0131 529 4689

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 - Quarterly Risk Overview, as at 20 September 2014

QUARTERLY RISK OVERVIEW

20 September 2014

UPDATE ON MOST NOTABLE RISKS

| Risk | Update |
|--|--|
| Investment performance leading to pressure on employer contribution | <p>The new lower volatility investment strategy continues to be implemented to mitigate this risk and more detailed reporting on the Investment Strategy has been produced for the Pensions Committee.</p> |
| Adverse movement against non-investment funding assumptions leading to pressure on employer contributions | <p>Progress on the 2014 actuarial valuation is being made. Experience against funding assumptions and employer contributions will be assessed.</p> |
| Collapse/restructuring of an employer body leading to pressure on other employers | <p>As reported to the Pensions Committee, we have concluded our covenant analysis and will look to prioritise the actions arising from this and implement them accordingly. The employers will be made aware of their results as part of the engagement process leading up to the 2014 valuation and we will look to build on this analysis and continue to monitor employer covenant on an ongoing basis.</p> |
| Recruitment and retention of key staff | <p>This risk remains high due to the continued improvement in UK economic and market conditions in the private sector and despite Scottish Widows Investment Partnership (SWIP) having recently laid-off a substantial number of Edinburgh based investment managers. Options to mitigate this risk have been proposed to Committee. In the meantime, contingency plans have been considered for the internal investment portfolios in the event of significant staff turnover.</p> <p>We have now recruited a permanent Finance Manager and an Investment Analyst to provide further resource in the Real and Other Asset team. We have also recruited a Portfolio Manager on a temporary basis to manage the Asia Pacific portfolio which we have brought in-house from Baillie Gifford.</p> <p>We are also looking to recruit a newly qualified solicitor to assist with progressing with the authorisation by the Financial Conduct Authority and provide appropriate cover for the Legal & Risk function in anticipation of our having to meet increased compliance requirements should we receive such authorisation. In addition, a legal trainee has joined the division for 6 months as part of the ongoing trainee rotation.</p> |
| Risk of incorrect pension payments | <p>Progress to achieve full integration/automation to reduce reliance on manual intervention in some processes is ongoing and a review of processes by internal audit will be undertaken. Once these are completed we would anticipate this risk being further reduced to the extent that it would not be worthwhile highlighting to the Committee.</p> |

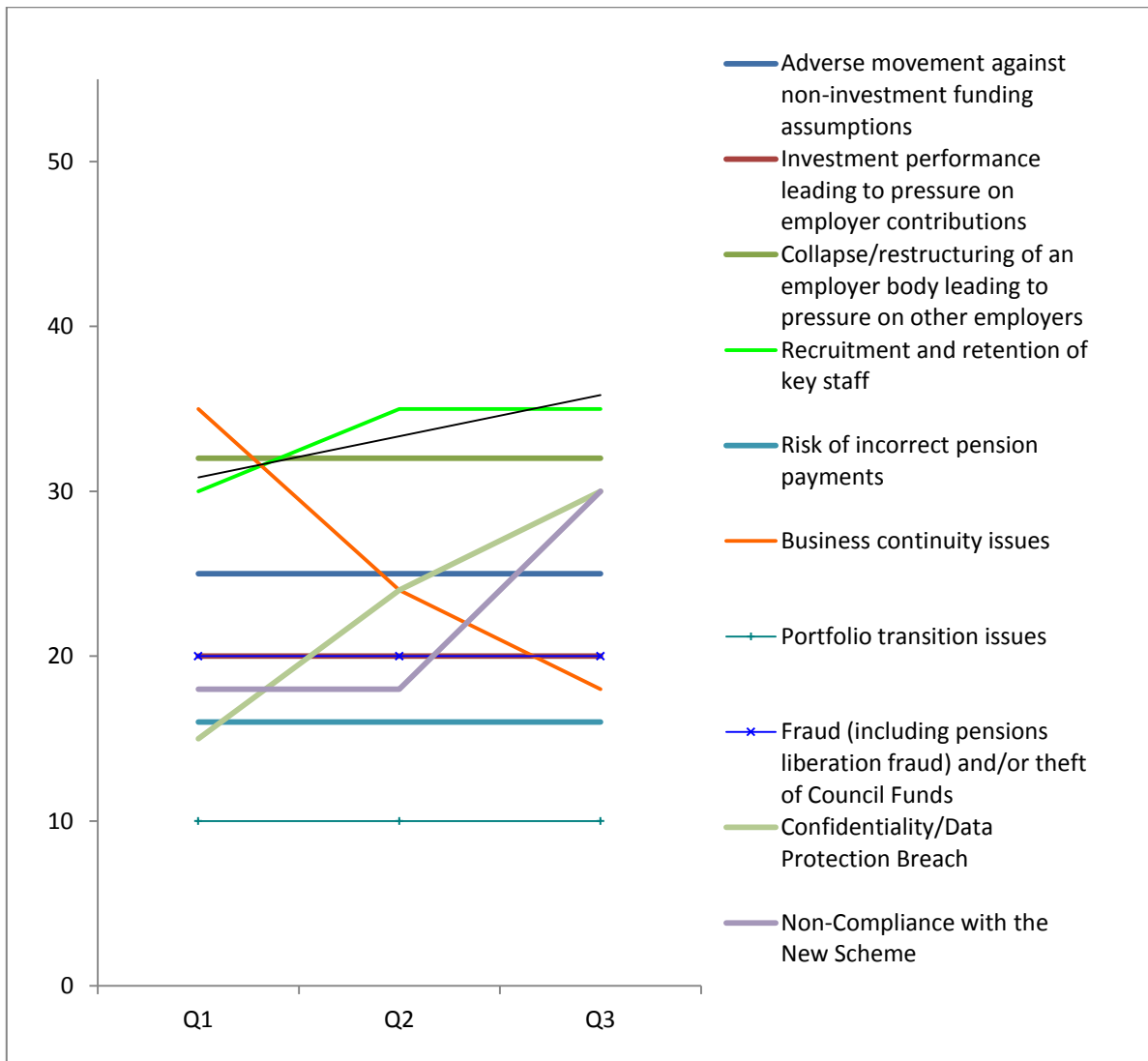
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| Members' Confidential Data is lost or made public / breach of Data Protection Act | <p>This risk has been increased due to our having a further, minor, data protection breach arising from an error in a bulk print run. This breach has been reported to the Data Protection team in the usual way and we are in the process of reviewing our internal printing systems, and the longer-term option of outsourcing bulk printing of this nature, in order to assess the best means of mitigating this risk.</p> <p>Separately, we are continuing to liaise with the Council's ICT and Data Protection teams regarding an overall review of our systems and processes. Initial feedback has been that our systems and processes are robust and fit for purpose, but we await more detailed feedback.</p> |
| Acting out-with proper authority / delegations | <p>We now have a more detailed set of sub-delegations in place for the division and so would not anticipate the need to highlight this risk in future reports.</p> |
| Fraud (including pensions liberation fraud) and/or theft of pension fund monies | <p>The risk around Fraud remains the same, as we are currently defending an IDR/P/appeal process, where a scheme is challenging our refusal to transfer one of our member's benefits to them. We will update the Committee on the outcome of this process and continue to monitor our transfer-out procedure to ensure that it does not have a disproportionate impact on our timescales and process for completing more routine requests.</p> |
| Adverse assumptions leading to pressure on employer contributions; Fraud. | <p>We are also closely monitoring the levels of transfers-out to determine whether there will be an increase in light of increased flexibility in Defined Contribution (DC) pensions and the decision to allow transfers from the LGPS to Defined Contribution schemes. This could have implications for funding and cashflow and investigations on the potential implications will be taken forward. We also anticipate that transfer requests are more likely to involve an element of personal investment of pension benefits by members and so may lead to requests for transfers within more demanding timescales. An increase in the volume of transfer requests, and an accompanying shift in expectations for timescales for such transfers, may also have an impact on our assessment of risk with respect to potential pensions liberation fraud cases.</p> |
| Breach of Contract | <p>The initial contract review is nearing completion and has not identified any material concerns. However, we are in the process of refining our review and so this risk should remain static until that process has been completed and we have liaised with the CEC procurement team to ensure that our early warning systems for contract terminations/extensions are robust.</p> <p>We anticipate that this risk should be significantly reduced once this review has been completed.</p> |
| Business continuity | <p>The Pensions Audit Sub-Committee, at its meeting on 16 June 2014, requested that the Director of Corporate Governance considers whether a test of the disaster recovery system (of the pensions administration system) was necessary to establish sufficient assurance. The software system for pensions administration is hosted by the supplier, Heywood Limited (part of the aquilaheywood group). In 2013, the company advised Lothian Pension Fund that it was outsourcing its hosting and disaster recovery provision to Blue Chip Limited in order to enhance these services. Migration of live data took place on 4 November 2013. Whilst the company is committed to an annual disaster recovery test, this is not scheduled until the anniversary of the data migration, that is November 2014. The rationale for this is that "aquilaheywood effectively carried out a full recovery of services as part of the migration of services from aquilaheywood's data centre in Redhill to Blue Chip's data centres in Bedford during November 2013". The company has stated its willingness to disclose the results of the annual test, on request, to its clients. Lothian Pension Fund has confirmed that it wishes to see the disaster recovery test report in full. The Fund, however, is not comfortable with the delay in the live</p> |

testing and would have preferred that this would have been undertaken sooner. Pending the outcome of this test in a few months time, the Fund has requested that the company provide more detail as to the basis of selection of Blue Chip Limited as the hosting services provider and also a statement confirming its continued confidence in the disaster recovery facility.

Non-compliance with the new LGPS Scheme in Scotland / Public Service Pensions Act 2013

Benefit regulations have been finalised but the timetable for producing the draft regulations for the governance of the new scheme has slipped. Implementation of the systems required to administer the new scheme and accompanying governance changes remain challenging. While this will likely present resource and other pressures as we move closer to the deadline for implementation in April 2015, feedback from funds in England and Wales (having worked to an extremely tight implementation timescale) suggests that this will be manageable. We will continue to be actively involved in the national discussions and closely monitor the position.

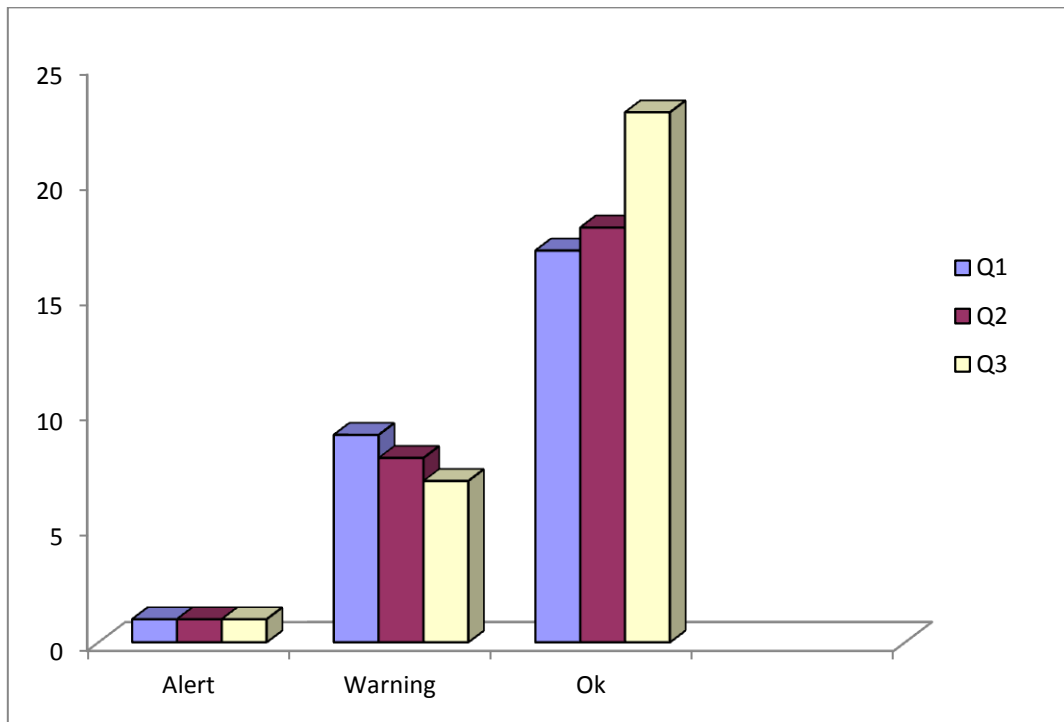
NOTABLE RISKS: PROGRESSION OF CURRENT RISK (ACCOUNTING FOR CONTROLS) IN LAST THREE QUARTERS



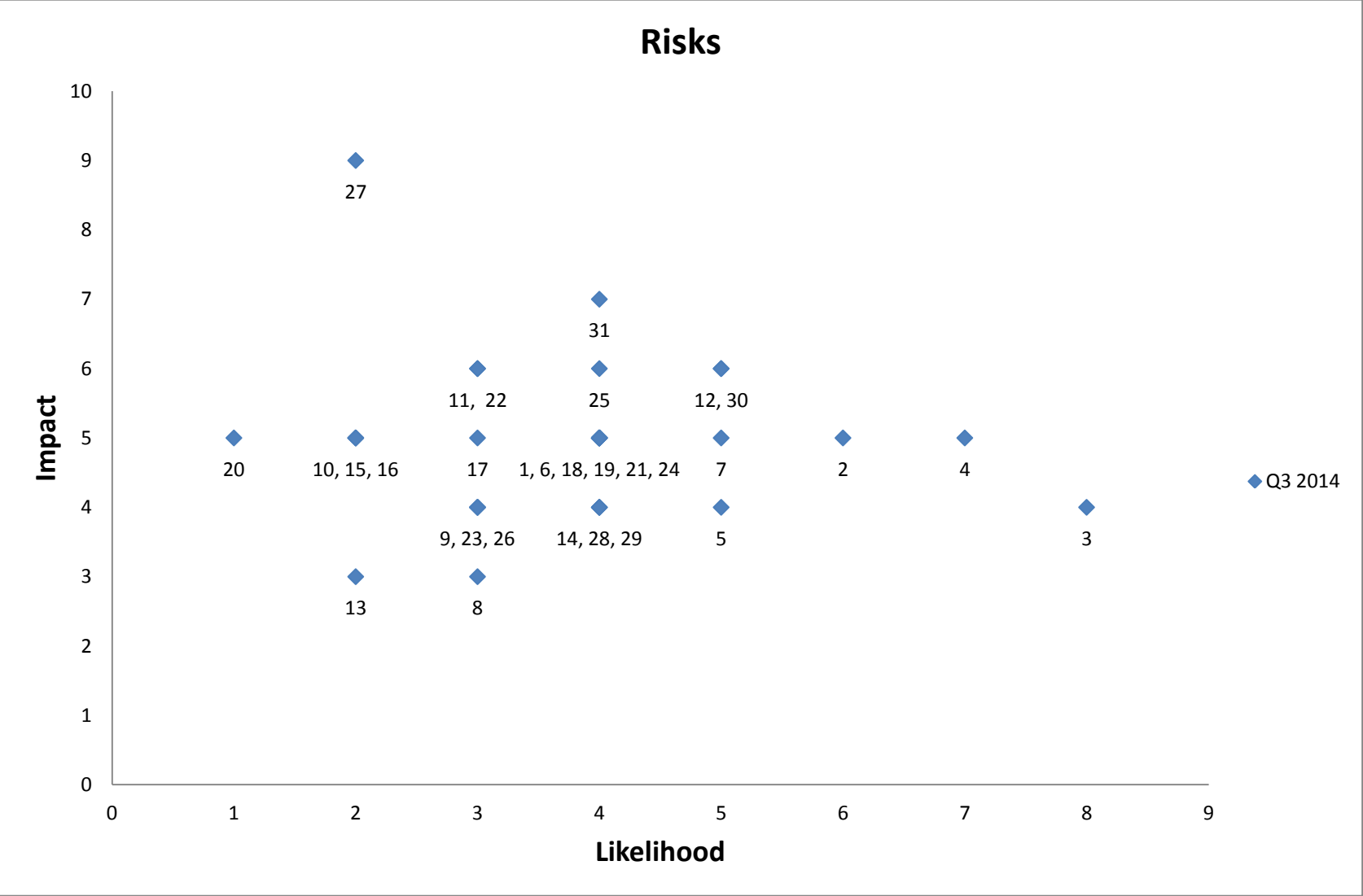
OTHER KEY POINTS

| | Comments |
|--------------------------------------|--|
| New significant risks | None |
| Other new risks | <p>Receiving services without adequate contractual protection: arising from our identifying the need to ensure that we have robust contract termination and extension processes in place.</p> <p>Over reliance on a single service provider for core functions, potentially leading to loss of service or artificially inflated costs: arising from our recognition of the need to monitor our key service providers.</p> <p>Unauthorised access to the PensionsWEB employer online system allowing access to member records</p> <p>The receipt of limited or incorrect data from employers leading to incorrect valuation of liabilities / benefit payments (potentially leading to fines from the Pensions Regulator from April 2015).</p> |
| New controls | Recruitment of a permanent Finance Manager, Investment Analyst and temporary Portfolio Manager. |
| Eliminated risks | None |
| Notable initiatives / actions | <p>Working closely with the Information Compliance and ICT teams to implement a review of our systems, procedures and contracts from a Data Protection and Information Security perspective.</p> <p>Options to manage the HR risk associated with the internal investment function have been considered and presented to Committee.</p> <p>Researching a Council controlled corporate entity which will facilitate FCA authorisation for the purpose of good governance of our in-house investment function and to achieve further efficiencies with other Local Government Pension Funds.</p> <p>Employer engagement with Lothian Buses and Scottish Government as part of the 2014 actuarial valuation. Initial outcomes of the employer covenant review due to be shared with employers and guarantors.</p> <p>The Scottish Information Commissioner has recently reinforced our decision not to disclose certain information in relation to a private equity fund, due to the particular circumstances for that fund, by deciding in our favour in a recent appeal case. The decision, which has previously been circulated to the Committee, supports our current procedures and engagement on these sometimes difficult matters.</p> |
| Material Litigation | None. |

All Risks: Status Overview



Q3 (2014) All Risks: Impact and Likelihood Overview



Key: Risks by Number

| | | | |
|----|---|----|--|
| 1 | Investment Performance pressure on employer contributions | 15 | Market abuse by investment team |
| 2 | Adverse Movement - pressure on employer contributions | 16 | Portfolio transition issues |
| 3 | Collapse of an employer | 17 | Disclosure of confidential information |
| 4 | Retention of key staff | 18 | Material breach of contract |
| 5 | Fraud or theft of Council/Pension Fund assets | 19 | Regulatory breach |
| 6 | Staff negligence | 20 | FOI process in accordance with law |
| 7 | Failure of IT systems | 21 | Incorrect communication with members |
| 8 | Employers HR decisions without consideration of fund | 22 | Acting in accordance with proper authority/delegations |
| 9 | Elected members take decisions against sound advice | 23 | Inappropriate use of pension fund monies |
| 10 | Failure to complete annual accounts | 24 | Procurement/framework breach |
| 11 | Business continuity issues | 25 | Non-compliance with the new LGPS |
| 12 | Members' confidential data is breached | 26 | Claim or liability arising from shared services |
| 13 | Loss due to stock lending default | 27 | Late Payment of Pensions |
| 14 | Risk of incorrect pension payments | 28 | Unauthorised access to PensionsWEB |
| 29 | Limited or incorrect data from Employers | 30 | Receiving services without adequate contractual protection |
| 31 | Over-reliance on single service provider | | |