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	

Report

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

Contents

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 been 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

Contents

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 administrating 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 advisors 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 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

CSE

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.

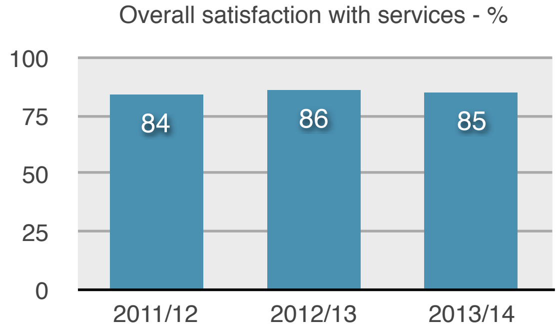
In February 2014, the Pension Fund again retained CSE for another year. The external assessor commented on the high quality and varied approaches the Fund uses for customer consultation ensuring differing customer views are gained. The assessment also noted the many changes the Fund had experienced and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

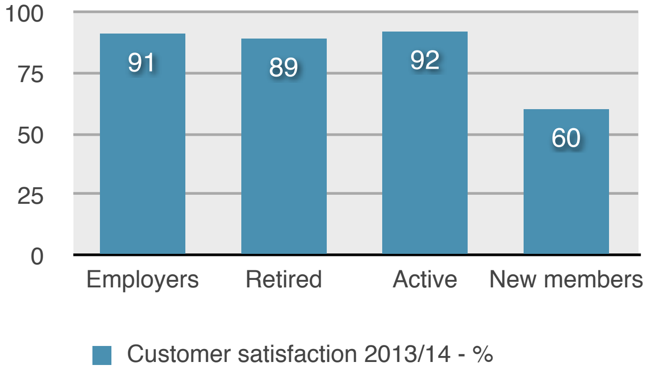
A key area for improvement has been identified as the exchange of information with employer partners and the impact this has. For example, new scheme members who have experienced delay in service from the Fund due to delays caused by some employers.

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.

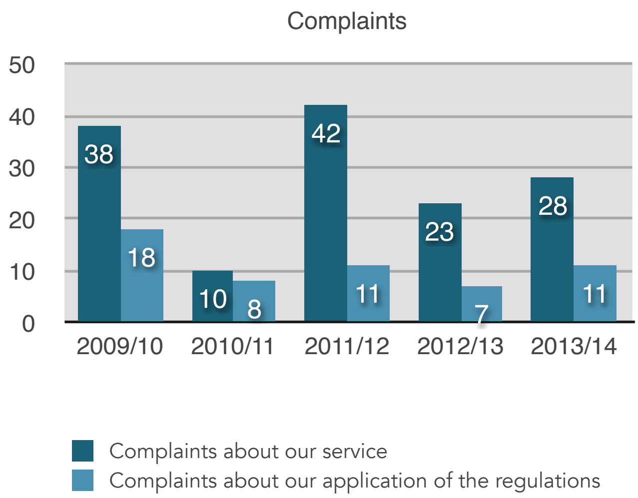
Complaints

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



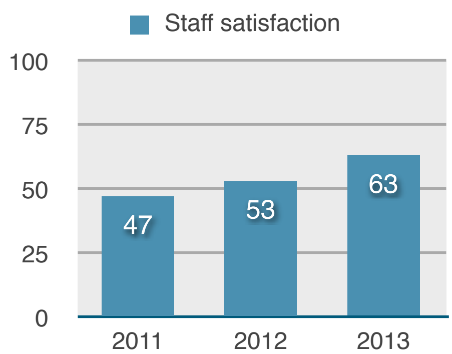
The graph shows the number of complaints in each of the categories. These represent less than 0.2% percentage of the procedures (over 19,000) we carried out in 2013/14.

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%.

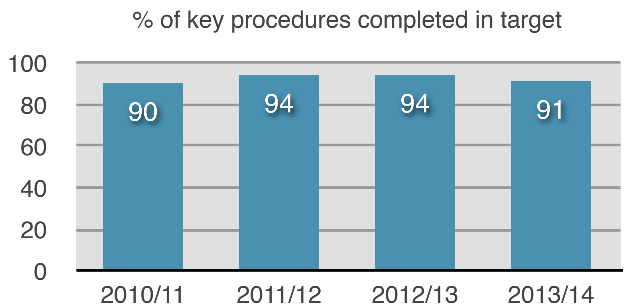


Service plan objective 3 – To continue to be a top performing Fund

	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.

		2012/13			2013/14		
Case type	Target (working days)	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 a annual basis by the Scheme Actuary in accordance with the requirements of IAS 19 and relevant actuarial standards.

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

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 the 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 the holding owned by the 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.

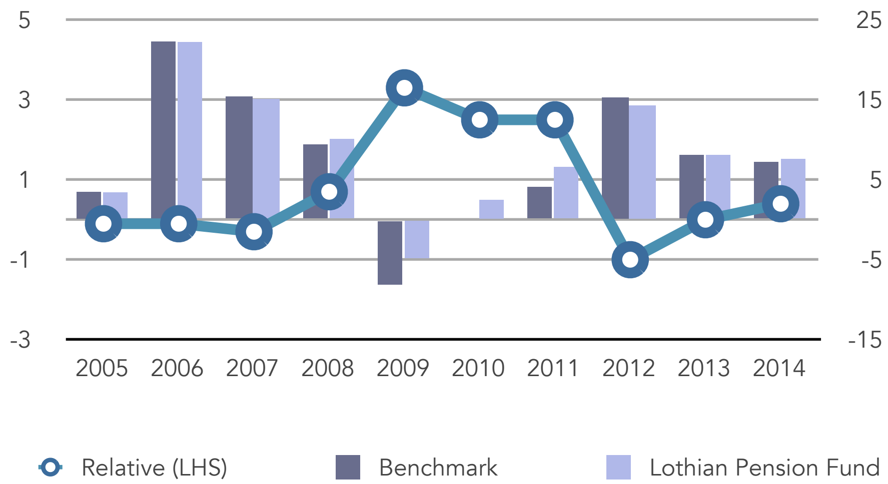
Investment performance

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		Note	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 £000		Note	31 March 2014 £000
	Investments		
4,086,938	Assets		4,349,645
(25,042)	Liabilities		(6,335)
4,061,896		*12, 14*	4,343,310
	Fixed assets		
157	Computer systems		397
157			397
	Current assets		
4,355	The City of Edinburgh Council	*20*	7,819
34,616	Cash balances	*14, 20*	31,734
10,299	Debtors	*17*	11,286
49,270			50,839
	Current liabilities		
(16,664)	Creditors	*18*	(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**	*13a*	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**

By employer type	2012/13 £000	2013/14 £000
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

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.

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).

12 Net investment assets

	31 March 2013 £000	31 March 2014 £000
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	Economic exposure £000	Market value at 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 bought £000	Local currency sold £000	Asset value £000	Liability value £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		
Financial assets	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
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 Designated as fair value through fund account £000	31 March 2013 Loans and receivables £000	31 March 2013 Financial liabilities at amortised cost £000	31 March 2014 Designated as fair value through fund account £000	31 March 2014 Loans and receivables £000	31 March 2014 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	*Aaa*	75,949	45,480
Northern Trust Company - cash deposits	*A1*	17,758	80,765
The City of Edinburgh Council - treasury management	*See below*	93,901	131,504
Total investment cash		187,608	257,749
Held for other purposes			
The City of Edinburgh Council - treasury management	*See below*	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:

Money market funds	Moody's Credit Rating 31 March 2014	Balances at 31 March 2013 £000	Balances at 31 March 2014 £000
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 % 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 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

	31 March 2013 £000	31 March 2014 £000
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

	31 March 2013 £000	31 March 2014 £000
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.

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

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.

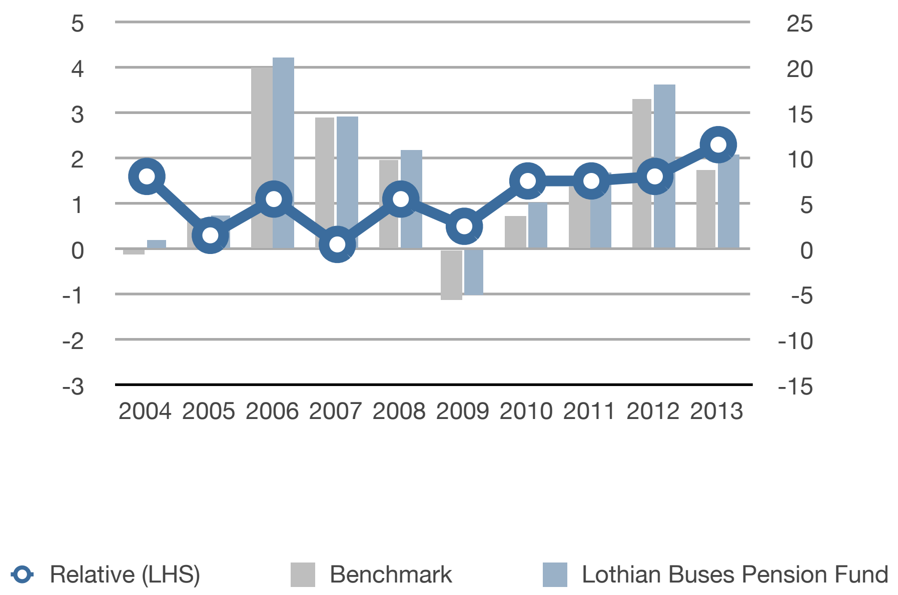
The Fund is gradually implementing the strategy and will continue to do so over the next few years. It is dependent on finding attractive assets in the Alternatives category to provide the desired diversification and an adequate return.

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)



	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 £000		Note	31 March 2014 £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
Lothian Buses Plc	£000	£000
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 £000	2013/14 £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 £000	2013/14 £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 £000	% of total funds %	Market value at 31 March 2014 £000	% of total funds %
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 £000	% of net assets of the Fund %	Market value at 31 March 2014 £000	% of net assets of the Fund %
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 £000	Percent of class 31 March 2013 %	Market value at 31 March 2014 £000	Percent of class 31 March 2014 %
UK Gov 1.125%Index Linked 22/11/37	Fixed int	-	-	1,226	18.8
UK Gov 2%Index Linked 26/01/35	Fixed int	-	-	1,179	18.1
UK Gov 1.25%Index Linked 22/11/32	Fixed int	-	-	1,170	18.0
UK Gov 0.75%Index Linked 22/03/34	Fixed int	-	-	988	15.2
UK Gov 0.625%Index Linked 22/03/40	Fixed int	-	-	987	15.2
UK Gov 4.125%Index Linked 22/07/30	Fixed int	-	-	961	14.8
Standard Life Property Fund	Pooled func	22,931	28.4	29,327	33.3
Baillie Gifford Inv Grade Bond Fund	Pooled func	22,551	27.9	24,039	27.3
Baillie Gifford Index Linked Gilt Fund	Pooled func	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	% of fund	Potential Change + / -	Value on increase	Value on decrease
	£000	%	%	£000	£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 2013 £000	31 March 2014 £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 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 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 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.

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

* plus an allowance for promotional pay increases. Short term pay growth was assumed to be 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.

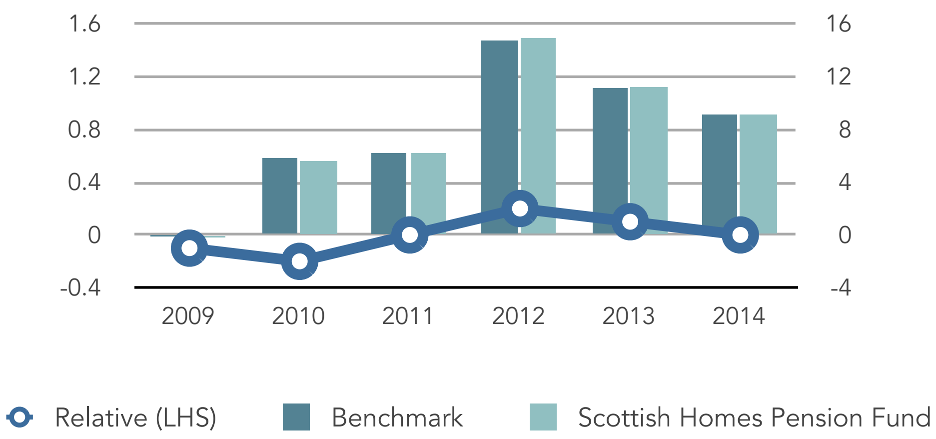
Investment performance

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)



	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		Note	2013/14 £000
	Income		
794	Contributions from employer	*2*	791
-	Transfers from other schemes		-
794			791
	Less: expenditure		
7,070	Pension payments including increases		7,083
488	Lump sum retirement payments		329
2	Lump sum death benefits		15
82	Transfers to other schemes	*3*	9
61	Administrative expenses	*4*	57
7,703			7,493
(6,909)	**Net withdrawals from dealing with members**		(6,702)
	Returns on investments		
333	Investment income	*5*	339
15,511	Change in market value of investments	*7a, 8b*	2,742
(236)	Investment management expenses	*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**	*8a, 8c*	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 £000		Note	31 March 2014 £000
	Investments		
138,006	Assets		133,761
-	Liabilities		-
138,006		*7, 9*	133,761
	Current assets		
-	The City of Edinburgh Council	*15*	175
2,514	Cash balances	*9, 15*	2,383
55	Debtors	*12*	48
2,569			2,606
	Current liabilities		
(442)	The City of Edinburgh Council	*15*	-
(16)	Creditors	*13*	(62)
(458)			(62)
2,111	**Net current assets**		2,544
140,117	**Net assets of the Fund at 31 March 2014**	*8a, 8c*	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 £000	2013/14 £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 £000	2013/14 £000
Group transfers	-	-
Individual transfers	82	9
	82	9

4 Administrative expenses

	2012/13 £000	2013/14 £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 £000	2013/14 £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 £000	2013/14 £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 2013 £000	31 March 2014 £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)

Pooled investment vehicles	2012/13 £000	2013/14 £000
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		
Financial assets	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
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.

	31 March 2013 £000	31 March 2014 £000
Year end balance on holding account	(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	31 March 2013 £000	31 March 2014 £000
Held for investment purposes	-	-
Held for other purposes	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.

	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. 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 £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.

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 £000	Changes made £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	ALASTAIR MACLEAN	COUNCILLOR ALASDAIR RANKIN
Chief Executive	Director of Corporate Governance	Convener of Pensions Committee
23 September 2014	23 September 2014	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	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: - 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	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. Fund members and employers are also represented by a Lothian Pension Funds' Consultative Panel. Membership includes six employer representatives and six member representatives. 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.
	That where a secondary committee or panel has been established, the structure ensures effective communication across both levels.	Yes	The Pensions Audit Sub-Committee consisting of three members of the Pensions Committee, report to the Pensions Committee on their findings and recommendations. 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.

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	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. 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.
Represent-ation	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	The Lothian Pension Funds' Consultative Panel consists of a mix of representatives: - 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	An Independent Professional Observer was appointed in March 2013 to help Committee scrutinise advice. Three independent investment advisers sit on the Investment Strategy Panel. A separate specialist Pension 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.
	That where lay members sit on a main or secondary committee, they are treated equally in terms of access to papers and meetings, training and are given full opportunity to contribute to the decision making process, with or without voting rights.	Yes	The Lothian Pension Funds' Consultative Panel attends the Pensions Committee meetings in an advisory capacity and take part in all Committee training events. The Pensions Committee takes account of the views of the Lothian Pension Fund's Consultative Panel when making decisions.
Selection and Role of Lay Members	That committee or panel members are made fully aware of the status, role and function that they are required to perform on either a main or secondary committee.	Yes	A comprehensive training programme including induction is in place. 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.

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	The declaration of members' interests is a standard item on the agenda of the Pensions Committee and Pensions Audit Sub-Committee. A Code of Conduct also applies to all members of the Pension Committee and to the Lothian Pension Funds' Consultative Panel.
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	The Lothian Pension Funds' Consultative Panel attends all the Pensions Committee meetings. Further meetings are held if necessary. The Pensions Audit Sub-Committee is held before the Pensions Committee at least three times with further meetings held if necessary. The Investment Strategy Panel meets quarterly or more frequently as required.
	c) That an administering authority who does not include lay members in their formal governance arrangements must provide a forum outside of those arrangements by which the interests of key stakeholders can be represented.	Not applicable	
Access	That subject to any rules in the council's constitution, all members of main and secondary committees or panels have equal access to committee papers, documents and advice that falls to be considered at meetings of the main committee.	Yes	Committee papers and minutes are publicly available on the Council's website and all Committee and Consultative Panel members have equal access.
Scope	That administering authorities have taken steps to bring wider scheme issues within the scope of their governance arrangements.	Yes	The Pensions Committee deals with all matters relating to both the administration and investment of the Funds. A separate specialist Pension Audit Sub-Committee consisting of three members (including at least two elected members from the City of Edinburgh Council) undertake the audit scrutiny of the pension funds.

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	The City of Edinburgh Council is responsible for the appointment of members to the Pensions Committee. However on an annual basis: - the employer representative to be nominated for the Pensions Committee is selected by the employer representatives of the Consultative Panel - the member representative to be nominated to the Pensions Committee is selected by the member representatives of the Consultative Panel. Membership of the Consultative Panel is rotated every three years. The Funds publish governance documents and communicates regularly with employers and scheme members. Two members of the Consultative Panel are recruited by self nomination.

Risk Management Statement

The Fund is committed to a strong control environment to ensure that risks are identified, understood, managed and monitored appropriately. The risks (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:

	Before controls			After controls
Description	**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:

	After controls			
Description	**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

2013-14 Audited v2.pages