Pensions Committee

2.00pm, Wednesday, 27 June 2018

Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund Annual Report 2018 (and Financial Statements) Unaudited

Item number	5.2
Report number	
Executive/routine	
Wards	All
Council Commitments	Delivering a Council that works for all

Executive Summary

The purpose of this report is to present the unaudited Annual Report for the year ended 31 March 2018 for the Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund.

A copy of the unaudited Pension Funds' Annual Report for the year to 31 March 2018 is attached as Appendix 1. Reflecting positive, albeit muted, investment returns, the Accounts show that the Lothian Pension Fund net asset valuation increased from £6,595m to £6,665m, Lothian Buses Pension Fund increased from £488m to £509m and, given its mature membership profile, Scottish Homes Pension Fund decreased from £171m to £164m.

Report

Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund Annual Report 2018 (and Financial Statements) Unaudited

1. Recommendations

Committee is requested to:

1.1 Note the unaudited Annual Report for the year ended 31 March 2018 for the Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund; and

1.2 Refer this report, for information, to the City of Edinburgh Council, in its role as administering authority of the Pension Funds.

2. Background

Statutory provisions and accounting guidance

2.1 The Scottish Government has issued statutory accounting guidance, which requires that Local Government Pension Scheme (LGPS) financial statements be published within an Annual Report. From 2010/11 onwards, the LGPS Annual Report should be published separately from the Authority's own financial statements and there should be a separate audit report.

2.2 On 11 May 2015, "Local Government Finance Circular No.6/2015" was issued to provide non-statutory guidance on the requirements of The Local Authority Accounts (Scotland) Regulations 2014. These introduced a new statutory requirement for the Financial Statements to include a Management Commentary and an Annual Governance Statement. Similar requirements are contained in The Local Government Pension Scheme (Administration) (Scotland) Regulations 2008.

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

2.4 In March 2016, CIPFA revised and updated this guidance. Whilst the underlying principle of transparency of investment cost remained unchanged, a degree of relaxation to full cost disclosure was introduced. Specifically, for complex “Fund of Fund” structures, “Investment costs incurred by a separate legal entity, or in respect of investment decisions over which the pension fund has no control, should not be included in the (Pension) Fund Account......If pension funds wish to provide information about the total cost of Fund of Fund investments, this should be included as part of the Investments section in the Annual Report”.

2.5 At its meeting on 28 September 2016, the Pensions Committee agreed to instruct the Committee Clerk to communicate, to the Chartered Institute of Public Finance and Accountancy (CIPFA), Audit Scotland and the Scottish Local Government Pension Scheme Advisory Board (SLGPSAB), the Committee’s and Convenor’s disquiet with the relaxation of the principle of full cost transparency of investment management fees, as explicit in CIPFA’s revised guidance “Accounting for Local Government Pension Scheme Management Costs”.

2.6 SLGPSAB has improving cost transparency and investment fee consistency in its current work plan. On 18 November 2016, it issued Circular 01/2016, entitled “Transparency Code”. This stated that it welcomed the “Code of Transparency for LGPS asset managers”, as developed by its counterpart in England and Wales, and asked “pension funds in Scotland to promote the code with their own asset managers”. This Code is voluntary with asset managers encouraged to demonstrate their commitment to transparent reporting of costs.

2.7 In May 2018, CIPFA published “Proposals for LGPS Fund Reporting in a ‘Pooled World’”. “This …. sets out proposals for revised reporting for LGPS pension funds to meet a number of objectives”, including “to further enhance reporting of costs reflecting the introduction of the LGPS SAB Code of Transparency for asset managers, and initiatives underway by the Financial Conduct Authority (FCA) and Department for Work and Pensions (DWP) which aim to create more transparent and granular reporting standards for both providers and trustees …. This paper has been issued by CIPFA as good practice which is to be incorporated into 2018/19 Annual Report guidance for local government pension funds. It would be helpful however if funds could also apply the guidance when preparing their 2017/18 annual reports and feedback any practical issues encountered. Proposals can then be refined as necessary before the Annual Report guidance is finalised.” Although this contains explicit reference to the SAB in England and Wales and to the applicable pooling arrangements, it is anticipated that CIPFA Guidance will be revised on a UK wide basis.

2.8 The financial statements of Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund continue to include full transparency of all investment management fees.

2.9 With the, FCA regulated, investment services company, LPFI Limited, commencing trading on 28 February 2017, consolidated financial statements have again been prepared for Lothian Pension Fund for the year ended 31 March 2018. These consolidated financial statements combine those of the Fund (the parent entity) and its controlled entities (the investment staffing company, LPFE Limited, and now also LPFI Limited) as defined in International Accounting Standard (IAS) 27.

2.10 The Local Government (Scotland) Act 1973 stipulates that unaudited financial statements must be presented to the Council and the Controller of Audit within three months of the financial year end, that is 30 June. It is within the Pensions Committee's remit to consider the unaudited Annual Report for the pension funds. As per Audit Scotland guidance, the Annual Report should be referred to Council on for the purpose of noting. The next Council meeting is on 28 June 2018.

3. Main report

Unaudited Lothian Pension Funds Annual Report

3.1 A copy of the unaudited Annual Report for the year to 31 March 2018 for the Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund is attached as Appendix 1.

3.2 In considering the unaudited Pensions Funds' Annual Report, Committee should note the following:

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

3.2.2 Reflecting positive, albeit muted, investment returns, the Accounts show that the Lothian Pension Fund net asset valuation increased from £6,595m to £6,665m, Lothian Buses Pension Fund increased from £488m to £509m and, given its mature membership profile, Scottish Homes Pension Fund decreased from £171m to £164m.

3.2.3 The Annual Report includes an Annual Governance Statement which sets out details of how the Funds are governed and the internal controls that are in place to manage risk. This mirrors the requirement to have a similar statement within the Financial Statements of the Council. The Annual Report also encompasses a Governance Compliance Statement, which is a requirement of the LGPS Regulations. Its purpose is to record the extent to which the constitutional governance arrangements comply with best practice guidance issued by the Scottish Public Pensions Agency.

3.2.4 Related to the Annual Governance Statement is the Statement of Responsibilities for the Statement of Accounts. This sets out the respective responsibilities of the Administering Authority and those delegated to the Chief Finance Officer, Lothian Pension Fund.

3.2.5 Each of the three funds has a separate Actuarial Statement, prepared in accordance with Regulation 55(1)(d) of the Local Government Pension Scheme (Scotland) Regulations 2014. This provides a summary of the triennial valuation as at 31 March 2017, with commentary by the Actuary of the experience over the subsequent year.

3.3 Following the consideration of the unaudited Annual Report by Pensions Committee, the next steps will be:

a. City of Edinburgh Council should note the unaudited accounts at its meeting on 28 June 2018.

b. In order to meet the statutory timetable, the Pensions Audit Sub-Committee of 25 September 2018 and thereafter the Pensions Committee, at its meeting on 26 September 2018, will consider the following reports:

   i. International Standard on Auditing (ISA) 260 Audit Report, which covers all significant issues arising from the audit of the accounts;

   ii. the Annual Report by the External Auditor which summarises all significant matters arising from the audit and overall conclusions about the management of key risks; and

   iii. the Audited Annual Report 2018.

c. It is anticipated that City of Edinburgh Council should note the audited accounts at its meeting on 25 October 2018.

4. Measures of success

4.1 The prime objective of the Council, as administering authority of the Lothian Pension Fund, Lothian Buses Pensions Fund and Scottish Homes Pension Fund, is to ensure an unqualified audit opinion of the Annual Report 2018. This will be determined in due course.

5. Financial impact

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

6. Risk, policy, compliance and governance impact

6.1 The Local Government (Scotland) Act 1973 stipulates that unaudited financial statements must be presented to the Pensions Committee and the Controller of Audit within three months of the financial year end, that is 30 June.

7. Equalities impact

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

8. Sustainability impact

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

9. Consultation and engagement

9.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the Fund and they are invited to comment on the relevant matters at Committee meetings.

10. Background reading/external references

10.1 None.

Stephen S. Moir

Executive Director of Resources

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11. Appendices

Appendix 1: Unaudited Annual Report 2018 for the Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund;

Appendix 2: Lothian Pension Funds – Annual Statement by Chief Internal Auditor;

Appendix 3: City of Edinburgh Council – Statement on the system of internal financial control by Head of Finance; and

Appendix 4: Lothian Pension Funds – Statement on the system of internal financial control by Chief Finance Officer, Lothian Pension Fund

Appendix 1

Unaudited Annual Report and Financial Statements 2017/18

Lothian Pension Fund
Lothian Buses Pension Fund
Scottish Homes Pension Fund

Lothian
PENSION FUND

Contents

Foreword

Report by the Convener of the Pensions Committee

Following the Council Elections in May 2017 I was reappointed as Convener of City of Edinburgh Council's Pensions Committee for a second term. I am therefore delighted, once again to present the Annual Report and Accounts for the three Funds: Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund.

This year the Funds completed their 2017 actuarial valuations which set contribution rates for employers for the three years from 1 April 2018. The funding levels of all three Funds increased from the actuarial valuation in 2014, with good asset returns offsetting increases in the value of the liabilities. Lower interest rates continue to be a challenge to the pension funds and its employers. The actuarial valuations are a significant undertaking from both staff within the Funds, our employers and our Actuary and I would like to thank them for the months of work involved.

2017 also saw the creation of the Fund's Joint Investment Strategy Panel, working alongside Falkirk Council Pension Fund. This is a new phase in our collaborative partnership which should bring further opportunities and efficiencies.

Finally, during the year Sarah Smart stepped down as the Fund's Independent Professional Observer, a position she has held since March 2013. I would like to record my thanks and those of all members of the Pensions Committee and Pension Board for the valuable contribution Sarah made during her time with the Funds.

Councillor Alasdair Rankin
Convener, Pensions Committee, City of Edinburgh Council

Report by the Convener of the Pensions Audit Sub-Committee

The Pensions Audit Sub-Committee, of which I am the Convener, assesses the controls the Funds have in place to ensure effective, efficient and value for money operations. Over 2017/18, the Sub-Committee met four times and one of the key duties is to consider the Funds accounts and the subsequent external audit of them.

Other key areas the Sub-Committee review include the findings from internal audits, considered risk assurance, fraud prevention, tax recovery on investment income and investment custodian services. I believe the Audit Sub-Committee plays a valuable role in the governance of the pension funds and adds value to members and employers.

Councillor Cameron Rose
Convener, Audit Sub Committee, City of Edinburgh Council

Report by the Chair of the Pension Board

The Pension Board forms part of the governance structure that ensures management and administration of the pension funds in accordance with the applicable law and regulation, working together with the Pensions Committee to provide oversight of the Funds operations in a transparent and collaborative manner. The Board is made up of five employer and five member representatives and I have had the pleasure of being a Pension Board member since its establishment in April 2015, serving as Chair this past year. During this year we saw a number of changes in the make-up of the Board with two new members joining, Diane Hogarth and Brian Robertson, while Catrina Warren and Eric Adair both stepped down. I would like to thank both Catrina and Eric for the work they have done with the Board.

The Board attends all meetings of the Pensions Committee and Audit Sub Committee and actively participates in the Funds' governance. Members of the Board undertook 320 hours of training within the year to ensure they are equipped with the knowledge and understanding to enable them to properly exercise the functions of a pension board member. This year the Board reviewed its approach to ensuring members have a good understanding and oversite of the Funds' compliance with The Pension Regulator's code of practice. An agenda planning document was developed to ensure regular Board review of the Funds' alignment with Pensions Regulator guidance, as well as extending the quarterly Pension Board meetings, allowing more time for this compliance activity in addition to critical review of the quarterly Committee papers. Most recently the Board received an update on the Funds' data quality from the scheme manager. Each year, the position of Chair of the Pension Board rotates and I am pleased to say that Jim Anderson was selected to take on the role of Board Chair from 1 April 2018. I look forward to continuing to support the Funds as a regular Board member in future.

Darren May
Scottish Water employer representative and Chair of the Pension Board

Report by the Independent Professional Observer

The Observer role is to assist the Pensions Committee and Pension Board undertake their governance responsibilities effectively and efficiently. Over the year, I provided support to allow them to carry out their roles ensuring the Funds comply with relevant pension legislation and requirements set by The Pensions Regulator.

As with previous years, I held surgeries before each Committee meeting to allow Pensions Committee and Pension Board members to raise questions with me, working collaboratively and efficiently together to ensure their joint oversight of the pension funds. The issues were wide ranging and included investment, actuarial valuations and collaboration and these have all been considered alongside the Funds' normal business. The quality of engagement and discussion over the year has demonstrated a high standard of governance within the Funds. This is my final report as Independent Professional Observer for the Funds. I have enjoyed working with the Pensions Committee and Pension Board and am happy to have contributed to the Funds' governance and the Committee and Board's knowledge on pension matters.

Sarah Smart
Independent Professional Observer to February 2018

Management commentary

Introduction

2017 Actuarial Valuations

During the year, the triennial assessment of the funding position of the pension funds was undertaken by the Funds' Actuary. In general, the results showed that despite better than expected asset returns since the 2014 actuarial valuation, employer costs increased due to a reduction in future expected investment returns. The Funding Strategy Statement was reviewed and amended following consultation with employers.

For Lothian Pension Fund, the funding level increased from 91% at 31 March 2014 to 98% at this valuation. The deficit decreased from £417million at 31 March 2014 to £145million at 31 March 2017. Reflecting the differences in the employers in the Fund, a third investment strategy was introduced for employers which are closed to new entrants but not close to exiting the Fund. To avoid time-consuming employer appeals of the results of the actuarial valuation, this year the Fund introduced a requirement for employers to provide written confirmation that minimum contribution rates set by the Actuary are affordable. It is not in the best interests of the individual employers or the Fund for employers to continue to accrue unaffordable pension liabilities. Four employers indicated that the minimum contribution rates are unaffordable and the Fund is working with them to manage their exit from the Fund. The Fund continues to work with employers to put in place funding agreement to address repayment of debt when an employer leaves, in order to avoid employer default or insolvency.

For Lothian Buses Pension Fund, the funding level on the ongoing basis has risen from 117% at in 2014 to 121% at 31 March 2017, showing a surplus of £84million. In comparison, the funding level on a low risk (gilts) basis was 89%, with a deficit of £59million. The actuarial valuation was signed by the Actuary on the basis that the company will continue to pay deficit contributions (if necessary) after the last active member leaves the Fund and it will continue to adopt a long-term investment approach. The company's Admission Agreement is being updated accordingly to strengthen governance and affirm the employer covenant. Further, it was agreed, following consultation with stakeholders and on completion of the revised Admission Agreement, to transfer the assets and liabilities of the Lothian Buses Pension Fund into the Lothian Pension Fund. This merger is expected to deliver investment efficiencies and administrative savings, whilst the assets attributable to this employer retains a bespoke investment strategy.

The funding level for Scottish Homes Pension Fund at 31 March 2017 was 104.7%, increased from 88.8% from the 2014 actuarial valuation. Consultation was undertaken with the Scottish Government on the potential benefits offered by revising the Funding Agreement for this Fund. However, it advised that it does not wish to revisit this and as a result the investments of the Fund are now fully invested in index-linked government bonds and cash.

Cashflow & Investment

All three Funds delivered single digit positive performance over the year, with strong global equity market performance tempered by the strength of sterling. Lothian Pension Fund's assets have increased by £60million, with investments returning 1.4% over the year. The internal team manages a significant proportion of assets of all three pension funds in-house.

For Lothian Pension Fund this includes approximately £3.4billion of listed assets specifically designed to provide downside protection in times of market stress, together with a currency hedging programme.

The expenditure of all three pension funds continues to exceed income. The investment strategies of the Funds have targeted investment income in recent years and this is expected to exceed net cashflow for the foreseeable future. It is therefore not anticipated that the sale of investments will be required to meet this funding requirement. Changes in membership of the Funds have implications for cashflow. On retirement there are immediate outflows due to the payment of tax free lump sums and pensions and a reduction to inflows as contributions cease. However, payment of strain costs by employers on early retirements helps to mitigate current cashflow pressures.

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

The Pensions Committee regularly considers the legal responsibilities of administering the Funds and its fiduciary duty to members and employers. Non-compliance with the fiduciary duty could leave the Council and Pensions Committee open to legal challenge or otherwise have an adverse impact on the Council, the Funds and their stakeholders. There continues to be significant lobbying from external interest groups on certain investments and the Funds continue to engage with these groups as appropriate.

Customer Service

The quality of membership data continues to be a key area of focus for the Funds to ensure we meet standards set by The Pensions Regulator. All employers are now providing monthly contribution data for each member which is enabling us to see changes in membership quickly and hence provide a better service. It continues to be a challenge to obtain information from some employers regarding members who have left the scheme. That said, the service continues to be rated highly with 95% of customers assessing the service as ‘excellent’.

During the year, the Funds completed a tender for its pensions administration system, combining the current three systems into one contract to deliver a more integrated, efficient and cost-effective service. Contractual terms and conditions are being finalised with the preferred supplier.

Good progress continues to be made with reconciling pension records for Guaranteed Minimum Pensions ahead of the HMRC deadline in December 2018, with notably this being achieved entirely through internal staff resourcing.

Staffing

In 2015, key investment staff were transferred to LPFE Limited in order to introduce new terms and conditions to reduce retention and recruitment risks facing the Funds. In February 2018, the Funds’ remaining staff transferred to LPFE Limited following consultation with staff and trades unions.
Employing all staff in one organisation will facilitate the collaborative efforts with other local government pension funds and ensure a consistent approach to resourcing.

We also undertook a gender pay gap analysis for the first time this year. We have 57 employees split as 24 male and 33 female. The overall mean and median gender pay gap based on hourly rates of pay was 38.9% and 43.9% respectively.

The figures excluding the Investment Management Team were 16.4% and 0.0% respectively. This data shows that men employed by the Fund are paid, on average, more than women. Although this reflects the industry norm for Investment Management firms, we intend to break that mould and seek innovative ways to achieve gender balance.

Collaboration with other Pension Funds

Collaboration brings tangible benefits to both Lothian Pension Fund and its collaborative partners by investing in greater scale and for other funds to benefit from the commercial advantage of the in-house team. In addition, sharing costs between collaborating funds allows reinvestment in systems and the in-house team to improve long-term sustainability.

Lothian Pension Fund has provided Falkirk Council Pension Fund with support on investment matters, including assisting with infrastructure investing, over recent years. During the year, a Joint Investment Strategy Panel was established, advising the Finance Directors of each administrating authority (the City of Edinburgh Council and Falkirk Council) on implementation of their respective investment strategies. This collaborative structure is expected to deliver significant efficiencies. The Pensions Committee of the respective Councils continue to retain responsibility for their investment strategy and the assets of Lothian Pension Funds and Falkirk Council Pension Fund will remain separate.

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

Lothian Pension Fund has also continued its collaboration in private markets investment with other Local Government Pension Scheme partners, Falkirk Council Pension Fund and Northern Ireland Local Government Officers' Superannuation Committee and, over the year, Scottish Borders Pension Fund joined the collaboration.

Awards

The Fund retained the Customer Service Excellence award in 2017/18 for the tenth year. A new assessor carried out the assessment this year. The assessor's feedback included that "Lothian Pension Fund are long term holders of the Customer Service Excellence Standard and is to be congratulated in retaining its accreditation and its endorsement of CSE as a key driver for customer focused development." In March 2017, the Fund gained accreditation from Pension Administration Standards Association (PASA), following a three-day visit and our assessment for reaccreditation will take place in 2019.

The Fund received two pension industry awards this year. At the LAPF Investment Awards 2017, the Fund won LGPS Fund of the Year (over £2.5billion) for Lothian Pension Fund and at the Professional Pension's Pension Scheme of the Year Awards won the DB Scheme of the Year (under £500m) for Lothian Buses Pension Fund.

Challenges

The Funds' Service Plan for 2018-2020 shows our plans for the coming years and outlines our ambitions and values:

- to provide an excellent service to our members and employers;
- to provide funding and investment strategies for employers to manage affordability and mitigate risk; and
- to be a partner of choice for other local government pension funds to improve efficiency and sustainability.

The challenge to improve the quality of member data is ongoing. For 2018/19, we have introduced a broader set of performance measures so that we can continue to improve our service. We will continue to liaise with employers to improve the speed of transfer.

New data protection legislation comes into force in May 2018 and the Funds are reviewing and updating processes accordingly. Changes to the Scheme regulations are also expected in 2018 which will bring additional flexibility for members with early retirement and additional voluntary contributions. We will need to communicate these changes to members and employers, and change processes accordingly.

A review of the structure of the Scottish LGPS is expected to be carried out in 2018 which will consider the number of funds across Scotland. We will participate in this consultation and meanwhile we will continue to explore wider opportunities for collaboration to improve services and sustainability.

There will be further oversight and scrutiny of the Funds when the Government analyses the 2017 actuarial valuations of all funds in Scotland and the cost of the benefits in relation to the employer cost cap.

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

Stephen Moir
Executive Director of Resources
The City of Edinburgh Council
June 2018

Clare Scott
Chief Executive
Lothian Pension Fund
June 2018

Governance

The City of Edinburgh Council is the administering authority for the Scottish Local Government Pension Scheme (LGPS) in the Lothian area. The Council administers the benefits and invests the assets of three LGPS funds, Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund.

Lothian Pension Fund is the second largest LGPS fund in Scotland with assets of £6.7 billion, 90 employers with active members and over 79,000 members.

The Lothian Buses Pension Fund holds assets of £0.5 billion and 3,700 members, while Scottish Homes Pension Fund investments amount to £0.16 billion with 1,600 members.

The Funds maintains a comprehensive website for easy access to all relevant pension information and this is found at www.lpf.org.uk. This includes the Annual Report & Accounts of the three pension funds, Statement of Investment Principles, Funding Strategy Statement and Pensions Administration Strategy and Pensions Discretions Policy.

The Pensions Committee and Pensions Audit Sub-Committee

The day to day running of the Funds is delegated to a specialist team who undertake pension administration, accounting and investment functions, managing the majority of the Funds' assets internally.

All pension matters are delegated to the Pensions Committee of the Council, supported by the Audit Sub Committee, and its members act as 'quasi trustees'. Both Committees held four meetings during the year. The table below shows the Committee members before the Local Government elections held on 4 May 2017 and following the appointment of members by the Council on 29 June 2017.

1 April 2017 to 3 May 2017	From 29 June 2017 to 31 March 2018
Pensions Committee	**Pensions Committee**
Councillor Alasdair Rankin (Convener)	Councillor Alasdair Rankin (Convener)
Councillor Maureen Child	Councillor Maureen Child
Councillor Jim Orr	Councillor Adam McVey (to 14 March 2018)
Councillor Bill Cook	Councillor Claire Miller
Councillor Cameron Rose	Councillor Cameron Rose
	Councillor Neil Ross (from 15 March 2018)
John Anzani (member representative, Midlothian Council)	John Anzani (member representative, Midlothian Council)
Richard Lamont (employer representative, VisitScotland)	Richard Lamont (employer representative, VisitScotland)

Pensions Audit Sub-Committee	Pensions Audit Sub-Committee
Councillor Cameron Rose (Convener)	Councillor Cameron Rose (Convener)
Councillor Jim Orr	Councillor Maureen Child
Councillor Bill Cook	John Anzani (member representative, Midlothian Council)

The Pension Board

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

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

The Pension Board membership for the period 1 April 2017 to 31 March 2018 was as follows. There were two vacancies as of 31 March 2018.

Member representatives

Jim Anderson	Unison
Catrina Warren	Unison (to 20 March 2018)
Thomas Carr Pollock	GMB
Diane Hogarth	Unite (from 13 September 2017)
Brian Robertson	Unite (from 4 August 2017)

Employer representatives

Eric Adair	EDI Group (to 26 March 2018)
Darren May (Chair)	Scottish Water
Sharon Dalli	Police Scotland
Paul Ritchie	East Lothian Council
Alan Williamson	Edinburgh College

Pensions Committee and Pension Board training

The Committee and Board members must attend no less than 21 hours of training per year as outlined in the Funds' training policy which is available on our website at www.lpf.org.uk. All new members of the Pensions Committee and Pension Board attend induction training. Other training provided internally covered topics including governance and the joint investment strategy panel, climate change and company engagement, actuarial valuation and the FCA, as well as sessions on collaboration and the LGPS Governance Review.

Committee and Board representatives also attended external conferences including the Pensions and Lifetime Savings Association Local Authority Investment Conference 2017 and the 2017 Local Authority Pension Fund Forum Annual conference. Six members of the Committee and all Pension Board members achieved the required training hours during 2017/18. Pensions Committee members collectively attended 249 hours of training over the year and members of the Pension Board undertook 320 training hours.

Joint Investment Strategy Panel

Investment strategy guidance to the Committee is provided by a Joint Investment Strategy Panel (JISP), working in collaboration with the Falkirk Council Pension Fund. The JISP meets quarterly and includes senior officers and external investment advisers (currently Scott Jamieson and Gordon Bagot). The Pensions Committee of each pension fund agree their own investment strategy but delegate the implementation of strategy, including selection of investment managers, to officers. The JISP advises both pension fund administrating authorities on implementation of investment strategy. The assets of Lothian Pension Fund and Falkirk Council Pension Fund remain separate.

Lothian Pension Fund staff

The team is employed by an arms-length company, LPFE Limited (LPFE), which is wholly owned by the Council (in its capacity as administering authority for the Funds) and it is supervised by a board of directors chaired by the Council's Executive Director of Resources and includes the Convener of the Pensions Committee. The team requires to carry out certain of its activities for the Funds through its Financial Conduct Authority authorised vehicle, LPFI Limited (LPFI). LPFI is also wholly owned by the Council (in its capacity as administering authority for the Funds). LPFI is supervised by a board of directors chaired by the Council's Head of Finance. Both the boards of LPFI and LPFE comprise an independent non-executive director (Leslie Robb). All the operations, costs and liabilities in relation to the Funds, including those of LPFE and LPFI, are borne by the Funds.

The day-to-day running of the three pension Funds is carried out by the Lothian Pension Fund group, comprising the investment and pensions team within the City of Edinburgh Council (acting in its capacity as the administering authority of the Funds), LPFE and LPFI (the LPF Group). The LPF Group's functions includes investment, pension administration, employer liaison, data quality, customer support, accounting, legal, risk and compliance, communications and general business support. The investment responsibilities include carrying out in-house investment management and the monitoring and selection of external investment managers, as well as external facing collaborative initiatives with other like-minded pension funds.

In 2015, key investment staff were transferred to LPFE. As part of the transfer new terms and conditions were introduced to enable the Funds to more effectively manage the risks and controls around its staff and enable it to pursue its collaborative initiatives for the benefit of the Fund's stakeholders within an acceptable tolerance or risk. The remaining staff were transferred to LPFE in January 2018 so that all staff within the LPF Group are employed by LPFE.

Over the year, senior officers from the Council were:

Stephen Moir, Executive Director of Resources, The City of Edinburgh Council
Hugh Dunn, Head of Finance, The City of Edinburgh Council
Katy Miller, Head of Human Resources, The City of Edinburgh Council.

And senior officers from LPFE were:

Clare Scott, Chief Executive Officer of Lothian Pension Fund
Bruce Miller, Chief Investment Officer of Lothian Pension Fund
Struan Fairbairn, Chief Risk Officer of Lothian Pension Fund
John Burns, Chief Finance Officer of Lothian Pension Fund
Esmond Hamilton, Financial Controller of Lothian Pension Fund.

Scheme Advisory Board

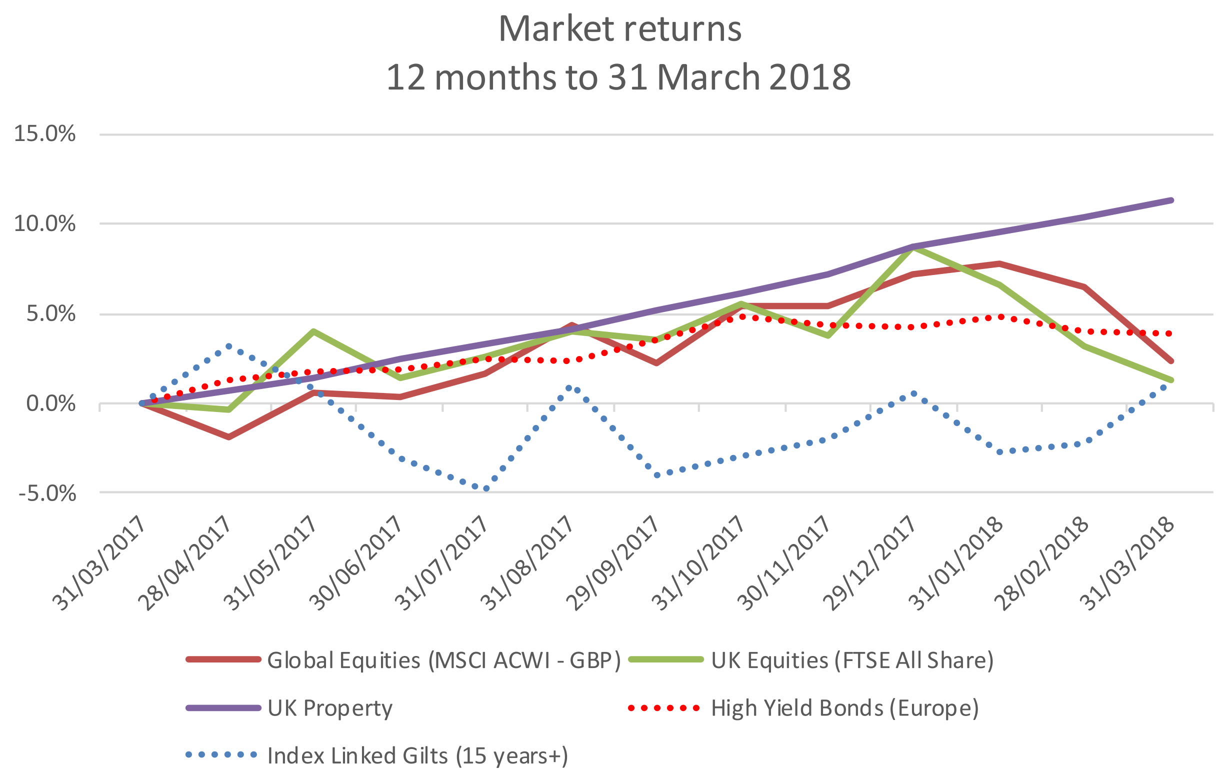
The Scheme Advisory Board for the Local Government Pension Scheme in Scotland was set up following the Public Service Pensions Act 2013. The Board's main function is to advise Scottish Ministers, when requested, on the desirability of changes to the Scheme. They can also provide advice to scheme managers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

The membership of the Scheme Advisory Board comprises of seven member representatives and seven employer representatives with a Joint Secretary to support each group. During the year, Councillor Rankin was a member and Vice-Chair of the Scheme Advisory Board and Fund officers have also advised the Board and Joint Secretaries. There is more information on the Scheme Advisory Board at www.lgpsab.scot.

Investment

Investment markets

For the 12 months to 31 March 2018, UK equities returned +1.3%, and global equities (in sterling terms) returned +2.4%. Equity market returns for sterling-based investors were dampened by the strength of the pound over the year (global equities returned +11.3% in local currency terms), which reversed much of the fall in value that followed the UK referendum in June 2016. The sharp fall in equity markets during the first quarter of 2018 was also a factor, with markets falling as much as 10% from their January 2018 highs to their lows in late March, before stabilising at the end of the quarter.



Government bond yields in most major markets were broadly unchanged, before rising in early 2018 as stronger US inflation data pushed up expectations that the US Federal Reserve would raise rates faster than previously anticipated, having already raised interest rates three times over 2017. Credit and high yield bond spreads also were broadly unchanged over the year, with high yield spreads in both the US and Europe trading close to their historic lows.

In the UK, the Bank of England increased its base rate as expected in November 2017. However, this was also accompanied by commentary at the time suggesting that further rate rises were less imminent given the Bank's cautious outlook for the economy as the path to the UK's exit from the European Union remains unclear. In Europe, 2017 saw significant positive economic momentum, though more recent data emerging in first quarter of 2018 suggested that economic activity was beginning to slow.

Over the year, the OECD raised its global economic growth forecast for 2017 and for 2018. While the latest global outlook has turned more positive, there remains significant dispersion at country level with the UK economic outlook the weakest of the major economies.

Following the passing of Trump's tax reform programme late in 2017, equities continued to march higher through January, before volatility in late January sent risk assets sharply lower before stabilising in March. Looking ahead, investors face the prospect of further tightening of monetary policy in the US, alongside concerns around increased protectionism and ongoing geo-political tensions concerning Russia, the Middle East and Korea.

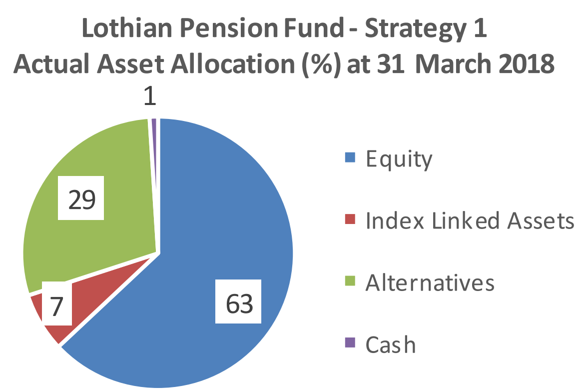
Investment strategies

The investment strategies for all three funds reflect the long-term plans to maintain an acceptable balance between contribution stability and the achievement of positive long term real returns from the assets owned. These plans were initially set during 2012, and reviewed again in 2015/2016, taking into account the results of the 2014 actuarial valuations.

At 31 March 2018, the three funds (Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund) were all invested in range of their target asset allocations, as expected. A review of the Funds' investment strategies will be undertaken again over 2018/2019, taking into account the results of the 2017 actuarial valuations.

Lothian Pension Fund

To provide suitable investment strategies for the differing requirements of employers, Lothian Pension Fund currently operates two investment strategies.
Most employer liabilities are funded under Strategy 1, which adopts a long-term investment strategy, aiming to maximise the investment return within reasonable and considered risk parameters and hence minimise the cost to the employer. The investment strategy is set at the broad asset class level of Equities, Index-Linked Gilts and Alternatives, which are the key determinants of investment risk and return.

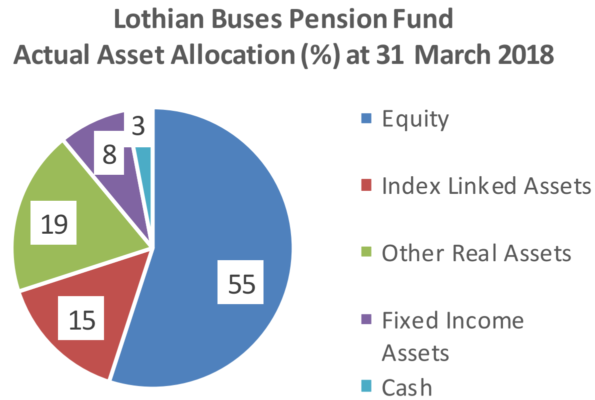


A small number of employers are funded in Strategy 2, which invests in a portfolio of UK index-linked gilts to reduce funding level and contribution rate risk to a level appropriate to their circumstances. The liabilities funded by Strategy 2 represent less than 1% of total Lothian Pension Fund liabilities.

As part of the 2017 actuarial valuation, an additional investment strategy was implemented at the end of the year. For employers who are closed to new members but do not yet qualify for Strategy 2 that aims for the middle ground between Strategy 1 and the lower risk Strategy 2.

Lothian Buses Pension Fund

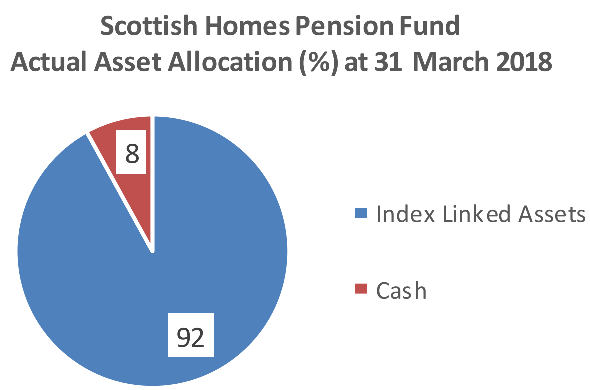
A long-term strategy allocation is in place for the Lothian Buses Pension Fund for the five-year period 2016-21. This was agreed by the Pensions Committee as part of the updated 2015/2016 strategy review. This involves making changes to the asset allocation over that timeframe reflecting the requirement for greater funding stability as the Fund grows and matures. (The Fund is closed to new entrants and is maturing at a faster pace than the Lothian Pension Fund.) In addition, as Lothian Buses Pension Fund is defined in regulations as a sub-fund of Lothian Pension Fund, the Pensions Committee agreed that the option for it to be merged into Lothian Pension Fund would be explored in consultation with stakeholders.



During the year to 31 March 2018, Lothian Pension Fund and Lothian Buses Pension Fund continued to reduce their equity allocations. This was achieved by redirecting, rather than re-investing, dividend income from equities and distributions from the Funds' private equity holdings. There were increased allocations to alternative assets, including infrastructure investments in the UK and overseas, and further investments in private debt. Over the past 10+ years, the Funds have built a portfolio of private market assets in equity, debt, real estate, timber and especially in infrastructure, which is the largest proportion of the private market assets held and is described in more detail below.

Scottish Homes Pension Fund

For Scottish Homes Pension Fund, the year to 31 March 2018 has seen further change. This follows on from the changes at the end of the prior year in March 2017, when the bond and equity portfolios were brought in-house, with the bonds restructured to improve cash-flow matching of the assets with future liability payments.



In September 2017, the fund's target equity allocation was reduced from 15% to 10% as the estimated funding level improved. Over the year, the results of the 2017 actuarial valuation showed a funding level of 104%+, significantly ahead of expectations and achieved primarily through better than anticipated investment returns. Discussions with the Scottish Government, as guarantor to the Fund confirmed that it preferred that the Fund disinvest its remaining equity and property allocation. At 31 March 2018, the Scottish Homes Pension Fund was invested in index-linked gilts and cash, structured to broadly match the expected liability payments as they fall due.

Strategies for all three funds are implemented and monitored by an experienced internal team of investment professionals supported by external advisers. Over recent years, the internal team has expanded with very positive effects on costs and capabilities. This is reflected in two structural shifts. Firstly, the percentage of Lothian Pension Fund's listed equity assets managed internally has risen from 23% to 85% and most publicly traded bond assets are also now managed internally. Secondly, the Fund has altered the construction of the listed equity portfolios, increasing the global mandates from 32% to more than 85%. Despite these large changes in Lothian Pension Fund, performance has been ahead of benchmark by 1.0% per year over the last five years and this has been achieved with lower risk than the benchmark. The Fund's guiding principle is to use strong internal investment capabilities to their maximum potential and to retain external managers for specialist mandates.

Infrastructure Investment

Infrastructure investment continues to receive publicity as governments and politicians encourage public pension funds to increase their investment in this area. Infrastructure investments have the potential to generate attractive risk-adjusted returns, with cash flows often linked to inflation. The long-term and defensive nature of these assets also can provide an element of diversification to the Funds' investment strategies.

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

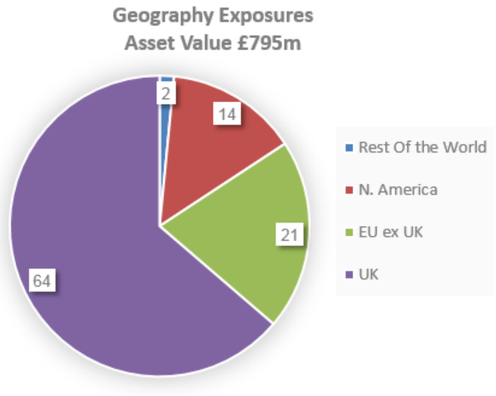
Infrastructure investments represented 11.4% of the value of Lothian Pension Fund assets at 31 March 2018, comprising one of the largest and most diversified allocations among UK LGPS funds. Lothian Buses Pension Fund investments in infrastructure accounted for 9.6% at 31 March 2018. Of the combined £795 million (31 March 2017: £730m) invested in infrastructure across both funds, the majority (64%) is invested in the UK.

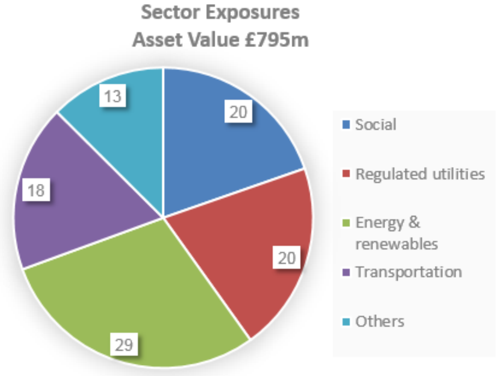
During 2017/18, Lothian Pension Fund and Lothian Buses Pension Fund completed one primary fund investment, acquired two secondary fund interests at discounts to net asset value and invested in five co-investment and/or specified asset investment vehicles. Approximately £105 million has been invested over the year in UK, European and Global infrastructure assets. During the same period, £138 million has been distributed to the Funds.

Investments are across a diverse range of projects, in the areas of:

- social infrastructure (including hospitals, schools and roads);
- regulated utilities (including water and electricity);
- energy & renewables (including solar, wind and hydro, as well as oil and gas storage and distribution);
- transportation (including airports, ports and rail); and
- others (including waste management, car parks and smart meters).

The geographic and sector exposures for the combined Lothian Pension Fund and Lothian Buses Pension Fund infrastructure allocations (at 31 March 2018) are shown in the charts below.





The market value of infrastructure investments in the UK at 31 March 2018 was £507 million. The map and table below shows the location of the Funds' 20 largest major UK infrastructure investments, representing c74% of the UK total (c£375m).

Location	Sector-Subsector	%
Various	Renewables-Solar	5.6
Worthing	Utility-Water	5.6
Livingston	Energy meters	5.4
Redhill	Roads	5.3
Liverpool	Ports	5.3
Isle of Man	Utility-Gas	5.3
Perth	Renewables-Hydro	4.9
Walsall	Utility-Water	4.8
Manchester	Energy meters	4.6
London	Sewage system	4.5
Warwick	Utility-Gas	3.8
North Sea	Pipeline	3.3
Barnsley	Utility-Water	2.5
Newport Pagnell	Motorway services	2.3
West Lothian	Renewables-Wind	2.3
Hertfordshire	Utility-Water	2.0
Edinburgh	Ports	2.0
Folkestone	Rail	1.8
Dudley	Healthcare	1.6
Southern North Sea	Electricity	1.4

Responsible Investment

The Funds have been a strong proponent of responsible investment for many years. It became a signatory to the Principles for Responsible Investment (PRI) in 2008. The PRI, which is supported by the United Nations, encourages investors to use responsible investment to enhance returns and better manage risks. By implementing the six principles (https://www.unpri.org/pri/about-the-pri), the goal of signatories is to develop a more sustainable global financial system.

The PRI undertakes a detailed annual assessment of each signatory and its responsible investment activities. It publishes its findings in two reports (Transparency and Assessment) and, for Lothian Pension Fund, these can be found on the Fund's website. The Assessment Report benchmarks performance against the Funds' history and against peers, and the latest report published in 2017 is very favourable. The Funds are a signatory to the Financial Reporting Council (FRC) UK Stewardship Code. The UK Stewardship Code provides seven principles that institutional investors should adhere to. Lothian Pension Fund is classed as a Tier 1 signatory, due to its close adherence to the code. The Funds also participates in the CDP (Carbon Disclosure Project), an international disclosure system that enables companies, cities, states and regions to measure and manage their environmental impacts.

The Funds receives queries about its approach to responsible investment on a regular basis. In particular, there are groups that lobby for the divestment of certain company shares, or those that operate in certain industries or in certain geographies on ethical grounds. Examples include companies operating in the defense arena, the extraction of fossil fuels and the sale of tobacco or alcohol, and companies operating in controversial areas of the world, such as the occupied territories of Palestine. The issues raised by lobby groups often involve complex social, legal and moral issues.

Whilst the Funds are sympathetic to some of the issues raised, it has its own obligations to fulfil within the constraints of the legal setting. The Funds' policy on responsible investment stems from its fiduciary duty to its members and employers, which was endorsed by a legal opinion in September 2016 on the responsibilities of Scottish Local Government Pension Scheme funds (available to view at www.lgpsab.scot).

Its approach is widely followed across the industry and reflects the fact that its primary objective is to pay pensions to its members when they fall due and it strives to do this by investing in a responsible manner, which includes engagement with companies. It does not have a policy of exclusion. Its policy is to engage with the companies in which it owns shares with a view to improving corporate behaviour to the benefit of shareholders. By doing this, the Funds aim to satisfy its most important social responsibility, which is to its members and employers by providing pensions, and it believes that this approach will also provide wider societal benefits.

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

Investment Process

The Funds' (and the industry's) investment processes have evolved over the years to include a greater focus on ESG issues, risks and opportunities. ESG issues can clearly affect the financial performance of the companies in which the Funds invests. As a signatory to the Principles for Responsible Investment, the Funds are obliged to incorporate ESG issues into investment analysis and decision-making processes (Principle 1).

Investment opportunities are assessed with a view to meeting a required level of financial return in the context of achieving an appropriate level of risk, and ESG issues are part of that assessment. ESG factors are an important element of investment risk and opportunity, and there is evidence that the shares of companies with improving ESG ratings are better investments than those that are simply highly rated. As such, engaging with companies to improve their positions on ESG issues can lead to better long-term outcomes for the Funds. However, it is also important to note that the Funds do disinvest from shares where it considers financial risk to be unrewarded.

The Funds' internal portfolios are actively managed using both fundamental and quantitative investment processes. For the portfolios managed on a fundamental basis, ESG factors are formally assessed as part of the due diligence process before shares are purchased, supported by the research of a specialist third party service (currently MSCI ESG Research), which provides ESG specific data, analysis and research to help identify the risks and opportunities that companies face. This ensures that consideration of ESG factors can be applied to the investment process using data that has been collated in a consistent manner.

The Funds' external managers are also selected and appointed after due consideration of their approach to integrating ESG considerations into their investment processes. Their activities, including scrutiny of how ESG considerations affected investment decisions, are monitored by the Funds quarterly.

Climate Change

Climate change concerns have prompted governments around the world to implement policies to limit global temperature increases. The Funds recognises that such policies will affect 'fossil fuel' companies in a significant way. However not all 'fossil fuels' are equal. Gas is much cleaner than coal - gas and renewables are expected to grow their share of the energy mix at the expense of coal. Many 'fossil fuel' companies are investing heavily in cleaner fuels and renewables – while they are part of the problem, they are also part of the solution.

Lothian Pension Fund has carried out a carbon footprint exercise to aid research, engagement and monitoring activities. The results show a footprint almost identical to its benchmark although it should be noted that there are limitations on the data used in these exercises. The Funds believes that divestment of 'fossil fuels' as a policy will have little or no impact on company operations.

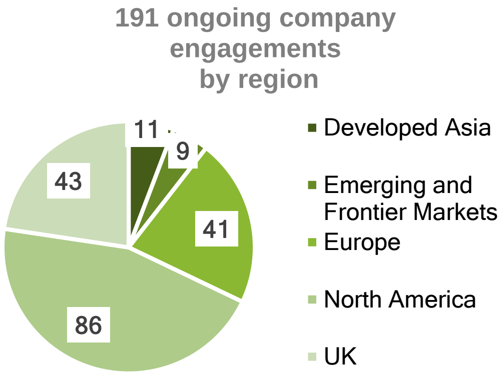
As highlighted above, the Funds have been researching opportunities and invests in the renewable sector within the private market for several years with renewables, including wind, solar and hydro assets, valued at £113m at 31 March 2018.

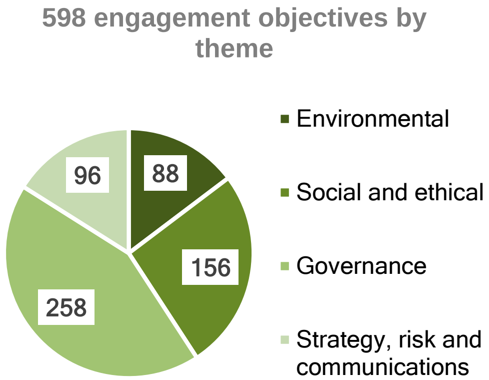
Voting and Engagement

Robust arrangements are in place to ensure that the Funds' shareholdings are monitored and appropriate voting and engagement activity is undertaken with the aim of bringing about positive long-term change at companies through a focused and value-oriented approach. Share ownership brings with it the right to engage with management to affect strategic change in a positive direction. Divestment relinquishes that right.

During 2017/18, voting and engagement activities related to the Funds' shareholdings were largely undertaken by Hermes Equity Ownership Services (EOS), with Baillie Gifford taking responsibility for the investments they manage on behalf of the Funds. A summary of these activities is provided in the charts below. The Funds' influence with investee companies is enhanced through Hermes EOS' aggregate representation for over £330bn in assets at 31 March 2018.

Hermes EOS collates voting and engagement data for the Funds and reports this for calendar year periods. During calendar year 2017, the Funds voted at the annual meetings of the 517 companies in which it was invested. There were votes on 7,446 resolutions, and the Funds opposed 614 of them. In addition, Hermes EOS engaged on the Funds' behalf with companies across the world on topics such as board structure, executive compensation and climate change. More details can be found on the Funds' website www.lpf.org.uk.





Engagement activities are also undertaken on behalf of the Funds and approximately 70 other UK Local Government Pension Scheme in the UK by the Local Authority Pension Fund Forum (LAPFF). Councillor Alasdair Rankin, Convener of the Pensions Committee, is a member of the Executive Committee of the LAPFF. Membership of the LAPFF Executive entails meeting with the boards of companies and attending company Annual General Meetings to represent shareholders' interests.

Funding Strategy Statement

The Funding Strategy Statement covers the funding strategies of each of the three Funds and can be viewed on our website at www.lpf.org.uk.

The purpose of the Funding Strategy Statement is:

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

These objectives are desirable individually but may be mutually conflicting.

The Funding Strategy Statement also ensures that the regulatory requirements to set contributions to ensure the solvency and long-term cost efficiency of the Funds, (as defined by the Public Service Pensions Act 2013) are met.

The Funding Strategy Statement was revised at the 2017 Actuarial Valuation. In addition to updates required as a result of changes to the Scheme Regulations and other guidance, changes included:

- the introduction of a new medium risk investment strategy, and;
- the requirement for employers to confirm commitment to contribution rates.

As required by Scheme regulations, the Funds consulted with employers as part of the review process.

The Funds must be able to meet all benefit payments as and when they fall due. These payments will be met by contributions (resulting from the funding strategy), or asset returns (resulting from the investment strategy). A formal review of the Funds' investment strategies is undertaken at least every three years to ensure appropriate alignment with liabilities. Further information on the investment strategies can be found in the Funds' Statement of Investment Principles also available at www.lpf.org.uk.

Financial Performance

Administration expenses

A summary of the Funds' administrative expenditure for 2017/18, against the budget approved by Pensions Committee, is shown in the table below. This budget includes adjustment agreed by Pensions Committee as part of the collaboration business case.

The budget focuses on controllable expenditures and therefore excludes all benefit payments and transfers of pensions from the Funds. Similarly, income does not include contributions receivable and pension transfers to the Funds. The total net cost outturn of £27,127k against budgeted of £27,808k represented an underspending of £681k (2.4%) for the Funds. The key budget variances serving to generate this underspending were:-

- Investment management fees - £867k overspend. This budget also includes investment management fees deducted from capital, but excludes the performance related element of these charges due to their unpredictable nature. During the year there was higher than expected deal flow for infrastructure and private debt assets which contributed to the overspend. Broker commission for the first three quarters of the period included research costs which had been budgeted separately in third party payments.
- Other third-party payments - £549k underspend. The rollout of direct investment broker research invoicing was delayed until the final quarter of the year. From April to December 2017 these charges continued to be paid via commission, with approximately £325k of this underspend offsetting the investment management fees for the year. The Funds did not suffer any broken deal costs in relation to its co-investment infrastructure investments during the period which contributed to the underspend.
- Supplies and Services - £606k underspend. Delays in the implementation of the investment front office system and further collaboration work resulted in the underspend for the period.
- Employees - £467k underspend. This arose from savings in unfilled posts, partly due to the timing of recruitment during the financial year.

	Approved budget	Actual outturn	Variance
	£000	**£000**	**£000**
Employees	3,210	2,747	(463)
Property	201	195	(6)
Plant and Transport	41	33	(8)
Supplies and Services	1,594	988	(606)
Investment Managers Fees*	22,300	23,167	867
Other Third-Party Payments	1,404	855	(549)
Capital funding - Depreciation	82	80	(2)
Direct Expenditure	28,832	28,065	(767)
Support Costs	286	250	(36)
Income	(1,310)	(1,188)	(122)
Total net controllable cost to the Funds	**27,808**	**27,127**	**(681)**

**Does not include performance elements*

Reconciliation to total costs

	Actual outturn
	£000
Actual outturn on budgeted items above	27,127
Add back securities lending revenue included in income above	865
Investment management fees deducted from capital – performance related element	9,322
IAS19 LPFE retirement benefits	1,030
LPFE deferred tax on retirement benefits	(175)
Total cost to the Funds (inclusive of full investment management fees)	38,169
Per Fund Accounts	
Lothian Pension Fund group	35,412
Lothian Buses Pension Fund	2,523
Scottish Homes Pension Fund	234
Total	**38,169**

Cash-flow

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

Lothian Pension Fund continued to experience a net reduction in value from its dealings with members. Despite active membership numbers rising marginally, reflecting pensions auto-enrolment, pensioner numbers increased more significantly, driven by demographic and economic factors. Outlays exceeded receipts by £17.0million representing a £7.9million change in position from 31 March 2017 (net withdrawals of £9.1million).

As a fund which is closed to new entrants, the income and expenditure of Lothian Buses Pension Fund reflect this relative maturity. As at 31 March 2018, outlays from dealing with members remained in excess of receipts, by £2.8million for 2017/18. This represents a change of £0.1million on the position as at 31 March 2017, where net outlays totaled £2.7million. Primarily, this was the result of significant outgoings due to the early payment of retirement benefits.

Scottish Homes Pension Fund is a mature fund with no active members. As a result, pension outlays are met from investment income and funding from the Scottish Government, supplemented by asset sales. Net pension outlays were £6.9million which is consistent with the previous year.

It is anticipated that for the next few years these cash flow trends will remain broadly consistent.

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

Investment management cost transparency

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

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

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

On 18 November 2016, the Scottish LGPS Scheme Advisory Board issued Circular 01/2016, entitled "Transparency Code". This stated that it welcomed the "Code of Transparency for LGPS Asset Managers", as developed by its counterpart in England and Wales, and asked "pension funds in Scotland to promote the code with their own asset managers". This Code is voluntary with asset managers encouraged to demonstrate their commitment to transparent reporting of costs.

In May 2018, CIPFA published "Proposals for LGPS Fund Reporting in a 'Pooled World'". "This …. sets out proposals for revised reporting for LGPS pension funds to meet a number of objectives", including "to further enhance reporting of costs reflecting the introduction of the LGPS SAB Code of Transparency for asset managers, and initiatives underway by the Financial Conduct Authority (FCA) and Department for Work and Pensions (DWP) which aim to create more transparent and granular reporting standards for both providers and trustees …. This paper has been issued by CIPFA as good practice which is to be incorporated into 2018/19 Annual Report guidance for local government pension funds. It would be helpful however if funds could also apply the guidance when preparing their 2017/18 annual reports and feedback any practical issues encountered. Proposals can then be refined as necessary before the Annual Report guidance is finalised." Although this contains explicit reference to the SAB in England and Wales and to the applicable pooling arrangements, it is anticipated that CIPFA Guidance will be revised on a UK wide basis.

The financial statements of Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund continue to include full transparency of all investment management fees.

	Investment management expenses in compliance with CIPFA guidance	Investment management expenses per 2017/18 financial statements	Disclosure in excess of CIPFA guidance
	£000	**£000**	**£000**
Lothian Pension Fund	27,687	33,261	5,574
Lothian Buses Pension Fund	2,086	2,424	338
Scottish Homes Pension Fund	165	165	0
TOTAL	**29,938**	**35,850**	**5,912**

Investment cost benchmarking

In an effort to provide stakeholders with some comfort that the Fund is carefully managing and fully understands investment costs, Lothian Pension Fund provides data to a benchmarking expert for analysis. Investment strategy focuses on risk adjusted returns, net of costs. The Fund has participated in investment cost benchmarking provided by CEM, an independent benchmarking expert for global pension funds with a database of 331 global pension funds representing £6.2 trillion in assets. To provide a fair comparison, CEM calculates a benchmark based on fund size and asset mix, which are key drivers of investment costs.

The latest analysis shows Lothian Pension Fund's investment costs of 0.41% of Fund assets are significantly lower than CEM's benchmark cost of 0.48%, an equivalent annual saving of approximately £4.3m. This saving largely reflects the fact that the Funds manage a relatively high percentage of assets internally compared with other similar pension funds and that it has low exposure to fund-of-fund investment vehicles.

Risk

An extensive risk register is maintained covering a wide range of issues across investments and benefit operations. The register is subject to internal review each quarter and a summary is reported to the Pensions Committee and Pensions Audit Sub-Committee. On an annual basis the Pensions Audit Sub-Committee reviews the register.

Risk Management

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

As at 31 March 2018, the most significant risks (after taking account of risk reduction controls), as assessed using a score out of 10 by the Funds' management team, were as follows:

Description	Impact	Likelihood	Risk score
Adverse investment performance leading to pressure on employer contributions	5	4	20
Adverse movement against non-investment funding assumptions leading to pressure on employer contributions	5	7	35
Recruitment and retention of appropriate key staff	6	6	36
Collapse/restructuring of an employer body leading to pressure on other employers	4	8	32
Failure of IT leading to poor ICT responsiveness, legal exposure and cost/risk implications	8	8	64
Human Resource within the Division not sufficient to carry out core task in conjunction with active or anticipated projects.	6	6	36

Risk Assurance

The Funds operates a bespoke assurance framework designed to ensure it meets its objectives, is adequately resourced, managed to high professional standards, meets legislative requirements and has high customer satisfaction.

Performance

The Funds have a strong commitment to customer service which drives the continual development of our services to ensure the best possible service for customers whilst recognising potential demands of the future. We set challenging performance standards and measure these through key indicators reported to our Pensions Committee and Pension Board and internal indicators reported to internal management.

Key Performance indicators 2017/18

We achieved all but one key indicator in 2017/18 except for the issuing of benefits statements. The table shows our performance against these indicators with a narrative on the performance highlights.

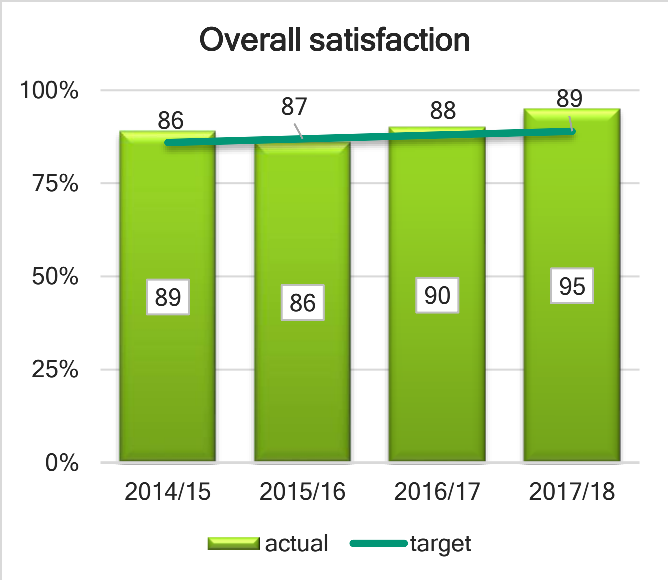
	Target	Actual
Maintain Customer Service Excellence Standard	Retain	Yes
Overall satisfaction of employers, active members and pensioners with our services as measured by surveys	89%	95.2%
Proportion of active members receiving a benefit statement by 31 August 2017	100%	99.9%
Proportion of critical pensions administration work completed within standards	Greater than 90%	94.8%
All staff complete at least two days training a year	Yes	Yes
Level of sickness absence	Less than 4%	1.55%
Staff survey satisfaction	75%	82%
Audit of Annual Report and Financial Statements	Unqualified opinion	Yes
Monthly pension payroll paid on time	Yes	Yes
Data quality - compliance with best practice as defined by The Pensions Regulator	Fully compliant	met
Contributions received within 19 days of the end of the month to which they relate	99.0%	99.7%

Key achievements in 2017/18

- Set up Joint Collaborative working with Falkirk Council Pension Fund
- Maintained Customer Service Excellence and Pensions Administration Standards Association accreditation
- Transferred remaining staff to LPFE
- Successfully completed the Actuarial Valuation 2017
- Completed 90% Guaranteed Minimum Pension (GMP) reconciliation with HMRC carried out inhouse.
- Provide other Scottish LGPS funds access to alternative investment through club deals
- Retained Customer Service Excellence for 10th year
- Winner – Professional Pension Scheme of the Year Awards 2017 (to £500m).

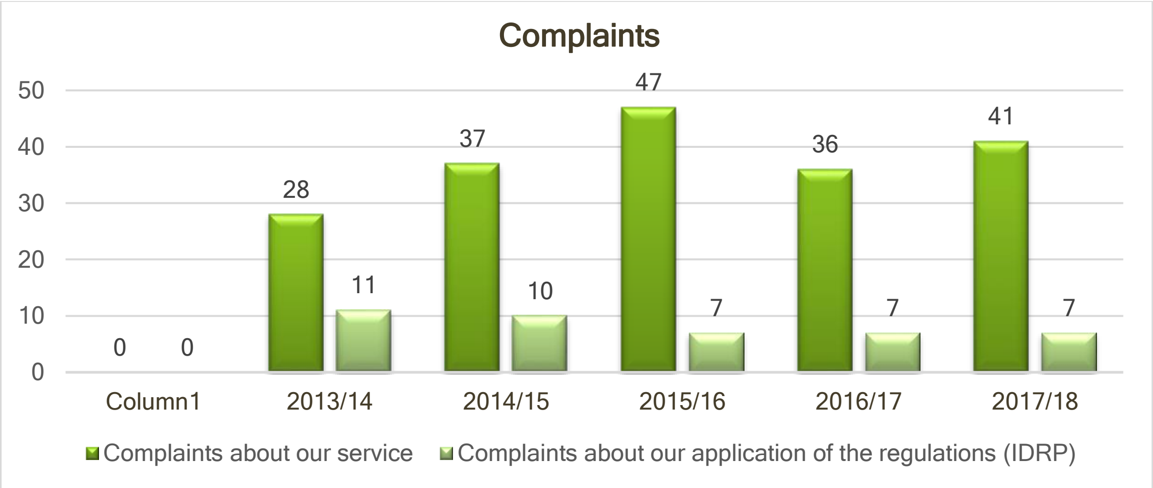
Customer feedback

Listening to feedback is key to our services and carry out surveys to monitor individual and overall satisfaction. Our overall satisfaction question is included in all our surveys and continues to improve rising to 95% this year from 90% in 2016/17. This exceeds the target of 89%.



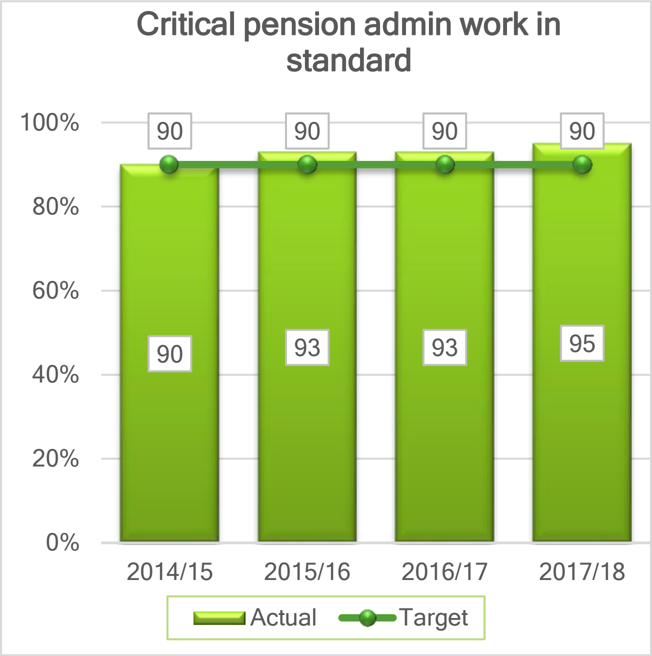
We also monitor complaints and ensure we respond and resolve where possible, within 20 working days. We investigate and learn from both formal and informal complaints to ensures we are continuously improving our services. Complaints are split by those about the service we provide and those about how scheme regulations are applied.

We carried out 23,500 processes in 2017/18 and there were very few complaints made, less than 0.1%. Complaints covered a broader range of issues including taking small pensions as a cash lump sum and the time it took to pay a CETV to new pension providers.



Our data

We issued 99.9% of benefit statements by the statutory deadline of 31 August 2017 with the remaining 26 statements being issued after. All employers are submitting contribution data monthly and the majority had cleaner membership data and fewer queries at the end of the year. The data of some employers continues to require significant attention.



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

We measure our pension record keeping standards against The Pension Regulator's best practice guidance. Poor record-keeping can lead to significant additional costs in areas such as administration, error correction, claims from members as well as fines from The Pensions Regulator. Over the year, we have continued data cleansing with our employers and carried out significant additional work as part of the Actuarial Valuation. We are also carrying out external tracing of members where we do not hold a current address.

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

For 2018/19, we are planning to use new tools that will provide more comprehensive analysis of membership data. This should allow us to identify and improve data quality and the service to our members.

Pension Administration

The introduction of the career average pension scheme in April 2015 has meant that pension administration has become more complex for both the Funds and employers.

We continue to review our processes to improve our performance so that the Funds can meet new challenges and deliver an excellent service to members.

Despite the challenging environment, 95% of key procedures in 2017/18 were completed in target.

Employer performance

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

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

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

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

Overall employer performance for 2017/18 is shown below, with 2016/17 shown for comparison purposes.

		2016/17			2017/18		
Case type	**Target (working days)**	**Number received**	**Number within target**	**% within target**	**Number received**	**Number within target**	**% within target**
New members	20	4,764	4,074	86%	6,204	5,439	88%
Leavers	20	3,425	1,421	42%	2,460	1,058	43%
Retirements	20	1,244	440	35%	1,050	427	41%
Deaths in Service	10	29	21	72%	26	13	50%

The majority of new starter information continues to be received within target in most cases and the increase in number received is due to auto-enrolment regulations. For leavers, whilst the provision of leaver information in target has increased slightly, the majority continue to be received out of target. We continue to target historical cases with employers and provide missing leaver queries to employers monthly.

Unfortunately, most retirement information continues to be provided out of target. This year we saw a large increase in the number of 'early' retirements where members are over age 60 but are taking their pension benefits with a permanent actuarial reduction.

Payment of employer contributions

We monitor the payment of employer contributions as employers are required under the Pensions Act 1995 to pay contributions by the 19th of the month after the deduction was made. This is a key performance indicator with a target of was 99% contributions paid in time.

99.77% of contributions by value were paid on time. Of the 1,152 payments made, 21 were paid later than the 19th and these are shown in the table below.

Employer	Number of late payments	Employer	Number of late payments
Dean Orphanage & Cauvins Trust	2	Cyrenians	1
Enjoy East Lothian	2	Four Square	1
Homeless Action Scotland	2	Into Work	1
ISS UK Ltd	2	Open Door Accommodation Project	1
Skanska	2	Scotland's Learning Partnership	1
Barony Housing Association Ltd	1	Scottish Police Services Authority	1
Centre for the Moving Image	1	Visit Scotland	1
Children's Hearing Scotland	1	Young Scot Enterprise	1
		TOTAL	21

Management commentary approved by:

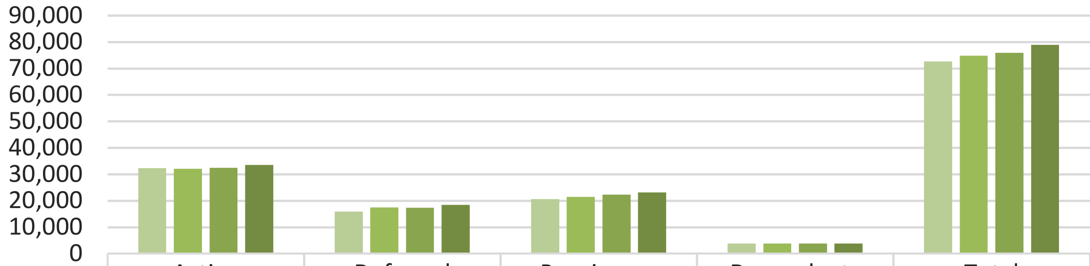
ANDREW KERR
Chief Executive
The City of Edinburgh Council
June 2018

CLARE SCOTT
Chief Executive
Lothian Pension Fund
June 2018

JOHN BURNS
Chief Financial Officer
Lothian Pension Fund
June 2018

Lothian Pension Fund

Lothian Pension Fund membership



	Active	Deferred	Pensioners	Dependants	Total
31 March 2015	32,273	15,916	20,636	3,810	72,635
31 March 2016	32,079	17,444	21,371	3,849	74,743
31 March 2017	32,457	17,299	22,315	3,842	75,913
31 March 2018	33,528	18,384	23,119	3,825	78,856

Investment Strategy

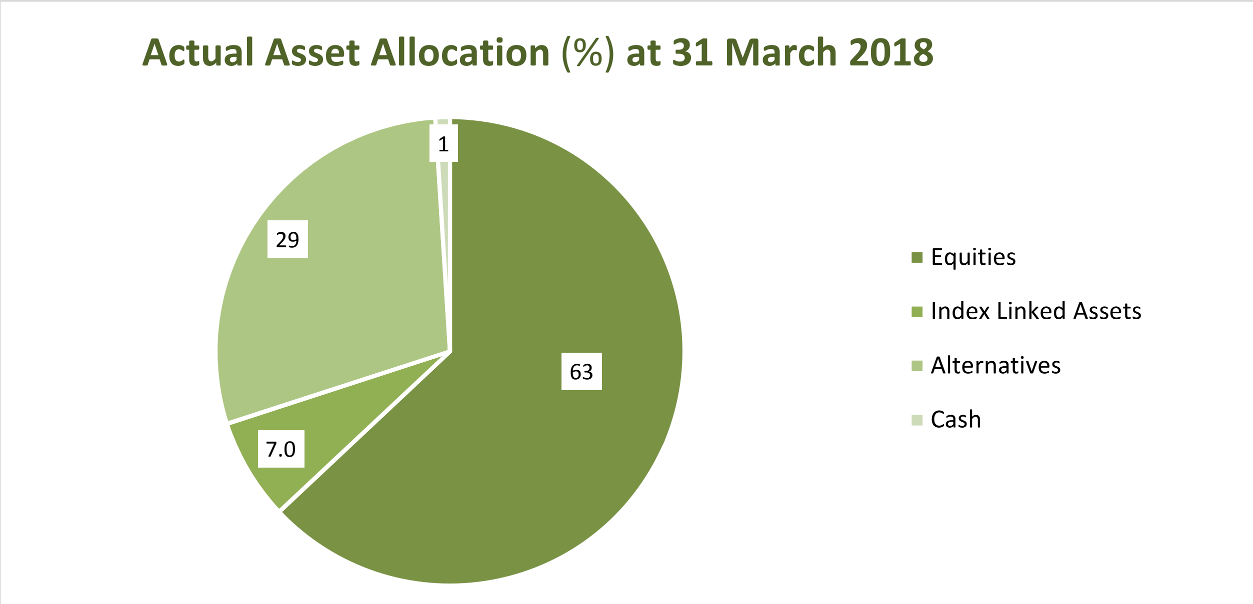
In order to provide suitable investment strategies for the differing requirements of employers, the Fund currently operates two investment strategies. Most employer liabilities are funded under Strategy 1, which adopts a long-term investment strategy, aiming to maximise the investment return within reasonable and considered risk parameters and hence minimise the cost to the employer. The investment strategy is set at the broad asset class level of Equities, Index-Linked Assets and Alternatives, which are the key determinants of investment risk and return.

A small number of employers are funded in Strategy 2, which invests in a portfolio of UK index-linked gilts to reduce funding level and contribution rate risk as these employers approach exit from the Fund. The liabilities funded by Strategy 2 represent less than 1% of total liabilities.

The plan for the Fund's investment strategy was initially set during 2012, and reviewed again in 2015/2016, taking into account the results of the 2014 actuarial valuation. A review of investment strategy will be undertaken again over the coming months, taking into account the results of the latest 2017 actuarial valuation.

The Fund's strategy incorporates a gradually changing risk profile for the Fund, but retains significant exposure to real investments, such as Index-Linked Assets and Equities, which have a history of protecting or enhancing purchasing power, after the effects of inflation have been taken into account. Prior to the 2012-17 investment strategy, the targeted allocation was 71.5% Equities, 5% Index-Linked gilts, 22.5% Alternatives and 1% Cash. The 2012-17 strategy is shown in the table below.

Strategy 1	Long term Strategy 2012 - 2017 %	Permitted ranges %
Equities	65	50 - 75
Index Linked Assets	7	0 - 20
Alternatives	28	20 - 35
Cash	0	0 - 10
Total	**100**	**n/a**



A key objective of the Fund's investment strategy is to reduce risk and this is largely achieved by reducing risk within the equity pool of assets. Implementation of the strategy has involved a shift from a regional to a global manager structure. Significant steps have been taken in this regard in prior years with the introduction of the internally managed global equity portfolios. As such, 2017/18 represented much more of a "steady state" in terms of the structure within the equity exposure.

The activity in recent years has been to increase the proportion of internally managed global equity strategies to reduce investment risk. The resultant equity pool of assets is expected to perform relatively well when equity markets are weak and produce good positive absolute returns in rising equity markets.

Almost 85% of the Fund's listed equities are managed internally with the majority of these in low cost, low turnover strategies, which are expected to enhance the Fund's risk-adjusted returns over the long term. The Fund also hedges exposures to the currencies of overseas listed equities with the explicit aim of reducing volatility rather than seeking to generate improved returns. The Fund therefore maintains exposure to currencies that are expected to reduce volatility, such as the US Dollar and Japanese Yen which tend to fall as equities rise, and hedges exposure to currencies that are expected to increase volatility, such as the Australian Dollar which tends to rise as equities rise.

Investment performance

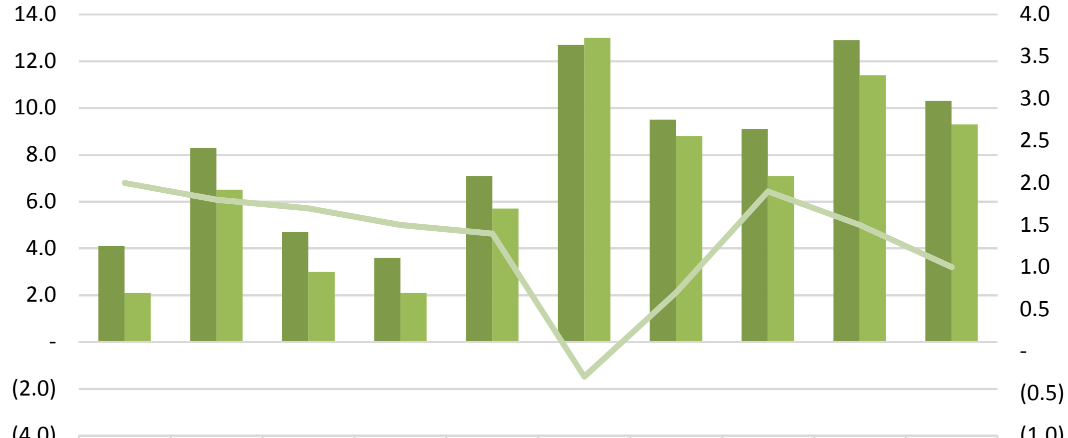
The Fund's performance over the last year and over longer-term timeframes is shown in the table below.

Annualised returns to 31 March 2017 (% per year)	1 year	5 year	10 years
Lothian Pension Fund - Strategy 1	1.4	10.3	8.7
Benchmark*	3.6	9.3	7.5
Lothian Pension Fund - Strategy 2 (from 2015)	0.5	-	-
Benchmark	0.5	-	-
Actuarial Valuation Assumptions - Strategy 1 **	3.2	4.8	5.4
Actuarial Valuation Assumptions - Strategy 2 **	1.7		
Retail Price Index (RPI)	3.3	2.3	2.7
Consumer Price Index (CPI)	2.3	1.4	2.3
National Average Earnings	2.4	2.6	1.6

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

**estimated

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



	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Fund	4.1	8.3	4.7	3.6	7.1	12.7	9.5	9.1	12.9	10.3
Benchmark	2.1	6.5	3.0	2.1	5.7	13.0	8.8	7.1	11.4	9.3
Relative (RHS)	2.0	1.8	1.7	1.5	1.4	(0.3)	0.7	1.9	1.5	1.0

The objectives of the Fund are:

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

The performance of Strategy 2 was in line with benchmark over the year, returning +0.5%. Performance of this strategy has also been in line with benchmark since inception (29 March 2016), with a return of +10.1% per annum.

The Fund's return has exceeded its objective of meeting the benchmark return over the economic cycle, with both the 5 and 10 year return ahead of benchmark. The direction of the Fund's performance when markets are increasing and decreasing is one way of measuring volatility. The lower volatility objective and strategy for Strategy 1 was put in place in December 2013 and over this period market volatility has been relatively benign, for the most part. Nevertheless, performance since the change in structure (with the launch of the global low volatility equity portfolio and the shift from regional passive to active) indicates that the Fund is delivering returns with lower volatility than its benchmark.

For Strategy 1, fund performance since January 2014 to March 2018 has been:

- better than the strategic allocation when markets fell (17 out of 51 months) with average performance of 0.32% better than the strategic benchmark and,
- very marginally worse than the strategic allocation when markets were rising (34 out of 51 months) with average performance 0.03% behind the strategic benchmark.

Risk analysis also shows that the portfolio is positioned well if markets fall significantly.

Lothian Pension Fund

Fund Account for year ended 31 March 2018

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

Lothian Pension Fund Parent 2016/17 £000	Lothian Pension Fund Group 2016/17 £000		Note	Lothian Pension Fund Parent 2017/18 £000	Lothian Pension Fund Group 2017/18 £000
		Income			
153,735	153,735	Contributions from employers	**4**	148,821	148,821
42,578	42,578	Contributions from members	**5**	43,421	43,421
5,536	5,536	Transfers from other schemes	**6**	4,191	4,191
201,849	**201,849**			**196,433**	**196,433**
		Less: expenditure			
141,778	141,778	Pension payments including increases	**7**	149,384	149,384
48,895	48,895	Lump sum retirement payments	**8**	42,533	42,533
6,384	6,384	Lump sum death benefits	**9**	6,359	6,359
615	615	Refunds to members leaving service		596	596
361	361	Premiums to State Scheme		129	129
11,098	11,098	Transfers to other schemes	**10**	12,517	12,517
1,895	1,954	Administrative expenses	**11a**	1,950	2,151
211,026	**211,085**			**213,468**	**213,669**
(9,177)	**(9,236)**	**Net (withdrawals)/additions from dealing with members**		**(17,035)**	**(17,236)**
		Returns on investments			
153,016	153,016	Investment income	**12**	163,869	163,869
1,044,952	1,044,952	Change in market value of investments	**14, 20b**	(43,288)	(43,288)
(27,375)	(27,712)	Investment management expenses	**11b**	(32,643)	(33,261)
1,170,593	**1,170,256**	**Net returns on investments**		**87,938**	**87,320**
1,161,416	**1,161,020**	**Net increase in the Fund during the year**		**70,903**	**70,084**
5,434,014	5,433,871	**Net assets of the Fund at 1 April 2017**		6,595,430	6,594,891
6,595,430	**6,594,891**	**Net assets of the Fund at 31 March 2018**		**6,666,333**	**6,664,975**

Lothian Pension Fund

Net Assets Statement as at 31 March 2018

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

Lothian Pension Fund Parent 31 March 2017 £000	Lothian Pension Fund Group 31 March 2017 £000		Note	Lothian Pension Fund Parent 31 March 2018 £000	Lothian Pension Fund Group 31 March 2018 £000
		Investments			
6,570,547	6,570,547	Assets		6,633,467	6,633,467
(1,798)	(1,798)	Liabilities		(5,112)	(5,112)
6,568,749	**6,568,749**	**Net investment assets**	**13**	**6,628,355**	**6,628,355**
		Non current assets			
259	259	Debtors	**24**	1,525	1,525
248	248	Computer systems		168	168
50	-	Share Capital		60	-
-	117	Deferred tax	**29b**	-	292
557	**624**			**1,753**	**1,985**
		Current assets			
4,467	4,467	The City of Edinburgh Council	**28**	2,784	2,784
27,278	27,362	Cash balances	**21, 28**	47,024	47,117
14,938	14,965	Debtors	**25**	15,564	15,634
46,683	**46,794**			**65,372**	**65,535**
		Non current liabilities			
-	(685)	Retirement benefit obligation	**30**	-	(1,715)
-	**(685)**			**-**	**(1,715)**
		Current liabilities			
(20,559)	(20,591)	Creditors	**26**	(29,147)	(29,185)
(20,559)	**(20,591)**			**(29,147)**	**(29,185)**
6,595,430	**6,594,891**	**Net assets of the Fund at 31 March**		**6,666,333**	**6,664,975**

The unaudited accounts were issued on 27 June 2018 and the audited accounts were authorised for issue on XX September 2018.

JOHN BURNS FCMA CGMA
Chief Finance Officer, Lothian Pension Fund
27 June 2018

Notes to the net asset statement

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

Notes to the Accounts

1 Statement of Accounting Policies

The statement of accounting policies for all Funds can be found on page 114.

2 Lothian Pension Fund Group

Basis of consolidation, presentation of financial statements and notes

Commencing with the year ended 31 March 2017, Consolidated Financial Statements have been prepared for Lothian Pension Fund. The Financial Statements of Lothian Buses Pension Fund and Scottish Homes Pension Fund continue to be prepared on a single entity basis.

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

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

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

Prior to the consolidation of the group accounts the LPFE and LPFI boards met on the 28th May 2018 and approved their respective audited financial statements for 2017/18. The figures used in the consolidation are from these audited financial statements.

3 Events after the Reporting Date

There have been no events since 31 March 2018, and up to the date when these accounts were authorised, that require any adjustments to these accounts.

At its meeting on 26 March 2018, the Pensions Committee approved the merger of the assets and liabilities of the Lothian Buses Pension Fund into the Lothian Pension Fund at the earliest suitable date (to be determined by the Executive Director of Resources), subject to the satisfactory completion of a revised admission agreement and shareholder guarantee.

Notes to the Accounts

4 Contributions from employers

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

By category	2016/17 £000	2017/18 £000
Future service rate	133,301	136,968
Past service deficit	7,668	7,694
Strain costs	12,558	2,747
Cessation contributions	208	1,412
	153,735	148,821

By employer type	2016/17 £000	2017/18 £000
Administering Authority	63,542	55,041
Other Scheduled Bodies	71,426	73,692
Community Admission Bodies	18,312	19,629
Transferee Admission Bodies	455	459
	153,735	148,821

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

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

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

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

5 Contributions from members

By employer type	2016/17 £000	2017/18 £000
Administering Authority	15,345	15,633
Other Scheduled Bodies	20,993	21,475
Community Admission Bodies	6,099	6,161
Transferee Admission Bodies	141	152
	42,578	43,421

Notes to the Accounts

6 Transfers in from other pension schemes

	2016/17 £000	2017/18 £000
Group transfers	-	-
Individual transfers	5,536	4,191
	5,536	4,191

7 Pensions payable

By employer type	2016/17 £000	2017/18 £000
Administering Authority	70,547	73,922
Other Scheduled Bodies	58,364	61,729
Community Admission Bodies	12,687	13,537
Transferee Admission Bodies	180	196
	141,778	149,384

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

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

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

8 Lump sum retirement benefits payable

By employer type	2016/17 £000	2017/18 £000
Administering Authority	26,340	16,623
Other Scheduled Bodies	18,503	20,650
Community Admission Bodies	3,900	5,131
Transferee Admission Bodies	152	129
	48,895	42,533

9 Lump sum death benefits payable

By employer type	2016/17 £000	2017/18 £000
Administering Authority	2,578	3,375
Other Scheduled Bodies	3,312	2,571
Community Admission Bodies	488	413
Transferee Admission Bodies	6	-
	6,384	6,359

Notes to the Accounts

10 Transfers out to other pension schemes

	2016/17 £000	2017/18 £000
Group transfers	173	-
Individual transfers	10,925	12,517
	11,098	12,517

11a Total management expenses

In accordance with CIPFA, the below analysis looks at the combined administration and investment management expenses in notes 11b and c and splits out the costs to include a third category covering oversight and governance expenditure. Administration costs such as Actuarial fees and Investment Management expenses such as investment consultancy would instead be shown in the Oversight and governance costs category.

	LPF Parent 2016/17 £000	LPF Group 2016/17 £000	LPF Parent 2017/18 £000	LPF Group 2017/18 £000
Administrative costs	1,686	1,719	1,615	1,801
Investment management expenses	26,345	26,592	31,620	31,918
Oversight and governance costs	1,239	1,355	1,359	1,693
	29,270	29,666	34,594	35,412

11b Administrative expenses

	LPF Parent 2016/17 £000	LPF Group 2016/17 £000	LPF Parent 2017/18 £000	LPF Group 2017/18 £000
Employee Costs	1,093	1,098	1,143	1,167
The City of Edinburgh Council - other support costs	132	132	-	-
System costs	231	231	292	293
Actuarial fees	64	64	116	116
External/Internal audit fees	41	49	65	71
Legal fees	60	60	2	2
Printing and postage	79	79	115	115
Depreciation	57	57	57	57
Office costs	110	110	102	102
Sundry costs less sundry income	28	18	58	57
IAS19 retirement benefit adjustments - see note 30		66	-	206
Deferred tax on retirement benefit obligation - see note 29a		(10)	-	(35)
Corporation tax losses utilised by CEC group - see note 28	-	-	-	-
	1,895	1,954	1,950	2,151

LPFE Ltd, which is a wholly owned subsidiary of the Council, is responsible for providing the staffing resource to administer the three pension Funds. The Service receives an allocation of the overheads of the Council. In turn the Service allocates administration and investment costs to the three pension funds. Costs directly attributable to a specific fund are charged to the relevant Fund, costs that are common to all three funds are allocated on a defined basis. Other costs are allocated on the basis of the number of members in each pension fund.

Notes to the Accounts

11c Investment management expenses

	LPF Parent 2016/17 £000	LPF Group 2016/17 £000	LPF Parent 2017/18 £000	LPF Group 2017/18 £000
External management fees -				
invoiced	3,970	3,970	4,270	4,270
deducted from capital (direct investment)	15,245	15,245	18,642	18,642
deducted from capital (indirect investment)	4,157	4,157	5,574	5,574
Securities lending fees	155	155	173	173
Transaction costs - Equities	956	956	1,148	1,148
Property operational costs	558	558	337	337
Employee costs	1,116	1,149	1,272	1,375
Custody fees	300	300	368	368
Engagement and voting fees	82	82	86	86
Performance measurement fees	50	50	62	62
Consultancy fees	64	64	49	49
Research fees	-	-	65	65
System costs	245	245	299	300
Legal fees	210	210	61	89
The City of Edinburgh Council - other support costs	111	111	-	-
Depreciation	7	7	7	7
Office costs	85	85	78	78
Sundry costs less sundry income	64	(1)	152	(54)
IAS19 retirement benefit adjustments - see note 30	-	439	-	824
Deferred tax on retirement benefit obligation - see note 29	-	(70)	-	(140)
Corporation tax losses utilised by CEC group - see note 28	-	-	-	8
	27,375	27,712	32,643	33,261

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

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

The external investment management fees (deducted from capital) above include £8.9m (£6.6m direct, £2.3m indirect) in respect of performance-related fees compared to £4.0m in 2016/17 (£3.9m direct, £0.1m indirect).

It should be noted that Lothian Pension Fund's disclosure on investment management fees goes further than CIPFA's LGPS Management Cost revised guidance on cost transparency which came into effect from 1st April 2016. Consistent with previous years, the Fund recognises fees deducted from investments not within its direct control (such as fund of fund fees) to give a full picture of its investment management costs. Further details can be found on page 25. This further disclosure highlights an extra £5.6m in costs (2017 £4.2m).

Notes to the Accounts

12 Investment income

	2016/17 £000	2017/18 £000
Income from fixed interest securities	3,589	4,006
Dividends from equities	120,326	131,588
Unquoted private equity and infrastructure	5,646	7,601
Income from pooled investment vehicles	1,111	5,130
Gross rents from properties	23,085	23,079
Interest on cash deposits	597	675
Stock lending and sundries	775	865
	155,129	172,944
Irrecoverable withholding tax	(2,113)	(9,075)
	153,016	163,869

Included within the dividend from equities income for the year is cross border withholding tax yet to be received. These reclaims have a high certainty of success and are completed and managed by the Fund's custodian Northern Trust. For the period of 2017/18 £4,014k of the stated income relates to tax yet to be received. At the 31st March 2018 £7,135k (including prior periods) of investment income receivable related to cross border withholding tax. The Fund monitors these claims to ensure its optimum tax efficiency and provides an annual progress report to the Pensions Audit Sub-Committee.

Notes to the Accounts

13 Net investment assets

Investment Assets	Region	31 March 2017 £000	31 March 2018 £000
Bonds			
Public sector fixed interest	UK	156,876	153,585
Public sector index linked gilts quoted	UK	502,439	508,572
		659,315	662,157
Equities			
Quoted	UK	655,522	528,882
Quoted	Overseas	3,564,953	3,481,292
		4,220,475	4,010,174
Pooled investment vehicles			
Private equity, infrastructure, private debt & timber	UK	457,647	495,441
Private equity, infrastructure, private debt & timber	Overseas	556,623	567,141
Property	UK	67,969	66,638
Other	UK	19,191	867
		1,101,430	1,130,087
Properties			
Direct property	UK	356,741	392,743
		356,741	392,743
Derivatives			
Derivatives - forward foreign exchange		1,081	12,121
		1,081	12,121
Cash deposits			
Deposits		216,036	407,689
		216,036	407,689
Other investment assets			
Due from broker		1,320	2,677
Dividends and other income due		14,521	15,819
		15,841	18,496
Total investment assets		6,570,919	6,633,467
Investment liabilities			
Derivatives			
Derivatives - forward foreign exchange		(424)	(204)
		(424)	(204)
Other financial liabilities			
Due to broker		(1,746)	(4,908)
		(1,746)	(4,908)
Total investment liabilities		(2,170)	(5,112)
Net investment assets		6,568,749	6,628,355

Notes to the Accounts

14a Reconciliation of movement in investments and derivatives

	Market value at 31 March 2017 £000	Purchases at cost & derivative payments £000	Sale & derivative receipts £000	Change in market value £000	Market value at 31 March 2018 £000
Bonds	659,315	38,157	(35,692)	377	662,157
Equities	4,220,475	878,940	(929,194)	(160,047)	4,010,174
Pooled investment vehicles	1,101,430	64,330	(145,328)	109,655	1,130,087
Property	356,741	40,758	(17,329)	12,573	392,743
Derivatives - futures	-	11	163	(174)	-
Derivatives - forward foreign exchange	657	2,968	(3,711)	12,003	11,917
	6,338,618	1,025,164	(1,131,091)	(25,613)	6,207,078
Other financial assets / liabilities					
Cash deposits*	216,036			(17,667)	407,689
Broker balances*	(426)			(8)	(2,231)
Investment income due*	14,521			-	15,819
	230,131			(17,675)	421,277
Net financial assets	6,568,749			(43,288)	6,628,355

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

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

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

** As per CIPFA disclosures the change in market value intentionally does not balance opening/closing market values*

Notes to the Accounts

14d Reconciliation of fair value measurements within level 3

Pooled investments	Market value at 31 March 2017	Level 3 transfers in	Level 3 transfers out	Purchases at cost & derivative payments	Sales & derivative receipts	Unrealised gains / (losses)	Realised gains / (losses)	Market value at 31 March 2018
Infrastructure	663,194	-	-	107,269	(111,609)	31,841	36,874	727,569
Property	67,969	-	-	-	(3,204)	6,801	(4,928)	66,638
Private Equity	129,311	-	-	297	(50,137)	(24,246)	35,178	90,403
Timber	132,532	-	-	-	(15,114)	(9,241)	3,220	111,397
Private debt	89,233	-	-	53,368	(15,317)	5,704	230	133,218
Freehold Property	356,741	-	-	40,758	(17,329)	5,842	6,731	392,743
	1,438,980	-	-	201,692	(212,710)	16,701	77,305	1,521,968

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

15 Derivatives - forward foreign exchange

Summary of contracts held at 31 March 2018

Contract settlement within	Currency bought	Currency sold	Local currency bought 000	Local currency sold 000	Asset value £000	Liability value £000
Up to one month	GBP	AUD	48,179	82,284	3,213	-
Up to one month	AUD	GBP	6,793	3,915	-	(202)
Up to one month	GBP	CAD	108,389	180,036	8,875	-
Up to one month	JPY	USD	33,328	314	-	(1)
Up to one month	ZAR	USD	4,359	369	-	(1)
One to six months	USD	CHF	9,264	8,695	33	-

Open forward currency contracts at 31 March 2018	12,121	(204)
Net forward currency contracts at 31 March 2018		11,917
Prior year comparative		
Open forward currency contracts at 31 March 2017	1,081	(424)
Net forward currency contracts at 31 March 2017		657

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

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

Notes to the Accounts

16 Investment managers and mandates

Manager	Mandate	Market value at 31 March 2017 £000	% of total 31 March 2017 %	Market value at 31 March 2018 £000	% of total 31 March 2018 %
In-house	UK all cap equities	130,362	2.0	139,655	2.1
In-house	UK mid cap equities	121,061	1.8	131,607	2.0
Total UK equities		251,423	3.8	271,262	4.1
In-house	European ex UK equities	120,393	1.8	130,696	2.0
In-house	US equities	150,941	2.3	146,279	2.2
Total regional overseas equities		271,334	4.1	276,975	4.2
In-house	Global high dividend	928,720	14.1	856,911	12.9
In-house	Global low volatility	1,162,921	17.7	1,097,057	16.6
In-house	Global multi factor value	985,286	15.0	934,708	14.1
Harris	Global equities	263,263	4.0	273,298	4.1
Nordea	Global equities	280,815	4.3	268,444	4.0
Total global equities		3,621,005	55.1	3,430,418	51.7
In-house	Currency hedge	708	0.0	11,885	0.2
Total currency overlay		708	0.0	11,885	0.2
Total listed equities		4,144,470	63.1	3,990,540	60.2
In-house	Private equity unquoted	129,311	2.0	90,403	1.4
In-house	Private equity quoted	75,902	1.2	61,885	0.9
Total private equity		205,213	3.2	152,288	2.3
Total equity		4,349,683	66.3	4,142,828	62.5
In-house	Index linked gilts	450,833	6.9	455,930	6.9
In-house	Gold	19,652	0.3	-	-
Total inflation linked assets		470,485	7.2	455,930	6.9
In-house	Property	38,038	0.6	37,447	0.6
Standard Life	Property	414,574	6.3	454,430	6.8
Total property		452,612	6.9	491,877	7.4
In-house	Infrastructure unquoted	663,194	10.1	727,569	11.0
In-house	Infrastructure quoted	23,548	0.4	18,981	0.3
In-house	Timber	132,532	2.0	111,397	1.7
Total other real assets		819,274	12.5	857,947	13.0
In-house	Secured loans	14,142	0.2	-	0.0
In-house	Private debt	89,233	1.4	133,218	2.0
In-house	Other bonds	159,307	2.4	158,280	2.4
Total debt assets		262,682	4.0	291,498	4.4

Notes to the Accounts

16 Investment managers and mandates (cont)

Manager	Mandate	Market value at 31 March 2017 £000	% of total 31 March 2017 %	Market value at 31 March 2018 £000	% of total 31 March 2018 %
In-house	Cash	159,645	2.4	332,090	5.0
In-house	Transitions	92	0.0	1,614	0.0
Total cash and sundries		159,737	2.4	333,704	5.0
Strategy A financial assets		6,514,473	99.2	6,573,784	99.2
In-house	Mature employer gilts	54,276	0.8	54,571	0.8
Strategy B financial assets		54,276	0.8	54,571	0.8
Net financial assets		6,568,749	100.0	6,628,355	100.0

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

18 Securities lending

During the year Lothian Pension Fund participated in a securities lending arrangement with the Northern Trust Company. As at 31 March 2018, £254.9m (2017 £220.3m) of securities were released to third parties. Collateral valued at 105.5% (2017 104.6%) of the market value of the securities on loan was held at that date.

19 Property holdings

	2016/17 £000	2017/18 £000
Opening balance	356,280	356,741
Additions	4,675	40,875
Disposals	(2,358)	(17,329)
Net change in market value	(1,856)	12,456
Closing balance	356,741	392,743

As at 31 March 2018, there were no restrictions on the realisability of the property or the remittance of income or sale proceeds. The Fund is not under any contractual obligations to purchase or construct any of these properties. However, at year end the Fund does have funding approval in place of £850,000 for the planning, design and contractor procurement to potentially re-develop 100 St John Street, London

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

	2016/17 £000	2017/18 £000
Within one year	22,526	23,327
Between one and five years	67,195	66,574
Later than five years	99,741	101,160
	189,462	191,061

Notes to the Accounts

20 Financial Instruments

20a Classification of financial instruments

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

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

Classification of financial instruments - parent	31 March 2017			31 March 2018		
	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						
Bonds	659,316	-	-	662,156	-	-
Equities	4,220,475	-	-	4,010,174	-	-
Pooled investments	1,101,430	-	-	1,130,087	-	-
Property Leases	6,243	-	-	4,376	-	-
Derivative contracts	1,081	-	-	12,121	-	-
Margin balances	-	-	-	-	-	-
Cash	-	216,036	-	-	407,689	-
Other balances	-	15,841	-	-	18,496	-
	5,988,545	231,877	-	5,818,914	426,185	-
Other assets						
City of Edinburgh Council	-	4,467	-	-	2,784	-
Cash	-	27,278	-	-	47,024	-
Share Capital	-	50	-	-	60	-
Debtors - current	-	14,937	-	-	15,564	-
Debtors - non-current	-	259	-	-	1,525	-
	-	46,991	-	-	66,957	-
Assets total	5,988,545	278,868	-	5,818,914	493,142	-
Financial liabilities						
Investment liabilities						
Derivative contracts	(424)	-	-	(204)	-	-
Other investment balances	(1,746)	-	-	(4,908)	-	-
	(2,170)	-	-	(5,112)	-	-
Other liabilities						
Creditors	-	-	(20,559)	-	-	(29,147)
Liabilities total	(2,170)	-	(20,559)	(5,112)	-	(29,147)
Total net assets	5,986,375	278,868	(20,559)	5,813,802	493,142	(29,147)

	31 March 2017	31 March 2018
Total net financial instruments	6,244,684	6,277,797
Amounts not classified as financial instruments	348,707	388,536
Total net assets - parent	6,593,391	6,666,333

Notes to the Accounts

20a Classification of financial instruments (cont)

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

	31 March 2017			31 March 2018		
	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
Other assets						
Cash	-	84	-	-	93	-
Share Capital	-	(50)	-	-	(60)	-
Debtors - current	-	27	-	-	70	-
Debtors - non-current	-	117	-	-	292	-
	-	178	-	-	395	-
Assets total	-	178	-	-	395	-
Other liabilities						
Retire. benefit obligation	-	-	(685)	-	-	(1,715)
Creditors	-	-	(32)	-	-	(38)
Liabilities total	-	-	(717)	-	-	(1,753)
Total net assets	-	178	(717)	-	395	(1,753)

	31 March 2017	31 March 2018
Total adjustments to net financial instruments	(539)	(1,358)
Total net assets - group	6,592,852	6,664,975

20b Net gains and losses on financial instruments

	2016/17 £000	2017/18 £000
Designated as fair value through fund account	1,025,354	(38,186)
Loans and receivables	21,454	(17,675)
Financial liabilities at amortised cost	-	-
Total	1,046,808	(55,861)
Gains and losses on directly held freehold property	(1,856)	12,573
Change in market value of investments per fund account	1,044,952	(43,288)

Notes to the Accounts

20c Fair Value Hierarchy

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

Level 1

Financial instruments at Level 1 are those where the fair values are derived from unadjusted quoted prices in active markets for identical assets or liabilities. Products classified as level 1 comprise quoted equities and unit trusts.

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

Level 2

Financial instruments at Level 2 are those where quoted market prices are not available; for example, where an instrument is traded in a market that is not considered to be active, or where valuation techniques are used to determine fair value and where these techniques use inputs that are based significantly on observable market data.

Level 3

Financial instruments at Level 3 are those where at least one input that could have a significant effect on the instrument's valuation is not based on observable market data. Such instruments would include unquoted equity investments, which are valued using various valuation techniques that require significant judgement in determining appropriate assumptions.

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

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

	31 March 2018			
	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
Investment assets				
Designated as fair value through fund account	4,023,162	662,156	1,135,464	5,820,782
Non-financial assets at fair value through profit and loss	-	-	386,500	386,500
Loans and receivables	426,185	-	-	426,185
Total investment assets	4,449,347	662,156	1,521,964	6,633,467
Investment liabilities				
Designated as fair value through fund account	(5,112)	-	-	(5,112)
Total investment liabilities	(5,112)	-	-	(5,112)
Net investment assets	4,444,235	662,156	1,521,964	6,628,355

Notes to the Accounts

20c Fair Value Hierarchy

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

21 Nature and extent of risk arising from financial instruments

Risk and risk management

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

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

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

Types of investment risk

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

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

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

Notes to the Accounts

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

The Fund manages these risks in a number of ways:

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

Sensitivity analysis

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

Asset type	Potential price movement (+ or -)
Equities - Developed Markets	20.5%
Equities - Emerging Markets	30.0%
Private Equity	30.0%
Timber and Gold	18.0%
Secured Loans	10.0%
Fixed Interest Gilts	6.5%
Index-Linked Gilts	11.0%
Infrastructure	12.0%
Property	13.0%
Cash	1.0%

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 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.

Notes to the Accounts

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

	Value at 31 March 2018 £m	% of fund %	Potential Change +/- %	Value on increase £m	Value on decrease £m
Equities - Developed Markets	3,770	56.9	20.5	4,542.9	2,997.2
Equities - Emerging Markets	208	3.1	30.0	270.4	145.6
Private Equity	152	2.3	30.0	197.6	106.4
Timber and Gold	111	1.7	18.0	131.0	91.0
Secured Loan	133	2.0	10.0	146.3	119.7
Fixed Interest Gilts	158	2.4	6.5	168.3	147.7
Index-Linked Gilts	511	7.7	11.0	567.2	454.8
Infrastructure	747	11.3	12.0	836.6	657.4
Property	492	7.4	13.0	556.0	428.0
Cash and forward foreign exchange	346	5.2	1.0	349.5	342.5
Total [1]	6,628	100.0	17.2	7,765.8	5,490.3
Total [2]			13.8	7,545.6	5,710.4
Total [3]			13.9	7,551.4	n/a

[1] No allowance for correlations between assets

[2] Including allowance for correlations between assets

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

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

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

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

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

Credit risk

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

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

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

Notes to the Accounts

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

Cash deposits

At 31 March 2018, cash deposits represented £454.7m, 6.82% of total net assets. This was held with the following institutions:

	Moody's Credit Rating at 31 March 2018	Balances at 31 March 2017 £000	Balances at 31 March 2018 £000
Held for investment purposes			
Northern Trust Global Investment Limited - liquidity funds	Aaa-mf	83,249	8,075
Northern Trust Company - cash deposits	Aa2	40,697	308,831
The City of Edinburgh Council - treasury management	See below	92,090	90,783
Total investment cash		216,036	407,689
Held for other purposes			
The City of Edinburgh Council - treasury management	See below	27,278	47,024
Total cash - parent		243,314	454,713
Cash held by LPFE/LPFI Limited			
Royal Bank of Scotland	A3	84	93
Total cash - group		243,398	454,806

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.

	Moody's Credit Rating at 31 March 2018	Balances at 31 March 2017 £000	Balances at 31 March 2018 £000
Money market funds			
Deutsche Bank AG, London	Aaa-mf	652	596
Goldman Sachs	Aaa-mf	14	1
Standard Life Investments Sterling Liquidity Fund	Aaa-mf	-	20,424
Bank call accounts			
Bank of Scotland	Aa3	11,911	13,606
Royal Bank of Scotland	A3	169	501
Santander UK	Aa3	30	361
Barclays Bank	A1	2	11
Svenska Handelsbanken	Aa2	23	676
HSBC Bank PLC	Aa3	4	51
UK Pseudo-Sovereign risk instruments			
Other Local Authorities [1]	Aa1	106,563	101,580
		119,368	137,807

[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 2018 was 'Aa1').

Notes to the Accounts

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

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

(a) UK Government and other UK local Authorities with no limit, other public bodies up to £20 million per

(b) Money market funds (MMFs) no more than £30 million or 15% with any one Fund.

(c) Financial Institutions: Banks and Building Societies with multiple criteria based on a range of short and long term credit ratings, as well as any security, provided from maximum of £60 million / 20% of assets under management (AUM) for institutions with the highest criteria to £10 million / 5% of AUM for institutions with the lowest acceptable criteria.

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

Securities lending

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

Derivatives

The Fund transacts foreign currency derivatives over-the-counter and hence is exposed to credit risk in the event of a counterparty defaulting on the net payment or receipt that remains outstanding. This risk is minimised by the use of counterparties that are recognised financial intermediaries with acceptable credit ratings and by netting agreements. At 31 March 2018, the Fund was owed £11.9m on over-the-counter foreign currency derivatives.

Refinancing risk

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

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 77% (2017 78%)) of the Fund’s investments could be converted to cash within three months in a normal trading environment.

22 Actuarial statement

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

Notes to the Accounts

23 Actuarial present value of promised retirement benefits

The actuarial value of promised retirement benefits at the accounting date, calculated in line with International Accounting Standard 19 (IAS19) assumptions, is estimated to be £7,791m (2017 £8,210m). This figure is used for statutory accounting purposes by Lothian Pension Fund and complies with the requirements of IAS26. The assumptions underlying the figure match those adopted for the Administering Authority's FRS17/IAS19 reports at each year end.

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

	31 March 2017 % p.a.	31 March 2018 % p.a.
Inflation / pensions increase rate	2.4	2.4
Salary increase rate	4.4	4.1
Discount rate	2.6	2.7

Longevity assumptions

The life expectancy assumption is based on Fund specific statistical analysis with improvements in line with the CMI 2016 model, assuming that the current rate of improvements has reached a peak and will converge to a long term rate of 1.25% p.a.. Based on these assumptions, the average future life expectancies, in years, at age 65 are summarised below:

	31 March 2017		31 March 2018	
	Males	Females	Males	Females
Current pensioners	22.1 years	23.7 years	21.7 years	24.3 years
Future pensioners (assumed to be currently 45)	24.2 years	26.3 years	24.7 years	27.5 years

Commutation assumption

An allowance is included for future retirements to elect to take 50% of the maximum additional tax-free cash up to HMRC limits for pre-April 2009 service and 75% of the maximum tax-free cash for post-April 2009 service.

24 Non-current Debtors

	LPF Parent 31 March 2017 £000	LPF Group 31 March 2017 £000	LPF Parent 31 March 2018 £000	LPF Group 31 March 2018 £000
Contributions due - employers' cessation	259	259	1,525	1,525
	259	259	1,525	1,525

In accordance with the Funding Strategy Statement and in recognition of severe affordability constraints facing the charitable sector, “Funding Agreements” have been put in place to allow certain former employers to repay cessation valuation debt over longer terms (up to twenty years), to avoid potential default or insolvency.

The above debtors all relate to community admission bodies.

Notes to the Accounts

25 Debtors

	LPF Parent 31 March 2017 £000	LPF Group 31 March 2017 £000	LPF Parent 31 March 2018 £000	LPF Group 31 March 2018 £000
Contributions due - employers	11,434	11,434	11,586	11,586
Contributions due - members	3,304	3,304	3,517	3,517
Benefits paid in advance or recoverable	-	-	33	33
Sundry debtors	160	193	92	163
Corporation tax losses utilised by CEC group	-	1	-	-
Prepayments	283	292	325	335
LPFE & LPFI Limited Loan facility - see note 29	16	-	11	-
	15,197	15,224	15,564	15,634

Analysis of debtors

	LPF Parent 31 March 2017 £000	LPF Group 31 March 2017 £000	LPF Parent 31 March 2018 £000	LPF Group 31 March 2018 £000
Administering Authority	6,081	6,081	6,122	6,122
Other Scheduled Bodies	6,477	6,477	7,061	7,061
Community Admission Bodies	2,158	2,158	1,926	1,926
Transferee Admission Bodies	35	35	33	33
Other Local Authorities	22	56	7	43
Central Government Bodies	-	-	-	-
Other entities and individuals	424	417	415	449
	15,197	15,224	15,564	15,634

26 Creditors

	LPF Parent 31 March 2017 £000	LPF Group 31 March 2017 £000	LPF Parent 31 March 2018 £000	LPF Group 31 March 2018 £000
Benefits payable	5,745	5,745	6,914	6,914
VAT, PAYE and State Scheme premiums	2,940	3,052	1,432	1,571
Contributions in advance	8,719	8,719	18,290	18,290
Miscellaneous creditors and accrued expenses	2,760	2,809	1,982	2,167
Office - operating lease	266	266	243	243
LPFE Loan facility - see note 29	24	-	-	-
Intra group creditor - see note 29	105	-	287	-
	20,559	20,591	29,148	29,185

26 Creditors (cont)

Analysis of Creditors

	LPF Parent 31 March 2017 £000	LPF Group 31 March 2017 £000	LPF Parent 31 March 2018 £000	LPF Group 31 March 2018 £000
Administering Authority	51	51	295	295
Other Scheduled Bodies	11,715	11,715	18,251	18,251
Community Admission Bodies	19	19	28	28
Transferee Admission Bodies	-	-	-	
Central Government Bodies	2,889	3,001	1,432	1,571
Other entities and individuals	5,885	5,805	9,142	9,040
	20,559	20,591	29,148	29,185

27 Additional Voluntary Contributions

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

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

Total contributions during year for Lothian Pension fund	2016/17 £000	2017/18 £000
Standard Life	339	305
Prudential	1,816	1,983
	2,155	2,288

Total value at year end for Lothian Pension Fund	31 March 2017 £000	31 March 2018 £000
Standard Life	5,041	4,705
Prudential	5,097	6,259
	10,138	10,964

28 Related parties

The City of Edinburgh Council

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

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

Notes to the Accounts

28 Related parties (cont)

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

	31 March 2017 £000	31 March 2018 £000
Year end balance of holding account	4,467	2,784
	4,467	2,784

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 2018, the fund had an average investment balance of £117.1m (2016/17 £105.7m). Interest earned was £482k (2016/17 £427.4k).

Year end balance on treasury management account	31 March 2017 £000	31 March 2018 £000
Held for investment purposes	92,090	90,783
Held for other purposes	27,278	47,024
	119,368	137,807

Scheme employers

All scheme employers to the fund are (by definition) related parties, a full list of employers can be found on page 69. The employer contributions for the ten largest scheme employers are as follows -

	31 March 2017 £000	31 March 2018 £000
City of Edinburgh Council	63,542	50,041
West Lothian Council	22,214	22,895
East Lothian Council	13,267	13,812
Midlothian Council	11,849	13,148
Scottish Water	9,191	9,526
Edinburgh Napier University	5,001	4,938
Heriot-Watt University	3,077	3,324
Scottish Police Authority	3,519	2,945
Edinburgh College	2,924	2,289
Audit Scotland	2,020	1,944

Governance

As at 31 March 2018, all members of the Pensions Committee, with the exception of Richard Lamont, and all members of the Pension Board, were members of the Lothian Pension Fund or Lothian Buses Pension Fund, with one member of the Pension Board in reciept of pension benefits from Lothian Pension Fund.

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

28 Related parties (cont)

During the period from 1 April 2017 to the date of issuing of these accounts, a number of employees of the City of Edinburgh Council and its wholly owned subsidiary, LPFE Limited, held key positions in the financial management of the Lothian Pension Fund. With effect from 1 May 2015, all the employees listed below, with the exception of the City of Edinburgh Council members of staff, were employed by LPFE Limited. These employees and their financial relationship with the Fund (expressed as cash-equivalent transfer values or CETV) are set out below:

Name	Position held	Accrued CETV as at 31 March 2017 £000	Accrued CETV as at 31 March 2018 £000
Stephen Moir*	Executive Director of Resources, City of Edinburgh Council	-	22
Hugh Dunn*	Head of Finance, City of Edinburgh Council	1,251	949
Katy Miller*	Head of Human Resources, City of Edinburgh Council **	29	51
Clare Scott*	Chief Executive Officer, Lothian Pension Fund	221	270
Bruce Miller	Chief Investment Officer, Lothian Pension Fund	267	334
Struan Fairbairn	Chief Risk Officer, Lothian Pension Fund	46	64
John Burns	Chief Finance Officer, Lothian Pension Fund	538	624
Esmond Hamilton	Financial Controller, Lothian Pension Fund	200	238

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

** Appears due to being a Director in LPFE Ltd

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

	31 March 2017 £000	31 March 2018 £000
Short-term employee benefits	380	415
Post-employment benefits - employer pension contributions	78	85

Key management personnel employed by LPFE, had accrued pensions totalling £97,456 (1 April 2017: £81,825) and lump sums totalling £110,889 (1 April 2017: £100,185) at the end of the period.

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

LPFE Limited & LPFI Limited- loan facility

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

Interest payable by LPFE Limited during the period was £1,380 of which £198 was due at the year end and for LPFI Limited interest payable was £168 of which there was none due at year end. At 31 March 2018, the balance on the loan facility was £10k due to LPFE Limited and a zero balance from LPFI Limited.

Notes to the Accounts

28 Related parties (cont)

LPFE Limited - staffing services

Staffing services are provided to Lothian Pension Fund for the purposes of administering the Funds under a intra-group resourcing agreement. The agreement also provides for the running costs of the company to be covered as part of a service charge and allows for the provision of staffing services to LPFI Limited. During the year to 31 March 2018, the Fund was invoiced £1,450k (2017 £1,073k) for the services of LPFE Limited staff, £288k (2017 £105k) of this remained payable at year end.

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

Movement in deferred tax asset (Non-current asset)	LPF Group 2016/17 £000	LPF Group 2017/18 £000
At 1 April 2017	36	117
Credit for year to Fund Account	81	175
At 31 March 2018	117	292

Elements of closing deferred tax asset	LPF Group 31 March 2017 £000	LPF Group 31 March 2018 £000
Pension liability	117	292
	117	292

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

	31 March 2017 £	31 March 2018 £
Allotted, called up and fully paid Ordinary shares of £1 each - LPFE Limited*	1	1
Allotted, called up and fully paid Ordinary shares of £1 each - LPFI Limited	50,000	60,000
	50,001	60,001

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

30 Retirement benefits obligation - group

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

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

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

Notes to the Accounts

30 Retirement benefits obligation - group (cont)

Fund assets

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

Asset		Fair value at 31 March 2017 £000	% of total 31 March 2017 %	Fair value at 31 March 2018 £000	% of total 31 March 2018 %
Equity securities:	Consumer	425	15.0	1,185	14.0
	Manufacturing	429	15.2	1,288	15.0
	Energy and utilities	210	7.4	541	6.0
	Financial institutions	197	7.0	769	9.0
	Health and care	166	5.9	424	5.0
	Information technology	140	4.9	528	6.0
	Other	195	6.9	543	6.0
Debt securities:	Corporate Bonds	-	0.0	169	2.0
	UK Government	284	10.0	839	10.0
	Other	6	0.2	-	0.0
Private equity:	All	91	3.2	158	2.0
Real property	UK property	191	6.7	556	6.0
	Overseas property	-	0.0	9	0.0
Investment funds and unit trusts:	Equities	-	0.0	83	1.0
	Commodities	8	0.3	-	0.0
	Bonds	42	1.5	-	0.0
	Infrastructure	253	8.9	1,025	12.0
	Other	60	2.1	20	0.0
Derivatives:	Foreign Exchange	-	0.0	4	0.0
Cash and cash equivalents:	All	131	4.8	511	6.0
		2,828	100.0	8,652	100.0

Amounts recognised in the Net Assets Statement	LPF Group 31 March 2017 £000	LPF Group 31 March 2018 £000
Fair value of Fund assets	2,828	8,652
Present value of Fund liabilities	(3,513)	(10,367)
	(685)	(1,715)

Notes to the Accounts

30 Retirement benefits obligation - group (cont)

Movement in the defined benefit obligation during the period

	LPF Group 2016/17 £000	LPF Group 2017/18 £000
Brought forward	2,277	3,513
Current service cost	172	336
Interest cost on obligation	86	131
Fund participants contributions	76	7,175
Benefits paid	-	
Actuarial losses arising from changes in financial assumptions	902	(788)
Actuarial losses arising from changes in demographic assumptions	-	
Other actuarial losses	-	
Balance at year end	3,513	10,367

Movement in the fair value of Fund assets during the period

	LPF Group 2016/17 £000	LPF Group 2017/18 £000
Brought forward	2,097	2,828
Benefits paid	-	
Interest income on Fund assets	80	104
Contributions by employer	156	204
Contributions by member	76	91
Contributions in respect of unfunded benefits	-	-
Unfunded benefits paid	-	(4)
Effect of business combinations and disposals	-	5,711
Return on assets excluding amounts included in net interest	419	(282)
Balance at year end	2,828	8,652

Amounts recognised in the Fund Account

	LPF Group 2016/17 £000	LPF Group 2017/18 £000
Interest received on Fund assets	(80)	(104)
Interest cost on Fund liabilities	86	131
Current service costs	172	336
Transfer of opening retirement benefit obligation on 1 May 2015	-	-
Actuarial gains due to re-measurement of the defined benefit obligation	902	(788)
Return on Fund assets (excluding interest above)	(419)	282
Net cost recognised in Fund account	661	(143)
Less - cash flows	(156)	(204)
Increase in retirement benefit obligations	505	(347)

Notes to the Accounts

30 Retirement benefits obligation - group (cont)

Principal actuarial assumptions used in this valuation	**31 March 2017 % p.a.**	**31 March 2018 % p.a.**
Inflation / pensions increase rate	2.4	2.3
Salary increase rate	4.4	4.0
Discount rate	2.7	2.7

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

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

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

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

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

	31 March 2017		**31 March 2018**	
	Males	**Females**	**Males**	**Females**
Current pensioners	22.1 years	23.7 years	21.7 years	24.3 years
Future pensioners	24.2 years	26.3 years	24.7 years	27.5 years

Expected employer contributions to the defined benefit plan for the year ended 31 March 2019 are £415,000, based on a pensionable payroll cost of £1,742,000.

31 Contractual commitments

Investment commitments

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

	31 March 2017 £000	**31 March 2018 £000**
Outstanding investment commitments	235,565	202,723
	160,891	202,723

Notes to the Accounts

31 Contractual commitments (cont)

Office accommodation - 144 Morrison Street, Edinburgh

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

	31 March 2017 £000	31 March 2018 £000
Within one year	115	115
Between one and five years	345	345
After five years	877	762
	1,337	1,222

Recognised as an expense during the year	92	92

The above expense has been allocated across the three Funds, Lothian Pension Fund's share is £85.1k.

32 Contingent assets and liabilities

Contribution refunds

At 31st March 2018, Lothian Pension Fund had £894k in unclaimed refunds due to members.

Employer Cessations

As stated in note 24, "In accordance with the Funding Strategy Statement and in recognition of severe affordability constraints facing the charitable sector, "Funding Agreements" have been put in place with certain former employers to repay cessation valuation debt"…. In exceptional circumstances, this includes "repayment of less than the cessation debt in order to avoid employer insolvency, with an appropriate agreement which allows the Fund to revisit the repayment of the remaining debt at a future date (i.e. the debt would be a contingent liability and hence not recognised on an employer's balance sheet); and seeking, where appropriate, suitable "anti-embarrassment" provisions in legal agreement covering future increase in employer asset values". At 31 March 2018, such contingent assets of the Fund totalled £1,635k.

EU Tax claims & income recovery

The Fund participates in various claims to recover withheld investment income. EU tax claims relate to the recovery of tax deducted from dividend payments prior to receipt or payable tax credits thereon. The claims can be divided into three main types – "Manninen" / Foreign Income Dividends (Fids), "Fokus Bank" and Manufactured Dividends. Given the high level of uncertainty as to the eventual success of such claims from EU tax authorities, no accrual of income is made in the financial statements. The value of these outstanding claims is approximately £9.8m. To date, the amount of tax recovered exceeds the cost of pursuing claims. Legal costs are shared across a pool of claimants and the Fund has the right to cease participation without incurring further costs. An annual progress report is provided to Pensions Audit Sub-Committee.

33 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 £4.9k. This decreased the impairment to £27.7k at the year end.

Lothian Pension Fund

Actuarial Statement for 2017/18

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

Description of Funding Policy

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

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

The FSS sets out how the Administering Authority seeks to achieve these objectives.

Funding Position as at the last formal funding valuation

The most recent actuarial valuation carried out under Regulation 60 of the Local Government Pension Scheme (Scotland) Regulations 2014 was as at 31 March 2017. This valuation revealed that the Fund's assets, which at 31 March 2017 were valued at £6,598 million, were sufficient to meet 98% of the liabilities (i.e. the present value of promised retirement benefits) accrued up to that date. The resulting deficit at the 2017 valuation was £145 million. For the avoidance of doubt, these results are based on the assumptions that apply to the Fund's Primary investment strategy.

Each employer had contribution requirements set at the valuation with the aim of achieving full funding within a given time horizon. Contribution rates were set using one of two approaches depending on each employer's circumstances:

- Certain low risk and open employers participate in a contribution stability mechanism which limits annual changes in contribution rates. The mechanism is tested at each valuation to make sure it achieves the desired funding objectives.
- Other employers pay the contributions required to cover the cost of future service benefits and to recover the deficit/surplus identified as at 31 March 2017 over a given time period.

Individual employers' contributions for the period 1 April 2018 to 31 March 2021 were set in accordance with the Fund's funding policy as set out in its FSS, which includes further detail on the approaches mentioned above.

Principal Actuarial Assumptions and Method used to value the liabilities

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

Lothian Pension Fund

Actuarial Statement for 2017/18

Method

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

Assumptions

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

The key financial assumptions adopted under the Primary investment strategy for the 2017 valuation were as follows:

Financial assumptions	31 March 2017 % p.a.
Discount rate	5.0%
Pay increases*	5.0%
Price inflation/Pension increases	2.7%

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

	Males	Females
Current Pensioners	21.7 years	24.3 years
Future Pensioners *	24.7 years	27.5 years

*Aged 45 as at 31 March 2017

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

Experience over the period since 31 March 2017

Asset returns under the Primary investment strategy over the period have been lower than the valuation discount rate but real bond yields at 31 March 2018 are at a similar level to 31 March 2017. Combining the impact of these may mean that the overall funding level at 31 March 2018 has fallen slightly since the last formal valuation.

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

Richard Warden FFA
Fellow of the Institute and Faculty of Actuaries
For and on behalf of Hymans Robertson LLP
20 Waterloo Street, Glasgow, G2 6DB
28 April 2018

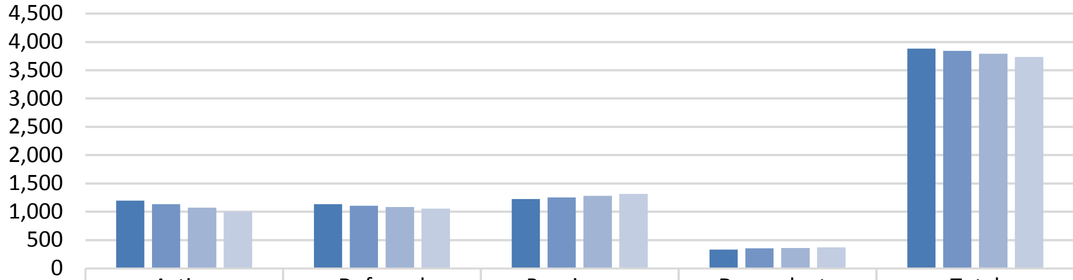
List of active employers at 31 March 2018

Scheduled Bodies	
City of Edinburgh Council (The)	Scottish Fire and Rescue Service
East Lothian Council	Scottish Police Authority
Edinburgh College	Scottish Water
Heriot-Watt University	SESTRAN
Lothian Valuation Joint Board	Visit Scotland
Midlothian Council	West Lothian College
Scotland’s Rural College (SRUC)	West Lothian Council

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

Lothian Buses Pension Fund

Lothian Buses Pension Fund membership



	Active	Deferred	Pensioners	Dependants	Total
31 March 2015	1,196	1,131	1,222	332	3,881
31 March 2016	1,130	1,104	1,253	350	3,837
31 March 2017	1,069	1,082	1,280	360	3,791
31 March 2018	1,000	1,053	1,311	370	3,734

Investment Strategy

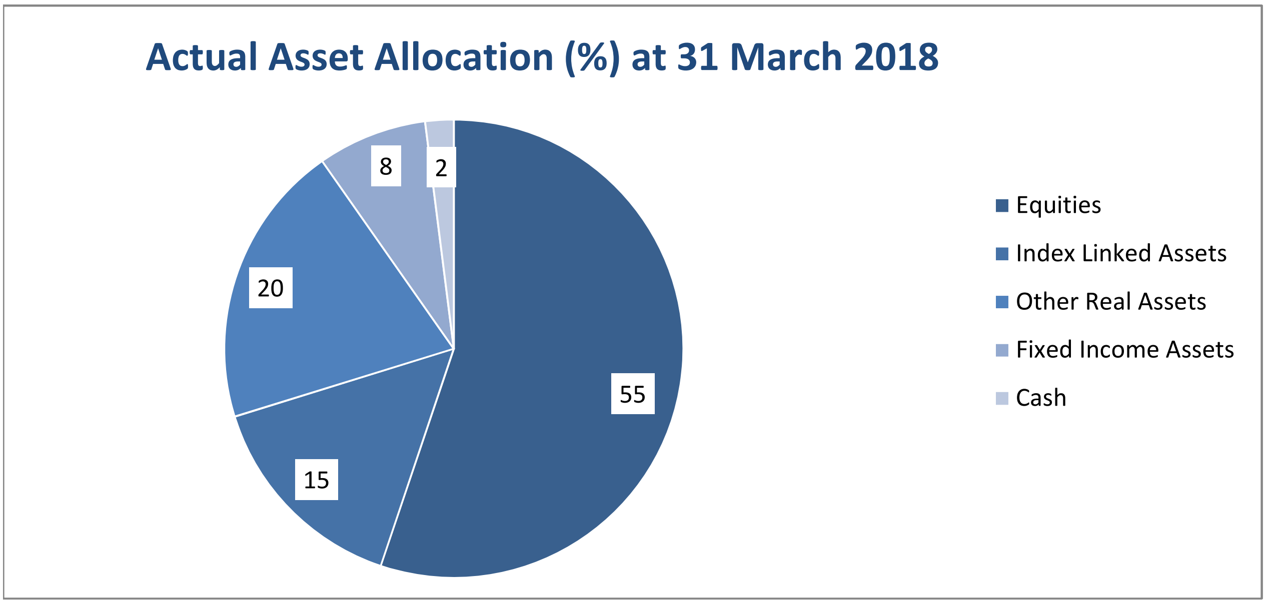
The Fund adopts a long-term investment strategy, aiming to maximise the investment return within reasonable and considered risk parameters and hence minimise the cost to the employer. A new Investment Strategy 2016-21 was agreed by Committee in March 2016. This aims to better align the risk assets held by the Fund with its maturing liability profile by reducing equity exposure to 40%, increasing the index-linked asset allocation to 20%, and increasing investments in real (18%) and fixed income (22%) assets to 40% in a phased manner over the 5-year time horizon.

A decision to merge Lothian Buses Pension Fund with the Lothian Pension Fund was made by the Pensions Committee in March 2018 subject to the satisfactory completion of a revised admission agreement and shareholders' guarantees. Progress is being made on putting in place the agreement and guarantees. The merger is expected to be enacted in the coming months, facilitated by the new employer unitisation accounting system and with the creation of a bespoke strategy for Lothian Buses in the main Lothian Pension Fund.

The implementation of the strategy progressed over the financial year 2017/18 as investment opportunities in real assets (largely infrastructure) and fixed income assets became available and as research on opportunities was completed. Implementation progress must also consider the fact that the actual asset allocation changes as markets fluctuate

The changes to the interim strategy allocations and actual allocations over the financial year 2017/18 are shown in the table below:

	Strategic Allocation 31/03/2018 %	Long term Strategy 2016 - 2021 %
Equities	55.5	40.0
Index Linked Assets	16.0	20.0
Other Real Assets	18.0	18.0
Fixed Income Assets	10.5	22.0
Cash	-	-
Total	**100.0**	**100.0**



Investment performance

The objectives of the Fund are:

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

Overall, the Fund produced a return of 4.9% over the year, ahead of the benchmark return of 3.5%. Over five years, the Fund returned 10.9% per annum, ahead of benchmark by 1.4% per annum.

The Fund investment return of 4.9% was dragged down by the impact of Sterling strength on overseas investments (global equities returned 15% in US$ terms but only 2% when converted to Sterling). The return exceeded that of the strategy allocation benchmark over the last year, due mainly to the strong performance of the Baillie Gifford Global Equity portfolio. The Fund continues to meet its main objective of achieving a return consistent with that of its strategic allocation over long-term economic cycles.

The Fund continues to meet its main objective of achieving a return consistent with that of its strategic allocation over long-term economic cycles. The five-year return was 10.9% per annum and the 10-year return was 10.1% per annum (compared to benchmark returns of 9.5% and 8.6% respectively).

Annualised returns to 31 March 2018 (% per year)	1 year	5 year	10 years
Lothian Buses Pension Fund	4.9	10.9	10.1
Benchmark	3.5	9.4	8.6
Actuarial Valuation Assumptions *	3.2	4.8	5.4
Retail Price Index (RPI)	3.3	2.3	2.8
Consumer Price Index (CPI)	2.4	1.4	2.3
National Average Earnings	2.4	2.6	1.6

*estimate

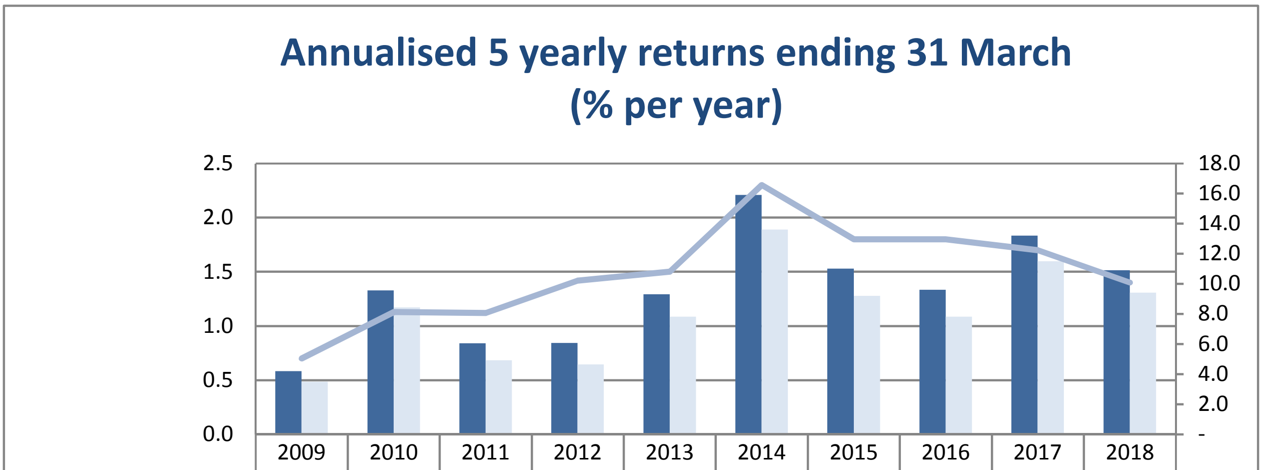
The Fund continues to meet its main objective of achieving a return consistent with that of its strategic allocation over long-term economic cycles. The five-year return was 10.9% per annum and the 10-year return was 10.1% per annum (compared to benchmark returns of 9.5% and 8.6% respectively).

The Fund's shorter-term objective, to perform better than the strategic allocation if markets fall significantly, is yet to be tested. The Fund's return (+4.9%) over the year was ahead of the benchmark return (+3.6%) due to the strong performance of the Baillie Gifford Global Equity portfolio.

The Fund's equity investments delivered more muted, though still positive, returns (+5.1%) in comparison to last year's exceptionally strong levels. However, the return was very strong compared to the benchmark return (+2.4%). Baillie Gifford's Global Alpha portfolio in particular contributed strongly, returning 13.2% (much better than benchmark), while the much smaller Private Equity portfolio rose 5.6% (also better than benchmark). The performance of the internally-managed Global High Yield Equity portfolio tempered this somewhat, returning -2.1% over the year as high yielding, "safe haven" stocks lagged the wider market. As these stocks are lower risk than the benchmark, this is consistent with expectations.

The Fund's internally-managed index-linked assets produced a modest 1.1% gain over the year, in line with the benchmark return as expected as the portfolio is passively managed.

The chart below shows the rolling 5-year performance of the Fund against its strategic benchmark over the last 10 years. The Fund has consistently outperformed its benchmark over rolling 5-year periods, with the average excess return over the last 10 years being 1.5% pa.



	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Fund	4.2	9.6	6.0	6.1	9.3	15.9	11.0	9.6	13.2	10.9
Benchmark	3.50	8.4	4.9	4.6	7.8	13.6	9.2	7.8	11.5	9.4
Relative (LHS)	0.7	1.1	1.1	1.4	1.5	2.3	1.8	1.8	1.7	1.4

Lothian Buses Pension Fund

Fund Account for year ended 31 March 2018

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

2016/17 £000		Note	2017/18 £000
	Income		
7,731	Contributions from employer	3	7,581
2,060	Contributions from members		1,988
10	Transfers from other schemes		13
9,801			**9,582**
	Less: expenditure		
8,425	Pension payments including increases		8,755
3,277	Lump sum retirement payments		2,584
295	Lump sum death benefits		283
9	Refunds to members leaving service		4
418	Transfers to other schemes		657
98	Administrative expenses	4b	99
12,522			**12,382**
(2,721)	**Net withdrawals from dealing with members**		**(2,800)**
	Returns on investments		
7,641	Investment income	5	8,079
90,672	Change in market value of investments	7, 11b	17,749
(1,880)	Investment management expenses	4c	(2,424)
96,433	**Net returns on investments**		**23,404**
93,712	**Net increase in the Fund during the year**		**20,604**
394,431	**Net assets of the Fund at 1 April 2017**		488,143
488,143	**Net assets of the Fund at 31 March 2018**		**508,747**

Lothian Buses Pension Fund

Net Assets Statement as at 31 March 2018

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

31 March 2017 £000		Note	31 March 2018 £000
	Investment Assets		
73,313	Bonds	**6**	74,321
273,603	Equities	**6**	277,290
122,566	Pooled investment vehicles	**6, 19**	134,466
14,074	Cash Deposits	**12**	18,691
1,398	Other investment assets		1,614
484,954			**506,382**
	Investment Liabilities		
(18)	Other investment assets		(250)
(18)			**(250)**
484,936	**Net investment assets**	**6, 7, 8, 9, 11**	**506,132**
	Current assets		
385	The City of Edinburgh Council	**18**	299
2,440	Cash balances	**12, 18**	1,809
744	Debtors	**15**	842
3,569			**2,950**
	Current liabilities		
(362)	Creditors	**16**	(335)
(362)			**(335)**
3,207	**Net current assets**		**2,615**
488,143	**Net assets of the Fund at 31 March 2018**	**11**	**508,747**

The unaudited accounts were issued on 27 June 2018 and the audited accounts were authorised for issue on XX September 2018.

JOHN BURNS FCMA CGMA
Chief Finance Officer, Lothian Pension Fund
27 June 2018

<u>Notes to the net asset statement</u>

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

Notes to the Financial Statements

1 Statement of Accounting Policies

The statement of accounting policies for all three Funds can be found on page 114.

2 Events after the Reporting Date

There have been no events since 31 March 2018, and up to the date when these accounts were authorised, that require any adjustments to these accounts.

At its meeting on 26 March 2018, the Pensions Committee approved the merger of the assets and liabilities of the Lothian Buses Pension Fund into the Lothian Pension Fund at the earliest suitable date (to be determined by the Executive Director of Resources), subject to the satisfactory completion of a revised admission agreement and shareholder guarantee.

3 Contributions from employer

By category	2016/17 £000	2017/18 £000
Normal (ongoing contributions)	7,516	7,581
Deficit contribution	-	-
Strain costs and augmentation contributions	215	-
	7,731	7,581

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

The employer contribution rate was 24.1% for the financial year.

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

4a Total management expenses

In accordance with CIPFA, the analysis below looks at the combined administration and investment management expenses in notes 4a and b and splits out the costs to include a third category covering oversight and governance expenditure. Administration costs such as Actuarial fees and Investment Management expenses such as investment consultancy would instead be shown in the Oversight and governance costs category.

	2016/17 £000	2017/18 £000
Administrative costs	78	78
Investment management expenses*	1,814	2,323
Oversight and governance costs	86	122
	1,978	2,523

* as per note 4c, includes £325k (2016/17 £3325k) in costs above CIPFA guidance

Notes to the Financial Statements

4b Administrative expenses

	2016/17 £000	2017/18 £000
Employee Costs	55	55
The City of Edinburgh Council - other support costs	6	-
System costs	13	14
Actuarial fees	9	11
Internal and External audit fees	2	3
Legal fees	-	-
Printing and postage	4	5
Depreciation	3	3
Office costs	5	5
Sundry costs less sundry income	1	3
	98	99

LPFE Ltd, which is a wholly owned subsidiary of the Council, is responsible for providing the staffing resource to administer the three pension Funds. The Service receives an allocation of the overheads of the Council. In turn the Service allocates administration and investment costs to the three pension funds. Costs directly attributable to a specific fund are charged to the relevant Fund, costs that are common to all three funds are allocated on a defined basis.

4c Investment management expenses

	2016/17 £000	2017/18 £000
External management fees -		
invoiced	616	661
deducted from capital (direct investment)	694	1,135
deducted from capital (indirect investment)	325	338
Securities lending fees	20	18
Transaction costs	33	59
Employee costs	82	96
Custody fees	33	28
Engagement and voting fees	6	7
Performance measurement fees	19	23
Consultancy fees	5	3
System costs	18	23
Legal fees	9	10
The City of Edinburgh Council - other support costs	8	-
Depreciation	2	1
Office costs	6	6
Sundry costs less sundry income	4	16
	1,880	2,424

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

The external investment management fees above include £0.5m in respect of performance-related fees (2016/17 £0.3m).

Notes to the Financial Statements

4c Investment management expenses (cont)

It should be noted that Lothian Buses Pension Fund's disclosure on investment management fees goes further than CIPFA's LGPS Management Cost revised guidance on cost transparency which came into effect on 1st April 2016. Consistent with recent years, the Fund recognises fees deducted from investments not within its direct control (such as fund of fund fees) to give a full picture of its investment management costs. Further details can be found on page 25. This further disclosure highlights an extra £338k in costs (2016/17 £325k)

5 Investment income

	2016/17 £000	2017/18 £000
Income from bonds	186	261
Dividends from equities	7,026	6,996
Income from pooled investment vehicles	452	1,077
Interest on cash deposits	18	33
Stock lending and sundries	103	92
	7,785	8,459
Irrecoverable withholding tax	(144)	(380)
	7,641	8,079

Included within the dividend from equities income for the year is cross border withholding tax yet to be received. These reclaims have a high certainty of success and are completed and managed by the Fund’s custodian Northern Trust. For the period of 2017/18 £245k of the stated income relates to tax yet to be received. At the 31st March 2018 £525k (including prior periods) of investment income receivable related to cross border withholding tax. The Fund monitors these claims to ensure its optimum tax efficiency and provides an annual progress report to the Pensions Audit Sub-Committee.

6 Analysis of investments

Investment Assets	Region	31 March 2017 £000	31 March 2018 £000
Bonds			
Public sector index linked gilts quoted	UK	73,313	74,321
		73,313	74,321
Equities			
Quoted	UK	33,935	28,853
Quoted	Overseas	239,668	248,437
		273,603	277,290
Pooled investment vehicles			
Managed funds - property	UK	38,146	41,487
Managed funds - other bonds	UK	30,100	30,490
Timber funds - unquoted	Overseas	8,361	6,838
Infrastructure - unquoted	UK	26,636	28,850
Infrastructure - unquoted	Overseas	12,607	16,774
Private debt funds - unquoted	UK	2,266	2,881
Private debt funds - unquoted	Overseas	4,450	7,146
		122,566	134,466

Notes to the Financial Statements

7 Reconciliation of movement in investments and derivatives

	Market value at 31 March 2017 £000	Purchases at cost & derivative payments £000	Sales & derivative receipts £000	Change in market value £000	Market value at 31 March 2018 £000
Bonds	73,313	4,043	(3,613)	578	74,321
Equities	273,603	28,779	(32,933)	7,841	277,290
Pooled investment vehicles	122,566	5,736	(3,764)	9,928	134,466
Derivatives - fwd foreign exchange	-	15	(11)	(4)	-
	469,482	38,573	(40,321)	18,343	486,077
Other financial assets / (liabilities)					
Cash deposits*	14,074			(605)	18,691
Broker balances*	(18)			11	20
Investment income due*	1,398				1,344
	15,454			(594)	20,055
Net financial assets	484,936			17,749	506,132

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

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

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

** As per CIPFA disclosures the change in market value intentionally does not balance opening/closing market values*

Notes to the Financial Statements

8 Investment managers and mandates

Manager	Mandate	Market value at 31 March 2017 £000	% of total 31 March 2017 %	Market value at 31 March 2018 £000	% of total 31 March 2018 %
Baillie Gifford	Global equities	124,570	25.7	141,217	27.9
In-house	Global high dividend	142,297	29.3	131,248	25.9
In-house	Private equity quoted	6,287	1.3	5,605	1.1
Total global equities		273,154	56.3	278,070	54.9
In-house	Index linked gilts	73,793	15.2	74,630	14.7
Total inflation linked assets		73,793	15.2	74,630	14.7
Baillie Gifford	Corporate bonds	30,100	6.2	30,490	6.0
In-house	Secured loans unquoted	6,716	1.4	10,027	2.0
Total fixed income assets		36,816	7.6	40,517	8.0
Standard Life	Property	38,146	7.9	41,487	8.2
In-house	Infrastructure unquoted	39,243	8.1	45,625	9.0
In-house	Infrastructure quoted	3,661	0.8	2,950	0.6
In-house	Timber unquoted	8,361	1.7	6,838	1.4
Total other real assets		89,411	18.5	96,900	18.5
In-house	Cash	11,762	2.4	16,015	3.2
Total cash and sundries		11,762	2.4	16,015	3.2
Net financial assets		484,936	100.0	506,132	100.0

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

	Market value at 31 March 2017 £000	% of net assets 31 March 2017	Market value at 31 March 2018 £000	% of net assets 31 March 2018
Standard Life Property Fund	38,146	7.9	41,487	8.2
Baillie Gifford Inv Grade Bond Fund	30,100	6.2	30,490	6.0

10 Securities lending

During the year Lothian Buses Pension Fund participated in a securities lending arrangement with the Northern Trust Company. As at 31 March 2018, £16.8m (2017 £17.4m) of securities were released to third parties. Collateral valued at 106.19% (2017 105.24%) of the market value of the securities on loan was held at that date.

Notes to the Financial Statements

11 Financial Instruments

11a 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 2017			31 March 2018		
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						
Bonds	73,313	-	-	74,321	-	-
Equities	273,603	-	-	277,290	-	-
Pooled investments	122,566	-	-	134,466	-	-
Cash	-	14,074	-	-	18,691	-
Other balances	-	1,398	-	-	1,614	-
	469,482	15,472	-	486,077	20,305	-
Other assets						
City of Edinburgh Council	-	385	-	-	299	-
Cash	-	2,440	-	-	1,809	-
Debtors	-	744	-	-	842	-
	-	3,569	-	-	2,950	-
Assets total	469,482	19,041	-	486,077	23,255	-
Financial liabilities						
Investment liabilities						
Other investment balances	-	-	(18)	-	-	(250)
	-	-	(18)	-	-	(250)
Other liabilities						
Creditors	-	-	(362)	-	-	(335)
Liabilities total	-	-	(380)	-	-	(585)
Total net assets	469,482	19,041	(380)	486,077	23,255	(585)

Total net financial assets	488,143	508,747

Notes to the Financial Statements

11b Net gains and losses on financial instruments

	2016/17 £000	2017/18 £000
Designated as fair value through fund account	90,519	18,343
Loans and receivables	153	(594)
Financial liabilities at amortised cost	-	-
Total	90,672	17,749

11c Valuation of financial instruments carried at fair value

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

Level 1

Financial instruments at Level 1 are those where the fair values are derived from unadjusted quoted prices in active markets for identical assets or liabilities. Products classified as level 1 comprise quoted equities and unit trusts.

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

Level 2

Financial instruments at Level 2 are those where quoted market prices are not available; for example, where an instrument is traded in a market that is not considered to be active, or where valuation techniques are used to determine fair value and where these techniques use inputs that are based significantly on observable market data.

Level 3

Financial instruments at Level 3 are those where at least one input that could have a significant effect on the instrument's valuation is not based on observable market data. Such instruments would include unquoted equity investments, which are valued using various valuation techniques that require significant judgement in determining appropriate assumptions.

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

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

Notes to the Financial Statements

11c Valuation of financial instruments carried at fair value (cont)

	31 March 2018 Level 1 £000	Level 2 £000	Level 3 £000	Total £000
Investment assets				
Designated as fair value through fund account	349,267	74,321	62,489	486,077
Loans and receivables	20,305	-	-	20,305
Total investments assets	369,572	74,321	62,489	506,382
Investment liabilities				
Designated as fair value through fund account	(250)	-	-	(250)
Total investment liabilities	(250)	-	-	(250)
Net Investment assets	369,322	74,321	62,489	506,132

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

11d Reconciliation of fair value measurements within level 3

Pooled investments	Market value at 31 March 2017	Level 3 transfers in	Level 3 transfers out	Purchases at cost & derivative payments	Sales & derivative receipts	Unrealised gains / (losses)	Realised gains / (losses)	Market value at 31 March 2018
Infrastructure	39,243	-	-	7,026	(6,215)	4,050	1,520	45,624
Timber	8,361	-	-	-	(1,124)	(641)	242	6,838
Secured loans	6,716	-	-	4,018	(1,153)	429	17	10,027
	54,320	-	-	11,044	(8,492)	3,838	1,779	62,489

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

Notes to the Financial Statements

12 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
- monitoring market risk and market conditions to ensure risk remains within tolerable levels
- using equity futures contracts from time to time to manage market risk. Options are not used by the Fund.

Notes to the Financial Statements

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

Sensitivity analysis

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

Asset type	Potential price movement (+ or -)
Equities - Developed Markets	20.5%
Private Equity	30.0%
Timber and Gold	18.0%
Secured Loans	10.0%
Corporate Bonds	5.6%
Index-Linked Gilts	11.0%
Infrastructure	12.0%
Property	13.0%
Cash	1.0%

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

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

	Value at 31 March 2018 £000	% of fund %	Potential Change +/- %	Value on increase £000	Value on decrease £000
Equities - Developed Markets	272,465	55.1	20.5	328,320	216,610
Private Equity	5,605	1.1	30.0	7,287	3,924
Timber and Gold	6,838	1.4	18.0	8,069	5,607
Secured Loan	10,027	2.0	10.0	11,030	9,024
Corporate Bonds	30,490	6.0	5.6	32,185	28,795
Index-Linked Gilts	74,630	14.7	11.0	82,802	66,458
Infrastructure	48,574	9.6	12.0	54,403	42,745
Property	41,487	8.2	13.0	46,880	36,094
Cash and forward foreign exchange	16,016	3.2	1.0	16,174	15,858
Total [1]	506,132	100.0	16.0	587,150	425,114
Total [2]			12.6	569,766	442,498
Total [3]			12.6	570,062	n/a

[1] No allowance for correlations between assets

[2] Including allowance for correlations between assets

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

Notes to the Financial Statements

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

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

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

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

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

Credit risk

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

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

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

Cash deposits

At 31 March 2018, cash deposits represented £17.8m, 3.5% of total net assets. This was held with the following institutions:

	Moody's Credit Rating at 31 March 2018	Balances at 31 March 2017 £000	Balances at 31 March 2018 £000
Held for investment purposes			
Northern Trust Global Investment Limited - liquidity funds	Aaa-mf	3,270	2,496
Northern Trust Company - cash deposits	A2	9,882	15,269
The City of Edinburgh Council - treasury management	See below	922	926
Total investment cash		14,074	18,691
Held for other purposes			
The City of Edinburgh Council - treasury management	See below	2,440	1,809
Total cash		16,514	20,500

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

Notes to the Financial Statements

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

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

(a) UK Government and other UK local Authorities with no limit, other public bodies up to £20 million per

(b) Money market funds (MMFs) no more than £30 million or 15% with any one Fund.

(c) Financial Institutions: Banks and Building Societies with multiple criteria based on a range of short and long term credit ratings, as well as any security provided, from maximum of £60 million / 20% of assets under management (AUM) for institutions with the highest criteria to £10 million / 5% of AUM for institutions with the lowest acceptable criteria.

	Moody's Credit Rating at 31 March 2018	Balances at 31 March 2017 £000	Balances at 31 March 2018 £000
Money market funds			
Deutsche Bank AG, London	Aaa-mf	18	12
Standard Life Investments Sterling Liquidity Fund	Aaa-mf	-	406
Bank call accounts			
Bank of Scotland	Aa3	336	270
Royal Bank of Scotland	A3	5	10
Santander UK	Aa3	1	7
Barclays Bank	A1	-	-
Svenska Handelsbanken	Aa2	1	13
HSBC Bank PLC	Aa3	1	1
UK Pseudo-Sovereign risk instruments			
Other Local Authorities [1]	Aa1	3,001	2,016
		3,363	2,735

[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 2018 was 'Aa1').

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

Securities lending

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

Derivatives

The Fund transacts foreign currency derivatives over-the-counter and hence is exposed to credit risk in the event of a counterparty defaulting on the net payment or receipt that remains outstanding. This risk is minimised by the use of counterparties that are recognised financial intermediaries with acceptable credit ratings and by netting agreements. At 31 March 2018, the Fund had no over-the-counter foreign currency derivatives.

Notes to the Financial Statements

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

Refinancing risk

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

Liquidity risk

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

The majority (estimated to be approximately 88% (2017 89%)) of the Fund's investments could be converted to cash within three months in a normal trading environment.

13 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.

14 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 £463m (2017 £488m). This figure is used for statutory accounting purposes by Lothian Buses Pension Fund and complies with the requirements of IAS26.

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

Financial assumptions	**31 March 2017 % p.a.**	**31 March 2018 % p.a.**
Inflation/pensions increase rate	2.4	2.4
Salary increase rate	4.4	4.1
Discount rate	2.6	2.7

Longevity assumptions

The life expectancy assumption is based on Fund specific statistical analysis with improvements in line with the CMI 2016 model, assuming that the current rate of improvements has reached a peak and will converge to a long term rate of 1.25% p.a.. Based on these assumptions, the average future life expectancies, in years, at age 65 are summarised below:

	31 March 2017		31 March 2018	
	Males	Females	Males	Females
Current pensioners	20.4 years	22.9 years	19.7 years	22.3 years
Future pensioners (assumed to be currently 45)	23.5 years	25.9 years	21.9 years	24.8 years

Commutation assumption

An allowance is included for future retirements to elect to take 50% of the maximum additional tax-free cash up to HMRC limits for pre-April 2009 service and 75% of the maximum tax-free cash for post-April 2009 service.

Notes to the Financial Statements

15 Debtors

	2016/17 £000	2017/18 £000
Contributions due - employer	581	664
Contributions due - members	153	173
Sundry debtors	10	5
	744	842

Analysis of debtors

	31 March 2017 £000	31 March 2018 £000
Administering Authority	1	1
Lothian Buses Limited	733	837
Other entities and individuals	10	4
	744	842

16 Creditors

	31 March 2017 £000	31 March 2018 £000
Benefits payable	201	149
Miscellaneous creditors and accrued expenses	161	186
	362	335

Analysis of creditors

	31 March 2017 £000	31 March 2018 £000
Central Government Bodies	-	11
Other entities and individuals	362	324
	362	335

17 Additional Voluntary Contributions

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

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

Total contributions during year

	2016/17 £000	2017/18 £000
Standard Life	8	7
Prudential	70	76
	78	83

Total value at year end

	31 March 2017 £000	31 March 2018 £000
Standard Life	155	145
Prudential	294	375
	449	520

Notes to the Financial Statements

18 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

LPFE Ltd, which is a wholly owned subsidiary of the Council, is responsible for providing the staffing resource to administer the three pension Funds. The Service receives an allocation of the overheads of the Council, based on the amount of central services consumed. In turn, the Service allocates its costs to the three Pension Funds. Costs directly attributable to a specific Fund are charged to the relevant Fund; costs that are common to all three Funds are allocated on a defined basis.

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

	31 March 2017 £000	31 March 2018 £000
Year end balance of holding account	385	299
	385	299

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 2018, the fund had an average investment balance of £2.8m (2017 £3.0m). Interest earned was £10.5k (2017 £12.1k).

Year end balance on treasury management account	31 March 2017 £000	31 March 2018 £000
Held for investment purposes	922	926
Held for other purposes	2,440	1,809
	3,362	2,735

Scheme employer - Lothian Buses Limited

Lothian Buses Limited are (by definition) a related party to the scheme. The employer contributions to the Fund can be found in note 3 (page 75) of the notes to the Financial Statements.

Governance

As at 31 March 2018, all members of the Pensions Committee, with the exception of Richard Lamont, and all members of the Pensions Board, were members of the Lothian Pension Fund or Lothian Buses Pension Fund, with one member of the Pensions Board in reciept of pension benefits from Lothian Pension Fund.

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

Notes to the Financial Statements

18 Related party transactions (cont)

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

Name	Position held	Accrued CETV as at 31 March 2017 £000	Accrued CETV as at 31 March 2018 £000
Stephen Moir*	Executive Director of Resources, City of Edinburgh Council	-	22
Hugh Dunn*	Head of Finance, City of Edinburgh Council	1,251	949
Katy Miller*	Head of Human Resources, City of Edinburgh Council **	29	51
Clare Scott*	Chief Executive Officer, Lothian Pension Fund	221	270
Bruce Miller	Chief Investment Officer, Lothian Pension Fund	267	334
Struan Fairbairn	Chief Risk Officer, Lothian Pension Fund	46	64
John Burns	Chief Finance Officer, Lothian Pension Fund	538	624
Esmond Hamilton	Financial Controller, Lothian Pension Fund	200	238

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

** Appears due to being a Director in LPFE Ltd

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

	31 March 2017 £000	31 March 2018 £000
Short-term employee benefits	380	415
Post-employment benefits - employer pension contributions	78	85

Key management personnel employed by LPFE, had accrued pensions totalling £97,456 (1 April 2017: £81,825) and lump sums totalling £110,889 (1 April 2017: £100,185) at the end of the period.

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

19 Contractual commitments

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

	31 March 2017 £000	31 March 2018 £000
Outstanding investment commitments	12,462	11,051
	12,462	11,051

Notes to the Financial Statements

20 Contingent assets and liabilities

At 31 March 2018 the Fund does not have any exposure to any contingent assets/liabilities.

21 Impairment losses

No impairment losses have been identified during the year.

Lothian Buses Pension Fund

Actuarial Statement for 2017/18

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

Description of Funding Policy

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

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

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

Funding Position as at the last formal funding valuation

The most recent actuarial valuation carried out under Regulation 60 of the Local Government Pension Scheme (Scotland) Regulations 2014 was as at 31 March 2017. This valuation revealed that the Fund's assets, which at 31 March 2017 were valued at £488 million, were sufficient to meet 121% of the liabilities (i.e. the present value of promised retirement benefits) accrued up to that date. The resulting surplus at the 2017 valuation was £84 million.

On the more prudent gilts basis, the Fund's assets at 31 March 2017 were sufficient to meet 89% of the liabilities accrued to that date. The resulting deficit at the 2017 valuation, on the gilts basis, was £59 million.

The required contributions for the period 1 April 2018 to 31 March 2021 were set at the 2017 valuation in accordance with the Fund's funding policy as set out in its FSS.

Principal Actuarial Assumptions and Method used to value the liabilities

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

Method

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

Assumptions

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

Lothian Buses Pension Fund

Actuarial Statement for 2017/18

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

Financial assumptions	31 March 2017 % p.a.
Discount rate	3.2 %
Salary increase assumption	4.1%
Benefit increase assumption (CPI)	2.4%

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

	Males	Females
Current Pensioners	19.7 years	22.3 years
Future Pensioners *	21.9 years	24.8 years

*Aged 45 as at 31 March 2017

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

Experience over the period since 31 March 2017

Asset returns over the period have been lower than the valuation discount rate and real bond yields at 31 March 2018 are at a similar level to 31 March 2017. Combining the impact of these may mean that the funding level at 31 March 2018 has fallen slightly since the last formal valuation.

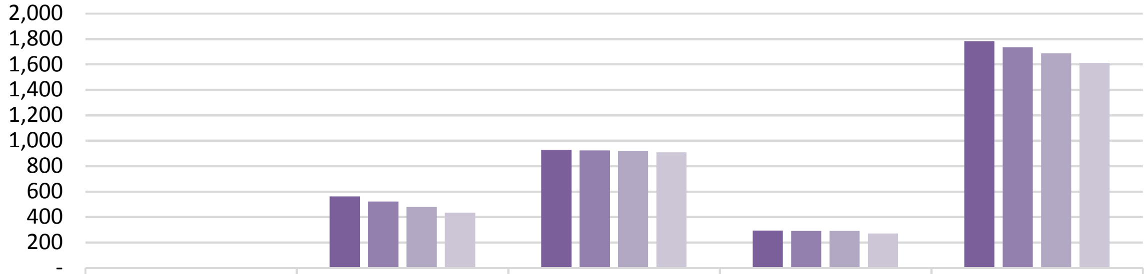
The next actuarial valuation will be carried out as at 31 March 2020. The Funding Strategy Statement will also be reviewed at that time.

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

27 April 2018

Scottish Homes Pension Fund

Scottish Homes Pension Fund membership



	Active	Deferred	Pensioners	Dependants	Total
31 March 2015	-	562	928	293	1,783
31 March 2016	-	522	922	291	1,735
31 March 2017	-	478	919	289	1,686
31 March 2018	-	433	908	269	1,610

Investment strategy

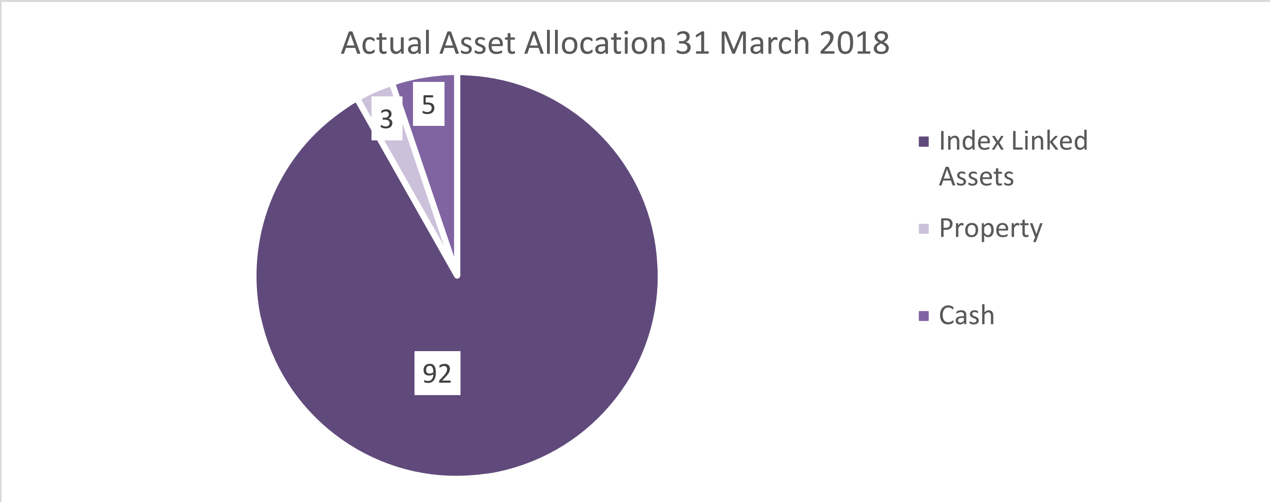
The funding level of the Scottish Homes Pension Fund at 31 March 2017 was 104.7%, an increase from 88.8% at the 2014 valuation.

The Fund's actuary monitors the intra-valuation fluctuations in the funding level using a system that reflects movements in interest rates and asset markets. Over the year to 2018, these fluctuations have been small as the mix of assets owned by the Fund are mostly index-linked gilts, which move proportionately with liability values.

	Strategic Allocation 31 March 2017 %	Strategic Allocation 31 March 2018 %
Equities	17.5	-
Bonds	77.5	100.0
Property	5.0	-
Cash	-	-
Total	**100.0**	**100.0**

The initial changes to the strategy allocation were triggered by movements in interest rates and asset prices that affected the actuary's funding level estimate. However, the final change increasing Bonds to 100% was prompted by the results of the triennial Actuarial Valuation at 31 March 2017, which indicated that the funding level was higher than previously estimated. This was partly because the actuary made some revisions to the financial and demographic assumptions to reflect actual experience over the intervening three years.

The Fund's Equity and Bond portfolios were managed by the internal team over the last year. The Property portfolio was managed by Schroder in a pooled fund of UK commercial real estate. Over the year, the Equity allocation was invested in a portfolio of shares of global companies that generate robust and growing dividends. The Bond allocation was invested in a portfolio of UK index-linked gilts designed to match the liability payments of the Fund as closely as possible.



Investment performance

The objectives of the Fund over the past year, were:

• over long-term economic cycles (typically 5 years or more), the achievement of the same return as that generated by the strategic allocation;

• over shorter periods, the Fund should perform better than the strategic allocation if markets fall significantly.

The Fund's benchmark comprises global equity, index-linked gilt and property indices. Over 2017/18, these returned +2.4%, -0.2% and +11.3% respectively.

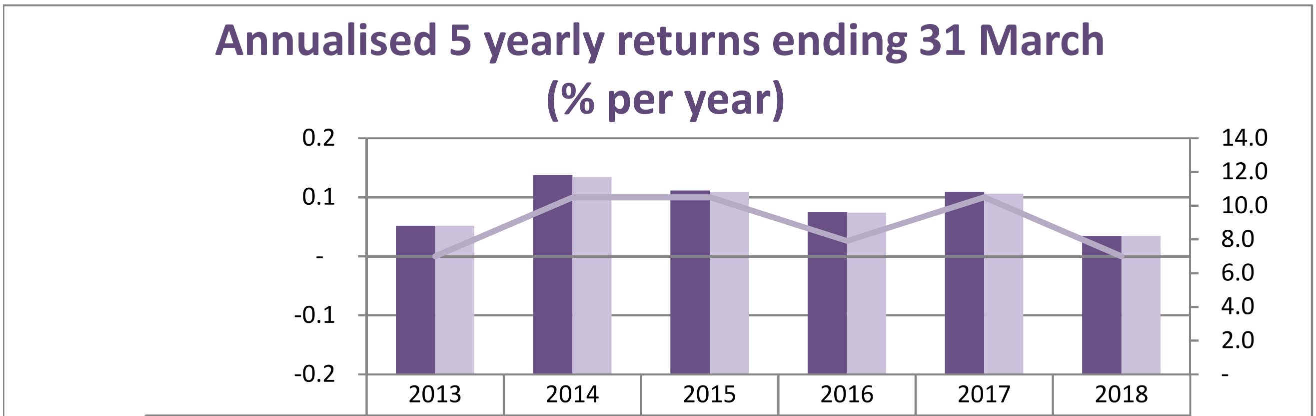
The Fund's annualised performance over the year and longer-term periods is shown in the table below.

Annualised returns to 31 March 2018 (% per year)	1 year	5 years	10 years
Scottish Homes Pension Fund	0.3	8.2	8.5
Benchmark	0.7	8.2	8.5
Actuarial Valuation Assumptions *	1.7	3.2	3.8
Retail Price Index (RPI)	3.3	2.3	2.8
Consumer Price Index (CPI)	2.4	1.4	2.3
National Average Earnings	2.4	2.6	1.6

* estimated

The Fund has performed in line with its strategic allocation (benchmark) over the long run. The difference between the Fund return and the benchmark over the last year reflects the fact that the equity allocation was invested in a portfolio of low risk shares that lagged the higher risk benchmark. This equity portfolio was funded during 2016/17 to generate higher income with which to pay pensions, following analysis of the Fund's cash flow requirements. Over 2017/18, it generated a significantly higher income yield (3.8%) than the benchmark (2.5%).
Now that the Fund has achieved full funding faster than expected and the Fund is fully invested in index-linked gilts to minimise funding level risk, it is appropriate to change the investment objectives.

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



	2013	2014	2015	2016	2017	2018
Fund	8.8	11.8	10.9	9.6	10.8	8.2
Benchmark	8.8	11.7	10.8	9.6	10.7	8.2
Relative (LHS)	-	0.1	0.1	0.0	0.1	-

Scottish Homes Pension Fund

Fund Account for year ended 31 March 2018

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

2016/17 £000		Note	2017/18 £000
	Income		
675	Contributions from the Scottish Government	***3***	675
-	Transfers from other schemes		-
675			**675**
	Less: expenditure		
6,789	Pension payments including increases		6,666
563	Lump sum retirement payments		767
-	Lump sum death benefits		4
120	Transfers to other schemes	***4***	47
68	Administrative expenses	***5b***	69
7,540			**7,553**
(6,865)	**Net withdrawals from dealing with members**		**(6,878)**
	Returns on investments		
877	Investment income	***6***	2,474
26,569	Change in market value of investments	***7, 10b***	(1,615)
(212)	Investment management expenses	***5c***	(165)
27,234	**Net returns on investments**		**694**
20,369	**Net increase/(decrease) in the Fund during the year**		**(6,184)**
150,275	**Net assets of the Fund at 1 April 2017**		170,644
170,644	**Net assets of the Fund at 31 March 2018**	***10***	**164,460**

Net Assets Statement as at 31 March 2018

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

31 March 2017 £000		Note	31 March 2018 £000
	Investment Assets		
127,970	Bonds		148,064
4,450	Equities - UK		-
23,771	- Overseas		-
7,998	Pooled investment vehicles - UK property		-
3,602	Cash Deposits		9,094
459	Other investment assets		4,904
160,252			**162,062**
	Investment Liabilities		
-	Other investment liabilities		-
-			-
160,252	**Net investment assets**	***8***	**162,062**
	Current assets		
146	The City of Edinburgh Council	***16***	194
2,232	Cash balances	***11, 16***	2,240
31	Debtors	***14***	12
2,409			**2,446**
	Current liabilities		
(15)	Creditors	***15***	(48)
(15)			**(48)**
2,394	**Net current assets**		**2,398**
162,646	**Net assets of the Fund at 31 March 2018**	***10***	**164,460**

JOHN BURNS FCMA CGMA

Chief Finance Officer, Lothian Pension Fund

Note to the net asset statement

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

1 Statement of Accounting Policies

The statement of accounting policies for all Funds can be found on page 114.

2 Events after the Reporting Date

There have been no events since 31 March 2018, and up to the date when these Financial Statements were authorised, that require any adjustments to these Financial Statements.

3 Contributions from the Scottish Government

	2016/17 £000	2017/18 £000
Deficit funding	575	575
Administration expenses	100	100
	675	675

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

Following the actuarial valuation at 31 March 2014, deficit funding of £575,000 per year is being paid by the Scottish Government over the period April 2015 to March 2018. In addition, the Scottish Government agreed to pay £100,000 every year towards the cost of ongoing administration. After 31 March 2017 actuarial valuation Scottish Government will not provide deficit funding for the period April 2018 to March 2021 but have agreed to pay £70,000 every year towards the administration of the Fund.

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

4 Transfers out to other pension schemes

	2016/17 £000	2017/18 £000
Group transfers	-	-
Individual transfers	120	47
	120	47

5a Total Management expenses

	2016/17 £000	2017/18 £000
Administrative costs	38	35
Investment management expenses	149	107
Oversight and governance costs	93	92
	280	234

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

5b Administrative expenses

	2016/17 £000	2017/18 £000
Employee costs	26	24
The City of Edinburgh Council - other support costs	3	-
System costs	7	8
Actuarial fees	24	30
External audit fees	1	1
Printing and postage	2	2
Depreciation	1	1
Office costs	3	2
Sundry costs less sundry income	1	1
	68	69

LPFE Ltd, which is a wholly owned subsidiary of the Council, is responsible for providing the staffing resource to administer the three pension Funds. The Division receives an allocation of the overheads of the Council. In turn the Division apportioned administration and investment costs to the three pension funds. Costs directly attributable to a specific fund are charged to the relevant Fund, costs that are common to all three funds are apportioned on a defined basis.

5c Investment management expenses

	2016/17 £000	2017/18 £000
External management fees - invoiced	50	-
External management fees - deducted from capital (direct)	55	54
External management fees - deducted from capital (indirect)	-	-
Transaction costs	40	30
Employee costs	29	31
Custody fees	14	7
Engagement and voting fees	2	2
Performance measurement fees	5	10
Consultancy fees	2	16
System costs	6	7
Legal fees	3	1
The City of Edinburgh Council - other support costs	3	-
Office costs	2	2
Sundry costs less sundry income	1	5
	212	165

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 7 - Reconciliation of movements in investments).

The Fund has not incurred any performance-related investment management fees in 2017/18 or 2016/17.

6 Investment income

	2016/17 £000	2017/18 £000
Income from fixed interest securities	536	1,449
Dividends from equities	62	799
Income from pooled investments - property	265	270
Interest on cash deposits and sundries	16	29
	879	2,547
Irrecoverable withholding tax	(2)	(73)
	877	2,474

7 Reconciliation of movement in investments

	Market value at 31 March 2017 £000	Purchases at cost £000	Sales & proceeds £000	Change in market value £000	Market value at 31 March 2018 £000
Bonds	127,970	33,345	(11,838)	(1,413)	148,064
Equities	28,221	932	(28,451)	(702)	-
Pooled investment vehicles	7,998	-	(8,621)	623	-
	164,189	34,277	(48,910)	(1,492)	148,064
Other financial assets / (liabilities)					
Cash deposits*	3,602			(123)	9,094
Investment income due/amounts payable*	459			-	4,904
	4,061			(123)	13,998
Net financial assets	168,250			(1,615)	162,062

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

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

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

** As per CIPFA disclosures the change in market value intentionally does not balance opening/closing market values*

8 Investment managers and mandates

Manager	Mandate	Market value at 31 March 2017 £000	% of total 31 March 2017 %	Market value at 31 March 2018 £000	% of total 31 March 2018 %
In-house	High Div Equity	29,037	17.3	87	0.1
Total global equities		29,037	17.3	87	0.1
In-house	UK Index linked gilts	128,477	76.4	148,858	91.9
Total fixed interest and	**inflation linked bonds**	128,477	76.4	148,858	91.9
Standard Life	Property	7,998	4.8	4,363	2.7
Total property		7,998	4.8	4,363	2.7
In-house	Cash	2,738	1.5	8,754	1.5
Total cash		2,738	1.5	8,754	1.5
Net financial assets		168,250	100.0	162,062	100.0

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

	Market value at 31 March 2017 £000	% of total 31 March 2017 %	Market value at 31 March 2018 £000	% of total 31 March 2018 %
UK Gov 4.125% Index Linked 22/11/17	10,955	6.4	21,410	13.0
UK Gov 2.5% Index Linked 17/07/24	10,637	6.2	12,431	7.6
UK Gov 2.5% Index Linked 16/04/20	10,538	6.2	12,309	7.5
UK Gov 1.875% Index Linked 22/11/22	10,517	6.2	12,530	7.6
UK Gov 1.125% Index Linked 22/11/27	9,003	5.3	11,149	6.8
UK Gov 1.125% Index Linked 22/11/37	7,800	4.6	12,465	7.6
UK Gov 1.25% Index Linked 22/11/27	11,905	7.0		-

10 Financial Instruments

10a Classification of financial instruments

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

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

10a Classification of financial instruments (cont)

Financial assets	31 March 2017 Designated as fair value through fund account £000	31 March 2017 Loans and receivables £000	31 March 2017 Financial liabilities at amortised cost £000	31 March 2018 Designated as fair value through fund account £000	31 March 2018 Loans and receivables £000	31 March 2018 Financial liabilities at amortised cost £000
Investment assets						
Bonds	127,970	-	-	148,064	-	-
Equities	28,221	-	-	-	-	-
Pooled investments	7,998	-	-	-	-	-
Cash	-	3,602	-	-	9,094	-
Other balances	-	459	-	-	4,904	-
	164,189	4,061	-	148,064	13,998	-
Other assets						
City of Edinburgh Council	-	146	-	-	194	-
Cash	-	2,232	-	-	2,240	-
Debtors	-	31	-	-	12	-
	-	2,409	-	-	2,446	-
Assets total	164,189	6,470	-	148,064	16,444	-
Financial liabilities						
Other liabilities						
Creditors	-	-	(15)	-	-	(48)
Liabilities total	-	-	(15)	-	-	(48)
Total net assets	164,189	6,470	(15)	148,064	16,444	(48)

	31 March 2017	31 March 2018
Total net financial instruments	170,644	164,460

10b Net gains and losses on financial instruments

	2016/17 £000	2017/18 £000
Designated as fair value through fund account	26,489	(1,492)
Loans and receivables	80	(123)
Financial liabilities at amortised cost	-	-
Total	26,569	(1,615)

10c Valuation of financial instruments carried at fair value

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

Level 1

Financial instruments at Level 1 are those where the fair values are derived from unadjusted quoted prices in active markets for identical assets or liabilities. Products classified as level 1 comprise quoted equities and unit trusts.

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

Level 2

Financial instruments at Level 2 are those where quoted market prices are not available; for example, where an instrument is traded in a market that is not considered to be active, or where valuation techniques are used to determine fair value and where these techniques use inputs that are based significantly on observable market data.

Level 3

Financial instruments at Level 3 are those where at least one input that could have a significant effect on the instrument's valuation is not based on observable market data. Such instruments would include unquoted equity investments, which are valued using various valuation techniques that require significant judgement in determining appropriate assumptions.

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

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

	31 March 2018			
	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
Investment assets				
Designated as fair value through fund account	-	148,064	-	148,064
Loans and receivables	13,998	-	-	13,998
Total investment assets	13,998	148,064	-	162,062
Investment liabilities				
Designated as fair value through fund account	-	-	-	-
Total investment liabilities	-	-	-	-
Net investment assets	13,998	148,064	-	162,062

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

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

11 Nature and extent of risk arising from financial instruments

Risk and risk management

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

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

Types of investment risk

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

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

The Fund manages these risks in a number of ways:

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

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

Sensitivity analysis

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

Asset type	Potential price movement (+ or -)
Index-Linked Gilts	11.0%
Cash	1.0%

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.

	Value at 31 March 2018 £000	% of fund %	Potential Change +/- %	Value on increase £000	Value on decrease £000
Index-Linked Gilts	148,856	91.9	11.0	165,157	132,555
Cash	13,204	8.1	1.0	13,334	13,074
Total [1]	162,060	100.0	10.1	178,491	145,629
Total [2]			10.1	178,387	145,733
Total [3]			9.1	176,847	n/a

[1] No allowance for correlations between assets

[2] Including allowance for correlations between assets

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

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

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

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.

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

Credit risk

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

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

Cash deposits are the major areas of credit exposure where credit risk is not reflected in market prices.

Cash deposits

At 31 March 2018, cash deposits represented £20.4m, 12.5% of total net assets. This was held with the following institutions:

	Moody's Credit Rating at 31 March 2018	Balances at 31 March 2017 £000	Balances at 31 March 2018 £000
Held for investment purposes			
Northern Trust Company - cash deposits	A2	3,602	1,077
The City of Edinburgh Council - treasury management	See below	-	8,017
		3,602	9,094
Held for other purposes			
The City of Edinburgh Council - treasury management	See below	2,232	2,240
Total cash		9,436	20,428

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

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

(a) UK Government and other UK local Authorities with no limit, other public bodies up to £20 million per organisation.

(b) Money market funds (MMFs) no more than £30 million or 15% with any one Fund.

(c) Financial Institutions: Banks and Building Societies with multiple criteria based on a range of short and long term credit ratings, as well as any security provided, from maximum of £60 million / 20% of assets under management (AUM) for institutions with the highest criteria to £10 million / 5% of AUM for institutions with the lowest acceptable criteria.

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

	Moody's Credit Rating at 31 March 2018	Balances at 31 March 2017 £000	Balances at 31 March 2018 £000
Money market funds			
Deutsche Bank AG, London	Aaa-mf	12	44
Standard Life Investments	Aaa-mf	-	1,520
Bank call accounts			
Bank of Scotland	A1	223	1,013
Royal Bank of Scotland	A3	3	37
Santander UK	Aa3	1	27
Barclays Bank	A1	-	1
HSBC Bank		-	4
Svenska Handelsbanken	Aa2	-	50
UK Pseudo-Sovereign risk instruments			
Other Local Authorities [1]	Aa1	1,993	7,561
UK Government Treasury Bills	Aa1	-	-
		2,232	10,257

[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 2018 was 'Aa1').

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

Refinancing risk

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

Liquidity risk

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

All of the Fund’s investments could be converted to cash within three months in a normal trading environment.

12 Actuarial statement

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

13 Actuarial present value of promised retirement benefits

The actuarial value of promised retirement benefits at the accounting date, calculated in line with International Accounting Standard 19 (IAS19) assumptions, is estimated to be £134m (2017 £145m). 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.

	31 March 2017 % p.a.	31 March 2018 % p.a.
Inflation/pensions increase rate	2.4%	2.4%
Discount rate	2.6%	2.7%

Longevity assumptions

The life expectancy assumption is based on Fund specific statistical analysis with improvements in line with the CMI 2016 model, assuming that the current rate of improvements has reached a peak and will converge to a long term rate of 1.75% p.a.. Based on these assumptions, the average future life expectancies, in years, at age 65 are summarised below:

	31 March 2017		31 March 2018	
	Males	Females	Males	Females
Current pensioners	24.5 years	25.4 years	22.4 years	24.8 years
Future pensioners (assumed to be currently 45)	26.8 years	28.6 years	24.8 years	27.8 years

Commutation assumption

An allowance is included for future retirements to elect to take 50% of the maximum additional tax-free cash up to HMRC limits for pre-April 2009 service and 75% of the maximum tax-free cash for post-April 2009 service.

14 Debtors

	31 March 2017 £000	31 March 2018 £000
Sundry debtors	31	12
	31	12

Analysis of debtors

	31 March 2017 £000	31 March 2018 £000
Administering Authority	1	1
Other entities and individuals	30	11
	31	12

15 Creditors

	31 March 2017 £000	31 March 2018 £000
Benefits payable	-	3
Miscellaneous creditors and accrued expenses	15	45
	15	48

Analysis of creditors	31 March 2017 £000	31 March 2018 £000
Other entities and individuals	15	48
	15	48

16 Related party transactions

The City of Edinburgh Council

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

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

Transactions between the Council and the Fund are managed via a holding account. Each month the Fund pays a cash sum to the Council leaving a working balance in the account.

	31 March 2017 £000	31 March 2018 £000
Year end balance of holding account	146	194
	146	194

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 2018, the fund had an average investment balance of £6.3m (2017 £2.1m). Interest earned was £29k (2017 £8k).

Year end balance on treasury management account	31 March 2017 £000	31 March 2018 £000
Held for investment purposes	-	8,011
Held for other purposes	2,232	2,240
	2,232	10,251

Scheme Guarantor

The scheme guarantor (by definition) is a related party to the scheme. The Scottish Government's contributions to the Fund can be found in note 3 (page 99) of the notes to the Financial Statements.

Governance

As at 31 March 2018, all members of the Pensions Committee, with the exception of Richard Lamont, and all members of the Pensions Board, were members of the Lothian Pension Fund or Lothian Buses Pension Fund, with one member of the Pensions Board in receipt of pension benefits from Lothian Pension Fund.

16 Related party transactions (cont)

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

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

Name	Position held	Accrued CETV as at 31 March 2017 £000	Accrued CETV as at 31 March 2018 £000
Stephen Moir*	Executive Director of Resources, City of Edinburgh Council	-	22
Hugh Dunn*	Head of Finance, City of Edinburgh Council	1,251	949
Katy Miller*	Head of Human Resources, City of Edinburgh Council **	29	51
Clare Scott*	Chief Executive, Lothian Pension Fund	221	270
Bruce Miller	Chief Investment Officer, Lothian Pension Fund	267	334
Struan Fairbairn	Chief Risk Officer, Lothian Pension Fund	46	64
John Burns	Chief Finance Officer, Lothian Pension Fund	538	624
Esmond Hamilton	Financial Controller, Lothian Pension Fund	200	238

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

** Appears due to being a Director in LPFE Ltd

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

	31 March 2017 £000	31 March 2018 £000
Short-term employee benefits	380	415
Post-employment benefits - employer pension contributions	78	85

Key management personnel employed by LPFE, had accrued pensions totalling £97,456 (1 April 2017: £81,825) and lump sums totalling £110,889 (1 April 2017: £100,185) at the end of the period.

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

17 Contingent assets/liabilities and contractual commitments

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

18 Impairment losses

No impairment losses have been identified during the year.

Scottish Homes Pension Fund

Actuarial Statement for 2017/18

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

Description of Funding Policy

The Administering Authority's Funding Strategy Statement (FSS), dated March 2018, states that a bespoke funding strategy has been adopted for the Fund.

The strategy aims for the Fund to be 100% solvent by 2044 using a discount rate based on government bonds. It includes target funding levels at each actuarial valuation. Contributions from the Scottish Government are determined by reference to the target funding levels. The deficit recovery period is 8 years.

As the Fund was well ahead of its Target Funding Level at the 2017 valuation, it took the decision to derisk its investment strategy and now invests 100% of its assets in index-linked gilts.

Funding Position as at the last formal funding valuation

The most recent actuarial valuation carried out under Regulation 60 of the Local Government Pension Scheme (Scotland) Regulations 2014 was as at 31 March 2017. This valuation revealed that the Fund's assets, which at 31 March 2017 were valued at £170.6 million, were sufficient to meet 104.7% of the liabilities (i.e. the present value of promised retirement benefits) accrued up to that date. The resulting surplus at the 2017 valuation was £7.7 million.

The Guarantor's contributions for the period 1 April 2018 to 31 March 2021 were set in accordance with the Fund's funding policy as set out in its FSS.

Principal Actuarial Assumptions and Method used to value the liabilities

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

Method

The liabilities were assessed using an accrued benefits method which takes into account pensionable membership up to the valuation date.

Assumptions

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

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

Financial assumptions	31 March 2017
Benefit increase assumption (CPI)	Bank of England nominal yield curve
Discount rate	Bank of England implied (RPI) curve less 1.0% p.a.

Actuarial Statement for 2017/18

The key demographic assumption was the allowance made for longevity. The life expectancy assumption was based on the Fund's Vita Curves alongside future improvements based on the CMI 2016 model with an allowance for smoothing of recent mortality experience and a long term rate of improvement of 1.75% p.a.

Based on these assumptions, the average future life expectancies at age 65 are as follows:

	Males	Females
Current Pensioners	24.5 years	25.4 years
Future Pensioners *	26.8 years	28.6 years

*Aged 45 as at 31 March 2017

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

Experience over the period since 31 March 2017

Asset returns over the period have been slightly higher than the valuation discount rate and real bond yields at 31 March 2018 are at a similar level to 31 March 2017. Combining the impact of these leads to a broadly similar overall funding position at 31 March 2018 compared to the last formal valuation.

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

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

27 April 2018

Statement of Accounting Policies and General Notes

1 Basis of preparation

The Financial Statements have been prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2017/18 which is based upon International Financial Reporting Standards (IFRS), as amended for the UK public sector.

The Financial Statements summarise the transactions of the Funds for the 2017/18 financial year and report on the net assets available to pay pension benefits as at 31 March 2018. The Financial Statements do not take account of obligations to pay pensions and benefits which fall due after the end of the financial year. The actuarial present values of promised retirement benefits, valued on an International Accounting Standard (IAS) 19 basis, are disclosed in the Notes to the Financial Statements.

2 Summary of significant accounting policies

General

a) Basis of consolidation

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

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

Further details of the consolidation are provided in the Notes to the Financial Statements of Lothian Pension Fund.

LPFE Limited and LPFI Limited are wholly owned by the City of Edinburgh Council in its capacity as administering authority for the Local Government Pension Scheme in the Lothian area. The purpose of LPFE Limited is to provide staff services in respect of management of the Funds. LPFI Limited's purpose is to provide FCA regulated services to the Funds and other Local Government Pension Scheme funds. It is considered appropriate to consolidate the Financial Statements of the two companies with those of Lothian Pension Fund.

Fund account - revenue recognition

b) Contribution income

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

Similarly, employer deficit funding contributions are accounted for on the due date on which they are payable as certified by the Scheme Actuary.

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

c) Transfers to and from other schemes

Transfer values represent the amounts received and paid during the year for members who have either joined or left the Funds during the financial year and are calculated in accordance with the Local Government Pension Scheme Regulations.

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

Transfers in from members wishing to use the proceeds of their additional voluntary contributions to purchase scheme benefits are accounted for on a receipts basis and are included in transfers in.

Bulk (group) transfers are accounted for on an accruals basis in accordance with the terms of the transfer agreement.

d) Investment income

i) Interest income

Interest income is recognised in the Funds accounts as it accrues, using the effective interest rate of the financial instrument as at the date of acquisition or origination. Income includes the amortisation of any discount or premium, transaction costs or other differences between the initial carrying amount of the instrument and its amount at maturity calculated on an effective interest rate basis.

ii) Dividend income

Dividend income is recognised on the date the shares are quoted ex-dividend. Any amount not received by the end of the reporting period is disclosed in the Net Assets Statement as a current financial asset.

iii) Distributions from pooled funds

Distributions from pooled funds are recognised at the date of issue. Any amount not received by the end of the reporting period is disclosed in the Net Assets Statement as a current financial asset.

iv) Income from unquoted private equity and infrastructure investments

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

v) Property related income

Property-related income consists primarily of rental income. Rental income from operating leases on properties owned by Lothian Pension Fund is recognised on a straight-line basis over the term of the lease. Any lease incentives granted are recognised as an integral part of the total rental income, over the term of the lease.

Rental income is reported gross with the operational costs of the properties included in investment management expenses.

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

vi) Movement in the net market value of investments

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

Fund Account - expense items

e) Benefits payable

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

f) Taxation

i) Pension Funds

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

ii) Controlled entities - LPFE Limited and LPFI Limited

The Companies are mutual traders and are therefore not liable to corporation tax on any surpluses generated from services provided in respect of the Funds. The tax charges for the period are based on any profit for the period from non-mutual trade, adjusted for any non-assessable or disallowed items. They are calculated using tax rates that have been enacted or are substantively enacted by the period end date.

Deferred tax is accounted for using the balance sheet liability method in respect of temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the Financial Statements. No deferred tax will be recognised from the initial recognition of an asset or liability, excluding a business combination, where there is no effect on accounting or taxable profit or loss.

Deferred tax is calculated at the tax rates that are expected to apply to the period when the asset is realised or liability is settled. Deferred tax is credited in the income statement except where it relates to items that may be credited directly to equity, in which case the deferred tax is adjusted directly against equity.

Deferred tax assets are recognised to the extent that it is probable that future profits will be available against which deductible temporary differences can be utilised.

The amount of benefit brought to account or which may be realised in the future is based on the assumption that no adverse change will occur in income taxation legislation and the anticipation that the economic entity will derive sufficient future assessable income to enable the benefit to be realised and comply with the conditions of deductibility imposed by the law.

g) Administrative expenses

All administrative expenses are accounted for on an accruals basis. The Lothian Pension Fund is responsible for administering the three Funds. The costs include charges from LPFE Limited and LPFI Limited for services rendered. The Fund receives an allocation of the overheads of the Council, this is based on the amount of central services consumed. In turn, these costs are allocated to the three Funds.

Costs directly attributable to a specific fund are charged to the relevant Fund. Investment management costs that are common to all three Funds are allocated in proportion to the value of the Funds as at the end of the year. Other administration costs are allocated in proportion to the number of members in each of the Funds at the end of the year.

h) Investment management expenses

All investment management expenses are accounted for on an accruals basis.

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

The cost of administering the Local Government Pension Scheme in the UK has come under increasing scrutiny in recent years. As a result, it has been decided to recognise investment management costs that are deducted from the value of an investment and recognised this as a cost in the Fund Account rather than as a reduction in the change in market value of investments. Investment transaction costs that are added to an investment purchase price or deducted from the proceeds of a sale are also recognised as a cost in the Fund Account rather than as a reduction in the change in market value of investments.

In June 2016, CIPFA revised and updated its guidance “Accounting for Local Government Pension Scheme Management Costs”. Whilst the underlying principle of transparency of investment costs remains unchanged, there has been a degree of relaxation to full cost disclosure. Specifically, for complex “fund of funds” structures, the new guidance states that “Investment costs incurred by a separate legal entity, or in respect of investment decisions over which the pension fund has no control, should not be included in the (Pension) Fund Account......If pension funds wish to provide information about the total cost of “fund of fund” investments, this should be included as part of the Investments section in the Annual Report”.

The impact of this is that investment management costs deducted from any underlying fund in a "fund of funds" investment would not be included in the costs disclosed in the Fund Account. As this would significantly under-report investment management costs the decision has been made not to adopt this element of the CIPFA guidance. However, this type of cost is separately identified as "external management fees - deducted from capital (indirect)" in the notes on investment management expenses.

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

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

The costs of the in-house investment management team are charged to the Funds. The basis of allocation is as described in section g.

Securities lending revenue is reported gross and their fees are disclosed in investment management expenses.

i) Operating lease

Lease payments under an operating lease are recognised as an expense on a straight-line basis over the term of the lease. In accordance with Standard Interpretations Committee (SIC) 15, subsequently endorsed by the International Accounting Standards Board (IASB), lease incentives are recognised as a reduction in the lease expense over the term of the lease on a straight-line basis.

Net Assets Statement

j) Financial assets

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

The values of investments as shown in the Net Assets Statement have been determined at fair value in accordance with the requirements of the Code and IFRS13. For the purposes of disclosing levels of fair value hierarchy, the Funds has adopted the classification guidelines recommended in Practical Guidance on Investment Disclosures (PRAG/Investment Association, 2016).

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

Description of asset	Valuation hierarchy	Basis of valuation	Observable and unobservable inputs	Key sensitivity affecting the valuations provided
Market quoted investments - Equities	Level 1	Closing bid value on published exchanges	Not required	Not required
Exchange traded pooled investments	Level 1	Closing bid value on published exchanges	Not required	Not required
Future derivative contracts	Level 1	Determined using exchange prices at the reporting date. Amounts due from or owed to the broker are the amounts outstanding in respect of the initial margin and variation margin.	Not required	Not required

Description of asset	Valuation hierarchy	Basis of valuation	Observable and unobservable inputs	Key sensitivity affecting the valuations provided
Forward foreign exchange derivatives	Level 1	Based on market forward exchange rates at the year-end date and determined as the gain or loss that would arise if the outstanding contract were matched at the year-end with an equal and opposite contract.	Not required	Not required
Government bonds - fixed interest / index linked gilts	Level 2	Recorded at net market value based on their current yields.	Evaluated price feeds	Not required
Freehold and leasehold properties	Level 3	Valued at fair value at the year-end using the investment method of valuation by John Symes-Thompson FRICS of independent valuers, CBRE Ltd in accordance with RICS Valuation – Global Standards 2017	Existing lease terms and rentals. Independent market research. Nature of tenancies. Covenant strength for existing tenants. Assumed vacancy levels. Estimated rental growth. Discount rate	Significant changes in rental growth, vacancy levels or the discount rate could affect valuations as could more general changes to market price
Unquoted Pooled investments – Private Equity, Infrastructure, Timber, Private Secured Loans & Property	Level 3	Comparable valuation of similar companies in accordance with International Private Equity and Venture Capital Guidelines (2015)	EBITDA multiple Revenue multiple. Discount for lack of marketability. Control premium.	Valuations could be affected by material events occurring between the date of the financial statements provided and the Funds' own reporting date, by changes to expected cashflows, and by any differences between audited and unaudited accounts.

Sensitivity of assets valued at level 3

Having analysed historical data and current market trends, and consulted with independent investment advisers, the Funds have determined that the valuation methods described above are likely to be accurate to within the following ranges, and has set out below the consequent potential impact on the closing value of investments held at 31 March 2018.

Lothian Pension Fund Unquoted	Assessed Valuation range (+ or -)	Value at 31 March 2018 £m	Value on increase £m	Value on decrease £m
Private Equity	30%	90.4	117.5	63.3
Infrastructure	12%	727.6	814.9	640.3
Timber	18%	111.4	131.5	91.3
Private Secured Loans	10%	133.2	146.5	119.9
Property	13%	459.3	519.0	399.6
		1,403.9	1,643.6	1,163.6

Lothian Buses Pension Fund Unquoted	Assessed Valuation range (+ or -)	Value at 31 March 2018 £m	Value on increase £m	Value on decrease £m
Infrastructure	12%	45.6	51.1	40.1
Timber	18%	6.8	8.0	5.6
Private Secured Loans	10%	10.0	11.0	9.0
		54.3	63.4	45.2

Scottish Homes Pension Fund has no assets valued at Level 3.

k) Foreign currency transactions and balances

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

l) Cash and cash equivalents

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

m) Financial liabilities

The Funds recognise financial liabilities at fair value as at the reporting date. A financial liability is recognised in the Net Assets Statement on the date the Funds becomes party to the liability. From this date, any gains or losses arising from changes in the fair value of the liability are recognised.

n) Actuarial present value of promised retirement benefits

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

As permitted under IAS26, the Funds have opted to disclose the actuarial present value of promised retirement benefits by way of a note to the Net Assets Statements.

o) Additional voluntary contributions

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

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

p) Contingent assets and contingent liabilities

A contingent liability arises where an event has taken place prior to the year-end giving rise to a possible financial obligation whose existence will only be confirmed or otherwise by the occurrence of future events. Contingent liabilities can also arise in circumstances where a provision would be made, except that it is not possible at the balance sheet date to measure the value of the financial obligation reliably.

A contingent asset arises where an event has taken place giving rise to a possible asset whose existence will only be confirmed or otherwise by the occurrence of future events.

Contingent assets and liabilities are not recognised in the Net Assets Statement but are disclosed by way of narrative in the notes.

q) Employee benefits

The employees of LPFE Limited are eligible to participate in Lothian Pension Fund.

In the Consolidated Financial Statements, the current service cost for the period is charged to the Fund Account. The assets of Lothian Pension Fund are held separately from those of the Company. The Company has fully adopted the accounting principles as required by IAS19 – Employee Benefits.

The liability recognised in the Net Asset Statement in respect of the defined benefit pension plan is the present value of the defined benefit obligation at the end of the reporting period less the fair value of plan assets, together with adjustments for unrecognised past-service costs. The defined benefit obligation is calculated annually, by the Scheme Actuary, using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that are denominated in a currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension obligations.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to the Fund Account in the period in which they arise.

Past-service costs are recognised immediately in the Fund Account, unless the changes to the pension plan are conditional on the employees remaining in service for a specified period of time (the vesting period). In this case, the past-service costs are amortised on a straight-line basis over the vesting period.

3 **Accounting Standards that have been issued but not yet adopted**

The Code requires the disclosure of information relating to the impact of an accounting change that will be required by a new standard that has been issued but not yet adopted. This applies to the adoption of the following new or amended standards within the 2017/18 Code:

The Code requires implementation from 1 April 2018 and there is therefore no impact on the 2017/18 financial statements.

- IFRS 9 Financial Instruments
- IFRS 15, Revenue from Contracts with Customers including amendments to IFRS 15 Clarifications to IFRS 15 Revenue Contracts with Customers
- amendments to IAS 12 Income Taxes: Recognition of Deferred Tax Assets for Unrealised Losses
- amendments to IAS 7 Statement of Cash Flows: Disclosure Initiative

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

4 Critical judgements in applying accounting policies

Unquoted private equity and infrastructure investments

It is important to recognise the highly subjective nature of determining the fair value of private equity and infrastructure investments. They are inherently based on forward-looking estimates and judgements involving many factors. These valuations are prepared in accordance with the International Private Equity and Venture Capital Valuation Guidelines or similar guidelines provided by the British Venture Capital Association, which follow the valuation principles of IFRS.

For the Lothian Pension Fund, the value of unquoted private equity, infrastructure, timber and secured loan investments at 31 March 2018 was £1,062.5m (2016 £1,014.2m).

For the Lothian Buses Pension Fund, the value of unquoted private equity, infrastructure and timber investments at 31 March 2018 was £62.5m (2017 £54.3m).

Actuarial present value of promised retirement benefits

Each Fund is required to disclose the estimated actuarial present value of promised retirement benefits as at the end of the financial year. These estimates are prepared by the Funds' Actuary. These values are calculated in line with International Accounting Standard 19 (IAS19) assumptions and comply with the requirements of IAS26. However, the results are subject to significant variances based on changes to the underlying assumptions.

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

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

The Financial Statements contain estimated figures that are based on assumptions made by the Council; private equity and infrastructure managers; other providers of valuation information; and the Scheme Actuary about the future or that are otherwise uncertain. Estimates are made taking into account historical experience, current trends and other relevant factors. However, because amounts cannot be determined with certainty, actual results could be materially different from the assumptions and estimates.

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

a) Actuarial present value of promised retirement benefits

Uncertainties

Estimation of the net liability to pay pensions depends on a number of complex judgements relating to the discount rate used, the rate at which salaries are projected to increase, changes in retirement ages, mortality rates and expected returns on the Funds' assets. The Funds' Actuary advises on the assumptions to be applied and prepares the estimates.

Effect if actual results differ from assumptions - Lothian Pension Fund

The effects on the net pension liability of changes in individual assumptions can be illustrated as follows:

Change in assumptions - year ended 31 March 2018	Approx % increase in liabilities %	Approx monetary amount £m
0.5% decrease in the real discount rate	10	814
1 year increase in member life expectancy	4	334
0.5% increase in salary increase rate	2	167
0.5% increase in pensions increase rate	7	582

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 2018	Approx % increase in liabilities %	Approx monetary amount £m
0.5% decrease in the real discount rate	10	48
1 year increase in member life expectancy	4	20
0.5% increase in salary increase rate	2	10
0.5% increase in pensions increase rate	7	48

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 2018	Approx % increase in liabilities %	Approx monetary amount £m
0.5% decrease in the real discount rate	5	7
1 year increase in member life expectancy	4	6
0.5% increase in pensions increase rate	5	7

b) Valuation of unquoted private equity and infrastructure investments

Uncertainties

These investments are not publicly listed and therefore there is a degree of estimation involved in their valuation, see 2j above for more details on the valuation methodology.

Effect if actual results differ from assumptions

There is a risk that these investments may be under or overstated in the accounts at any point in time. The actual financial return of this type of investment is only known with certainty when they reach the end of their lifecycles and the final distributions are made to investors. A sensitivity analysis can be found in note 2j above.

c) Quantifying the cost of investment fees deducted from capital

Uncertainties

Section 2 h) describes the accounting policy for investment management expenses in relation to expenses deducted from the capital value of investments. Quantification of these costs involves asking the relevant managers for information and only some of this information can be independently verified. In cases where the charges relate to an investment as a whole, an estimate needs to be made of the costs applicable to the holding owned by the relevant Fund.

Effect if actual results differ from assumptions

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

Statement of responsibilities for the Annual Accounts

The responsibilities of the Administering Authority

The Administering Authority's responsibilities require it to:

- Make arrangements for the proper administration of the financial affairs of the Funds in its charge and to secure that one of its officers has the responsibility for the administration of those affairs. The Head of Finance serves as the Section 95 Officer for all the Council's accounting arrangements, including those of Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund. For the Funds, this Section 95 responsibility has been delegated to the Chief Finance Officer, Lothian Pension Fund.
- Manage its affairs to secure economic, efficient and effective use of its resources and safeguard its assets.
- Ensure the Annual Accounts are prepared in accordance with legislation (The Local Authority Accounts (Scotland) Regulations 2014) and, so far as is compatible with that legislation, in accordance with proper accounting practices (section 12 of the Local Government in Scotland Act 2003).
- Approve the Audited Annual Accounts for signature.

HUGH DUNN
Head of Finance of The City of Edinburgh Council
June 2018

The responsibilities of the Chief Finance Officer, Lothian Pension Fund

The Chief Finance Officer, Lothian Pension Fund, is responsible for the preparation of the Funds' Financial Statements which, in terms of the CIPFA / LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2017/18 (the Code of Practice), is required to present a true and fair view of the financial position of the Funds at the accounting date and their income and expenditure for the year (ended 31 March 2018).

In preparing this statement of accounts, the Chief Finance Officer, Lothian Pension Fund, has:

- Selected suitable accounting policies and then applied them consistently
- Made judgements and estimates that were reasonable and prudent
- Complied with the Code of Practice.

The Chief Finance Officer, Lothian Pension Fund, has also:

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

The Statement of Accounts presents a true and fair view of the financial position of the Funds as at 31 March 2018, and their income and expenditure for the year ended 31 March 2018.

JOHN BURNS, FCMA CGMA
Chief Finance Officer of Lothian Pension Fund
June 2018

Annual Governance Statement

Roles and responsibilities

The City of Edinburgh Council (the Council) has statutory responsibility for the administration of the Local Government Pension Scheme (LGPS) in the Lothian area of Scotland. This responsibility is for three separate funds: the Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund (the Funds). The Lothian Pension Fund group comprises the investment and pensions team employed by LPFE Limited (LPFE) supporting the Council in its separate statutory capacity as the administering authority of the Funds (Administering Authority) and LPFI Limited (LPFI), the groups regulated investment vehicle (together the LPF Group).

The main functions of the Administering Authority are administration of scheme benefits and the investment of the assets of the Funds. These functions are conducted in accordance with the Local Government Pension Scheme (Scotland) Regulations which are statutory instruments made under the Superannuation Act 1972. The role of Administering Authority is carried out via:

- the Pensions Committee and the Pensions Audit Sub-Committee;
- the Pension Board;
- the Joint Investment Strategy Panel; and
- the LPF Group.

Further details on the above arrangements can be found in the Governance section of the Management Commentary towards the front of this document.

Scope of responsibility

As the Administering Authority of the Funds, the Council is responsible for ensuring that its business in administering the Funds, is conducted in accordance with the law and appropriate standards, and that monies are safeguarded, properly accounted for, and used economically, efficiently and effectively. The Council also has a statutory duty under the Local Government in Scotland Act 2003, to make arrangements to secure best value, which is defined as continuous improvement in the way its functions are carried out.

In discharging these overall responsibilities, elected members, senior officers and external representatives are responsible for implementing effective arrangements for governing the affairs of the LPF Group, and facilitating the effective exercise of its functions, including arrangements for the management of risk. The Pensions Committee oversees the operational administration of the Funds by the LPF Group.

The LPF Group has adopted a Local Code of Corporate Governance that is consistent with the principles of the Chartered Institute of Public Finance and Accountancy (CIPFA) and Society of Local Authority Chief Executives (SOLACE) framework 'Delivering Good Governance in Local Government'. This statement explains how the LPF Group has complied with the Local Code of Corporate Governance and how it meets the CIPFA Code of Practice on Local Authority Accounting in the United Kingdom.

The governance framework

The LPF Group operates within the wider governance framework of the Council but within specific ringfenced governance structures focused on the Funds themselves. The governance framework comprises the systems, processes, cultures and values by which the LPF Group directs and controls the Funds. It also describes the way the LPF Group engages with and accounts to its stakeholders in relation to the management of the administration of the Funds. It enables the LPF Group to monitor the achievement of its objectives and consider whether those objectives have led to the delivery of appropriate, cost-effective services. The framework also applies to any subsidiary companies which are members of the LPF Group, namely LPFI and LPFE. The LPF Group is also directly regulated by The Pensions Regulator, the Financial Conduct Authority (regarding its regulated investment activity), the Scottish Information Commissioner and is subject to other corporate and public sector rules and regulations.

The LPF Group's ongoing compliance with its governance framework and regulatory obligations is monitored on an ongoing basis by the Pensions Committee, the Audit Sub-Committee and the Pension Board.

The wider Council's Local Code of Corporate Governance is regularly reviewed and considered by the Governance, Risk & Best Value Committee. It has implemented arrangements for monitoring each element of the framework and providing evidence of compliance. The Council's Democracy, Governance and Resilience Senior Manager reviewed the arrangements and is satisfied that the Code continues to be adequate and effective. Internal Audit has also reviewed the annual assurance questionnaire process in relation to Arms-Length Companies and has found that this provides the Chief Executive with a level of assurance on the adequacy of the governance arrangements. The Council's Corporate governance framework meets the principles of effective governance.

The LPF Group places reliance upon certain of the internal financial controls within the Council's financial systems and the monitoring in place to ensure the effectiveness of these controls. The relevant key elements of the LPF Group and the Funds governance framework within the Council, include:

- Identifying the objectives of the Funds in the Funding Strategy Statement, Statement of Investment Principles and Service Plan.
- Since April 2015, The Pensions Regulator has been responsible for setting standards of governance and administration for the Local Government Pension Scheme. The LPF Group has taken steps to fully integrate compliance with these standards within the overall governance framework.
- A systematic approach to monitoring service performance by the Pensions Committee, Pensions Audit Sub-Committee, Pension Board (each including external stakeholder representation), Independent Professional Observer and senior officers.
- A structured programme to ensure that Pensions Committee and Pension Board members have the required standard of knowledge and understanding of Local Government Pension Scheme matters.
- Operating within clearly established investment guidelines defined by the Local Government Pension Scheme Investment Regulations and the Funds' Statement of Investment Principles.
- Compliance with the CIPFA Principles for Investment Decision Making and Disclosure in the Local Government Pension Scheme.
- With the exception of managed funds, unlisted investments and property, all investments are held under custody by a global custodian. The Funds benefit from the custodian's extensive internal control framework.
- Benchmarking of services in terms of standards and cost against other pension funds.
- LPFE and LPFI operating within their respective constitutional documentation and the relevant companies regulations.
- LPFI operating within the relevant governance policies and procedures to ensure compliance with the Financial Conduct Authority's rules, regulations and guidance.

- For LPF Group and Fund matters, the Pensions Committee, Pensions Audit Sub-Committee and Pension Board are responsible for scrutiny and challenge and a quarterly risk reporting process is in place to ensure full consideration of such matters.
- Officers of the LPF Group are managed separately through the processes and procedures of LPFE, overseen by its board of directors, with terms and conditions and a human resources performance review and management strategy tailored to the express needs of the Funds and their stakeholders.
- The directors of LPFE and LPFI have obligations to report to the Pensions Committee as the governing body for the Funds and Council in being the sole shareholder. In addition, the board and staff of LPFI are each individually regulated by the Financial Conduct Authority and so bound by the associated Principles and Standards of governance best practice.

Elements of the governance framework of the Council that are relevant to the LPF Group and Funds include:

- The Council is embedding a culture of commercial excellence to ensure that its services always deliver Best Value. That is ongoing and seeks to improve standards in buying practices and processes across the Council including, to the extent applicable, the LPF Group and the Funds which bear the cost of its operation and administration.
- The submission of reports, findings and recommendations from the external auditor, other inspectorates and internal audit, to the Pensions Committee, Pensions Audit Sub-Committee for all matters affecting the LPF Group and Funds and, in certain circumstances strictly for Council wide oversight purposes, the Corporate Leadership Group, Governance, Risk and Best Value Committee and wider Council.
- The roles and responsibilities of Elected Members and Officers are defined in Procedural Standing Orders, Committee Terms of Reference and Delegated Functions, Contract Standing Orders, Scheme of Delegation to Officers, the Member/officer protocol and Financial Regulations. These are subject to annual review.
- The Chief Executive has overall responsibility to Council, for all aspects of operational management and overall responsibility for ensuring the continued development and improvement of systems and processes concerned with ensuring appropriate direction, accountability and control.
- The Section 95 Officer has overall responsibility for ensuring appropriate advice is given to the Council and the LPF Group on all financial matters, keeping proper financial records of accounts and maintaining an effective system of internal financial control. For the Funds, the Section 95 officer responsibility has been sub-delegated to the Chief Finance Officer of the LPF Group.
- The Chief Internal Auditor has overall responsibility to review, appraise and report to management and the Governance, Risk and Best Value Committee, and for matters relating to the LPF Group and Funds to the Pensions Committee and Pensions Audit Sub-Committee, on the adequacy of relevant internal control and corporate governance arrangements and on risks relating to approved policies, programmes and projects.
- The Council's Democracy, Governance and Resilience Manager, reporting to the Head of Strategy and Insight, has responsibility for advising the Council on corporate governance arrangements and supports the LPF Group on certain aspects of its governance arrangements.
- The Governance, Risk and Best Value Committee, and for LPF Group and Fund matters the Pensions Committee and Pensions Audit Sub-Committee, provides the Council with independent assurance of the adequacy of the governance and risk management frameworks and internal control environment. Also providing independent scrutiny of financial and non-financial performance, approving and monitoring the progress of the Internal Audit risk based plan, and monitoring performance of the internal audit service.
- The risk management policy and framework set out the responsibilities of elected members, Governance, Risk and Best Value Committee, and for LPF Group and Fund matters the Pensions Committee and Pensions Audit Sub-Committee, management and staff for the identification and management of risks to corporate and service related priorities;
- The Resources Senior Management Team Risk Register and Council Risk Register all identify risks and proposed treatment and actions. These registers are regularly reviewed, updated and reported to the

Corporate Leadership Group, which reviews Council-wide risk and reports to the Governance, Risk and Best Value Committee for scrutiny and challenge.

- Resilience and business continuity plans are in place for all essential Council services. These set out arrangements for continuing to deliver essential services in the event of an emergency or other disruption.
- Senior management and Heads of Service have formal objectives, with performance reviewed by the appropriate chief officer. Officers have personal work objectives, and receive feedback on their performance through the Council-wide performance review and development process.
- An Elected Members remuneration and expenses scheme is in place and is consistent with the Scottish Government's 'Councillors Remuneration: allowances and expenses – Guidance'. Information on the amounts and composition of elected members salaries, allowances and expenses is published on the Council's website.
- The Council's Governance and Democratic Services Manager ensures that induction training on roles and responsibilities, and ongoing development opportunities, are provided for Elected Members. A separate policy on Pensions Committee and Pension Board member training has been adopted and is overseen by the LPF Group's officers.
- Mandatory training for Councillors newly appointed to the Pensions Committee is programmed within the Induction and Training programme for Elected Members. This focuses on governance, investment management and strategy and how the LPF Group and Funds work. Committee members are reminded of the requirement to undertake a minimum of 21 hours of training per financial year to fulfil their role on the Pensions Committee.
- Codes of Conduct, that set out the standards of behaviour expected from Elected Members and officers, are in place.
- The Employee Code of Conduct, Anti Bribery Policy and Policy on Fraud Prevention set out the responsibilities of officers and Elected Members in relation to fraud and corruption, and are reinforced by the Councillors' Code of Conduct, the Code of Ethical Standards and the Financial Regulations. The LPF Group has adapted policies to take into account the specific nature of its business and regulation.
- The Whistleblowing policy provides a process for disclosure in the public interest about the Council and its activities by officers, Elected Members and others. The LPF Group has an adapted policy to take into account the specific nature of its business and regulation.
- A Register of Members' Interests and Registers of Officers' interests are maintained and available for public inspection.

A significant element of the governance framework is the system of internal controls, which is based on an ongoing process to identify and prioritise risks to the achievement of the Council's objectives, including those relevant to the LPG Group and Funds. Following the establishment of the wholly-owned subsidiary companies, LPFE and LPFI, the Council continues to have appropriate assurance processes and procedures in relation to the responsible officers involved in the administration of those companies and so the wider LPF Group administering the Funds.

Review of Effectiveness

The Local Code of Governance details the Council's arrangements for monitoring each element of the framework and providing evidence of compliance. The Council's Governance and Democratic Services Manager has reviewed the effectiveness of the Code.

The Chief Internal Auditor has also provided an assurance statement on the effectiveness of the system of internal control. The opinion in the assurance statement states: "Internal Audit considers that significant enhancements are required to the LPF control environment and governance and risk management frameworks, and is raising a 'red' rated opinion, with our assessment towards the middle of this category."

In compliance with standard accounting practice, the Head of Finance, of the City of Edinburgh Council has provided the Chief Executive with a statement of the effectiveness of the Group's internal financial control system for the year ended 31st March 2018. It is the Head of Finance's opinion that "reasonable assurance can be placed upon the adequacy and effectiveness of the Group's systems of internal control".

The Chief Finance Officer of the LPF Group has provided a statement of the effectiveness of the internal financial control system for the year ended 31st March 2018 for the Funds. It is the Chief Finance Officer's opinion "that based on internal audit work undertaken during the year, has highlighted a need for significant enhancements to the control environment and associated governance and risk management frameworks. The control improvements implicit in this opinion will be examined and corresponding required improvements as they relate to financial systems implemented as a matter of urgency."

Certification

It is our opinion, in light of the foregoing, that reasonable assurance can be placed upon the adequacy and effectiveness of the systems of governance that operate within the LPF Group in its administration of the Funds. We consider the governance and internal control environment operating during the financial year from 1 April 2017 to 31 March 2018 to provide reasonable and objective assurance that any significant risks impacting on the LPF Group and its ability to achieve its objectives in properly administering the Funds have and will continue to be identified and suitably proportionate actions have and will be taken to avoid or mitigate the impact of any such risks.

The LPF Group has identified certain key areas for improvement, summarised as follows:

- ICT: Continuing to engage with ICT service provider and the City of Edinburgh Council to monitor and drive improvements in the ICT services which the LPF Group receives, whilst in tandem continuing to assess the position around the LPF Group procuring a separate ICT provider to solely and independently service its specific ICT requirements in support of its strategic business plan.
- Human resources: To continue to implement the new human resources strategy specific to LPF Group's requirements.
- Independent professional observer: To appoint a replacement Independent Professional Observer in support the work and governance of the Pensions Committee and the Pension Board.
- Pension Board: To ensure that vacancies in the Pension Board are filled timeously and by suitable candidates and that this body of external stakeholder representatives receives the training and support that it requires on an ongoing basis.
- Business continuity: To continue to assess and refresh the business continuity plan on an ongoing basis ensuring sufficient engagement with staff.
- Information governance: Having completed a full information governance compliance project prior to the implementation of new data protection laws on 25 May 2018, to continue to implement ongoing actions to ensure continuing best practice information governance and security within the LPF Group, including monitoring and engaging with third party suppliers where appropriate.
- Financial services regulatory compliance: To continue to instruct external compliance audits on the operations and governance of LPFI in order to ensure best practice compliance and assurance around its existing operations (and in preparation for its extended collaborative business model) and take action to address the recommendations from those audits on an ongoing basis.
- Wider governance: To continue to maintain and reinforce separate governance and controls specific to the needs of the LPF Group, the pensions funds it administers and its distinct duties to employer and member stakeholders; consistently throughout the LPF Group's governance structures. To ensure that oversight by the City of Edinburgh Council is supported in a manner consistent with these duties.

The LPF Group will ensure that these are treated as a priority and that progress towards implementation will be reviewed through the governance structures and processes established for the LPF Group and summarised herein.

ANDREW KERR	**STEPHEN MOIR**	**CLARE SCOTT**
Chief Executive	**Executive Director of Resources**	**Chief Executive**
The City of Edinburgh Council	**The City of Edinburgh Council**	**Lothian Pension Fund**
June 2018	**June 2018**	**June 2018**

Governance Compliance Statement

The Regulations that govern the management of Local Government Pension Scheme in Scotland require that a Governance Compliance Statement is published. This statement sets out the extent to which governance arrangements comply with best practice.

The statement below describes arrangements at 31 March 2018 and over the financial year.

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 Council elected members - Two external members, one drawn from the membership of the Funds and one drawn from the employers that participate in the Funds.
Structure	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. Fund members and employers are also represented within the Funds' Pension Board. Membership includes five employer representatives and five member representatives. All members of the Pension Board are invited to attend the meeting of the Pensions Committee and receive the relevant papers prior to those meetings. Two members of the Pension Board attend the Pensions Audit Sub-Committee.

Principle		Full Compliance	Comments
Structure	That where a secondary committee or board 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. Two members of the Pension Board attend the Pensions Audit Sub-Committee in a non-voting capacity. The Pension Board attends the Pensions Committee meetings and takes part in training events. Implementation of investment strategy is delegated to the Executive Director of Resources who then delegates to the Head of Finance, who takes advice from the Joint Investment Strategy Panel. The Panel meets quarterly and reports to the Pensions Committee annually. The Joint Investment Strategy Panel consists of the Head of Finance of the City of Edinburgh Council and the Chief Executive Officer, Chief Finance Officer, Chief Investment Officer of the LPF Group plus three experienced external industry advisers. The Pensions Committee receives annual updates from LPFE and LPFI.
Representation	That all key stakeholders are afforded the opportunity to be represented within the main or secondary committee structure. These include employing authorities (including non-scheme employers, e.g. admitted bodies) and scheme members (including deferred and pensioner scheme members).	Yes	The Pension Board consists of a mix of representatives: - Five employer representatives from non-administering authority employers; - Five member representatives appointed by the Trade Unions in accordance with the approach required under Scottish statute.

Principle		Full Compliance	Comments
Representation	Where appropriate, independent professional observers, and expert advisers (on an ad-hoc basis).	Yes	An Independent Professional Observer was appointed in March 2013 to help Committee scrutinise advice. This contract expired in February 2018 and a selection process is underway to reappoint this role. As above, external investment advisers sit on the Joint Investment Strategy Panel. A separate specialist Pensions Audit Sub-Committee consisting of three members (including at least two elected members from the City of Edinburgh Council) undertake the audit scrutiny of the funds. A non-executive director was appointed to the board of LPFI on 7 February 2017 and LPFE on 19 March 2018. An external compliance consultant supports the LPF Group on its ongoing compliance with the Financial Conduct Authority rules, regulations and guidance.
	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 Pension Board attends the Pensions Committee meetings to help ensure that the operation of the pension funds is in accordance with the applicable law and regulation. The Pension Board takes part in all Committee training events. The Pensions Committee takes account of the views of the Pension Board when making decision.
Selection and Role of Lay Members	That committee or board members are made fully aware of the status, role and function that they are required to perform on either a main or secondary committee.	Yes	A comprehensive training programme including induction is in place. Members of the Pensions Committee and Pension Board are expected to attend no less than three days of training (21 hours) per year. The non-elected members confirm that they have read, signed and will abide by a Code of Conduct (specifically tailored for the Pensions Committee and Pension Board) prior to their appointment to those bodies. The elected members are required to read, sign and abide by the Councillors' Code of Conduct.

Principle		Full Compliance	Comments
Selection and Role of Lay Members	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 for meetings of the Pensions Committee, Pensions Audit Sub-Committee and Pension Board. A Code of Conduct also applies to all members of the Pensions Committee and the Pension Board. The declaration of board members interest is a standard item on the agenda for the meetings for the LPFE and LPFI board meetings.
Voting	The policy of individual administering authorities on voting rights is clear and transparent, including the justification for not extending voting rights to each body or group represented on main LGPS committees.	Yes	Five of the seven places of the Pensions Committee are held by elected members of the City of Edinburgh Council, which is required to retain a 2/3 majority in line with the Local Government (Scotland) Act 1973. The LPF Group's Nomination and Appointments Policy clearly documents how employer and member representatives will be elected to the Pensions Committee and Pension Board. LPFI and LPFE board members conduct meetings and other matters in accordance with their respective articles of association and shareholders' agreements.
Training / Facility Time / Expenses	a) That in relation to the way in which statutory and related decisions are taken by the administering authority, there is a clear policy on training, facility time and reimbursement of expenses in respect of members involved in the decision-making process.	Yes	A Training and Attendance Policy is in place covering training requirements and reimbursement of expenses. The policy is available on the LPF Group's website . Board members and staff working for LPFI and LPFE also attend separate training for the purposes of their knowledge, understanding and (where appropriate) compliance with Financial Conduct Authority regulations.

Principle		Full Compliance	Comments
Training / Facility Time / Expenses	b) That where such a policy exists, it applies equally to all members of committees, sub-committees, advisory panels or any other form of secondary forum.	Yes	The Training and Attendance Policy applies to both the Pensions Committee and the Pension Board. Advisers have their own professional development obligations.
	c) That the administering authority considers the adoption of annual training plans for committee and board members and maintains a log of all such training.	Yes	Each Pensions Committee and Pension Board member is expected to attend no less than three days training per year (21 hours) per year. Attendance at meetings and training is monitored and reported.
Meetings frequency	a) That an administering authority's main committee or committees meet at least quarterly.	Yes	The Pensions Committee meets at least four times a year.
	b) That an administering authority's secondary committee or panel meet at least twice a year and is synchronised with the dates when the main committees sits.	Yes	The Pensions Audit Sub-Committee is held before the Pensions Committee at least three times a year with further meetings held if necessary. The Joint Investment Strategy Panel meets quarterly or more frequently as required. The Pension Board attends all the Pensions Committee meetings and separately meets in advance of such meetings. Further meetings are held if necessary. The LPFE board now meet five time a year (in February, May, August, October and December) and the LPFI board meet monthly.
	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	

Principle		Full Compliance	Comments
Access	That subject to any rules in the council's constitution, all members of main and secondary committees or boards have equal access to committee papers, documents and advice that falls to be considered at meetings of the main committee.	Yes	Pensions Committee papers and minutes are publicly available on the Council's website and all Pensions Committee and Pension Board members have equal access. Members of the Pensions Committee and Pension Board have equal access to the Independent Professional Observer who holds surgeries ahead of Committee meetings.
Scope	That administering authorities have taken steps to bring wider scheme issues within the scope of their governance arrangements.	Yes	The Pensions Committee deals with all matters relating to both the administration and investment of the Funds and the LPF Group. A separate specialist Pensions Audit Sub-Committee consisting of three members (including at least two elected members from the City of Edinburgh Council) undertake the audit scrutiny of the Funds.
Publicity	That administering authorities have published details of their governance arrangements in such a way that stakeholders with an interest in the way in which the scheme is governed, can express an interest in wanting to be part of those arrangements.	Yes	Governance documents, policies and details of Pension Board membership are on the LPF Group's website. The LPF Group also communicates regularly with employers and scheme members.

ANDREW KERR
Chief Executive
The City of Edinburgh Council
June 2018

STEPHEN MOIR
Executive Director of Resources
The City of Edinburgh Council
June 2018

CLARE SCOTT
Chief Executive
Lothian Pension Fund
June 2018

Additional information

Key documents online

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

- Actuarial Valuation reports
- Pension Board constitution
- Annual Report and Accounts
- Statement of Investment Principles
- Pension Administration Strategy
- Communications strategy
- Funding Strategy Statement
- Service Plan
- Training and attendance policy

Fund advisers

Actuaries:	Hymans Robertson LLP
Auditor:	Nick Bennett, Scott-Moncrieff
Bankers:	Royal Bank of Scotland
Investment consultancy:	KPMG LLP, Gordon Bagot and Scott Jamieson
Investment custodians:	The Northern Trust Company
Investment managers:	Details can be found in the notes to the accounts.
Additional Voluntary Contributions (AVC) managers:	Standard Life and Prudential
Property valuations:	CB Richard Ellis Limited
Solicitors:	In-house

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 the details on the back page.

LOTHIAN PENSION FUNDS

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

Pensions Committee

Appendix 2

Wednesday 27 June 2018

Lothian Pension Fund - Internal Audit Opinion and Annual Report for the Year Ended 31 March 2018

Executive summary

Item number	
Report number	
Executive/routine	
Wards	

This report details Internal Audit's annual opinion for Lothian Pension Fund (LPF) for the year ended 31 March 2018. Our opinion is based on the outcomes of four audits included in the LPF 2017/18 Internal Audit annual plan and the status of open Internal Audit findings.

Internal Audit considers that significant enhancements are required to the LPF control environment and governance and risk management frameworks and is therefore reporting a 'red' rated opinion (see Appendix 1), with our assessment towards the middle of this category.

This report is a component part of the overall annual assurance provided to LPF, as there are a number of additional assurance sources that the Committee should consider when forming their own view on the design and effectiveness of the control environment and governance and risk management frameworks within LPF.

Links

Coalition pledges	
Council outcomes	
Single Outcome Agreement	All

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THE CITY OF EDINBURGH COUNCIL

Report

Lothian Pension Fund - Internal Audit Opinion and Annual Report for the Year Ended 31 March 2017

Recommendations

1.1 It is recommended that the Committee notes the internal audit opinion for the year ended 31 March 2018.

Background

2.1 The Public Sector Internal Audit Standards (PSIAS) provide a coherent and consistent internal audit framework for public sector organisations. Adoption of the PSIAS is mandatory for internal audit teams within UK public sector organisations, and PSIAS require annual reporting on conformance.

2.2 It is the responsibility of the Council's Chief Internal Auditor to provide an independent and objective annual opinion on the adequacy and effectiveness of LPF's control environment and governance and risk management frameworks in line with PSIAS requirements. The opinion is provided to the Pensions Audit Sub-Committee, and should be used to inform the LPF Annual Governance Statement.

2.3 The annual opinion is based on the outcomes of the three audits included the LPF 2017/18 Internal Audit annual plan, and the additional audit on payroll outsourcing added to the plan at the request of LPF. These audits were designed to test the effectiveness of the controls, and governance and risk management frameworks, established to effectively mitigate and manage LPF's most significant risks.

2.4 The objective of Internal Audit is to provide a high quality independent audit service to Lothian Pension Fund (LPF), in accordance with PSIAS requirements, which provides assurance over the control environment established to manage LPF's key risks and their overall governance and risk management arrangements.

2.5 Where control weaknesses are identified, Internal Audit findings are raised, and management agree recommendations to address the gaps identified. However, it is the responsibility of management to address and rectify the weaknesses identified via timely implementation of these agreed management actions.

2.6 The IA definition of an overdue finding is any finding where all agreed management actions have not been implemented by the final date agreed by management and recorded in Internal Audit reports.

Main report

Internal Audit Opinion

3.1 Internal Audit considers that significant enhancements are required to the LPF control environment and governance and risk management frameworks, and is raising a 'red' rated opinion (see category 3 at Appendix 1), with our assessment towards the middle of this category.

3.2 This opinion is subject to the inherent limitations of internal audit (covering both the control environment and the assurance provided over controls) as set out in Appendix 2.

3.3 Internal Audit is not the only source of assurance provided to LPF as there are a number of additional assurance sources (for example, external audit) that the Committee should consider when forming their own view on the design and effectiveness of the LPF control environment and governance and risk management frameworks.

Basis of opinion

3.4 Our opinion is based on the outcome of audits completed in the year to 31 March 2018, and the status of open internal audit findings.

Audit outcomes

3.5 Four internal audit reviews were completed during the year, and a total of 12 findings (4 High; 3 Medium; 4 Low and 1 Advisory) were raised.

3.6 The most significant findings raised highlighted the need for LPF to ensure that third party systems suppliers have established adequate and effective resilience arrangements that are aligned with LPF recovery objectives; and effective change management controls to provide assurance on the ongoing integrity of their systems.

3.7 Given LPF's dependence on the City of Edinburgh Council for a number of support services, we have also considered the outcomes of relevant work performed on the Council's control environment and governance and risk management frameworks. The Council's annual internal audit opinion will be presented to the Governance, Risk, and Best Value Committee meeting in July 2018.

Status of Internal Audit Findings

3.8 LPF has a total of 7 open Internal Audit findings (4 High; 2 Medium; and 1 Low) that relate to reviews completed as part of the 2017/18 annual plan. Of these, one High and one Medium rated findings are overdue, as agreed management actions were not completed by the agreed implementation date. Further detail is included at Appendix 3.

3.9 As part of a Council wide exercise completed in April 2018, LPF management has attested that all agreed management actions designed to address the risks associated with historic internal audit findings (raised since 1 April 2015) have been effectively implemented and sustained.

Comparison to prior year

3.10 An amber rated opinion was reported in 2016/17 reflecting that the LPF control environment and governance and risk management frameworks were 'generally adequate but with some enhancements required', with our assessment towards the higher end of this category.

3.11 A direct comparison between annual Internal Audit opinions is not always possible as the scope of the audits included in the annual plans will vary in line with the changing LPF risk profile.

3.12 However, it should be noted that the number of findings raised in 2017/18 (12) has increased in comparison to the number raised in 2016/17 (7). The number of High rated findings raised has also increased from 1 to 4.

3.13 Of the 12 findings raised in 2017/18, 2 (1 High and 1 Low) related to the Payroll Outsourcing audit which was a unique project related review.

Internal Audit Independence

3.14 PSIAS require that Internal Audit must be independent and internal auditors must be objective in performing their work. To ensure conformance with these requirements, Internal Audit has established processes to ensure that both team and personal independence is consistently maintained and that any potential conflicts of interest are effectively managed.

3.15 We do not consider that we have faced any significant threats to our independence during 2017/18, nor do we consider that we have faced any inappropriate scope or resource limitations when completing our work.

Conformance with Public Sector Internal Audit Standards

3.16 Internal Audit has not conformed with PSIAS requirements during 2017/18 for the following reasons:

3.16.1 There has been insufficient follow-up of Internal Audit findings between April 2015 and October 2017 to monitor and ensure that management actions have been effectively implemented; and

3.16.2 Resourcing challenges within the Internal Audit team has impacted completion of the two internal quality assurance reviews included in the 2017/18 Internal Audit annual plan to ensure consistency of audit quality.

3.17 It should be noted that these instances of non-conformance have had no direct impact on the quality of internal audit reviews completed for LPF in 2017/18.

Action taken to address instances of non PSIAS conformance

3.18 A manual follow-up process was implemented immediately following identification of the historic issue, and a new software based automated process is scheduled for implementation in July 2018.

3.19 Resources were drawn down from the existing co-source arrangement with PwC to address resourcing gaps and ensure completion of the annual audit plan.

3.20 Internal quality assurance reviews will be reinstated with effect from 1 April 2018, with two quality assurance reviews have been scheduled for completion in the 2018/19 plan year.

Measures of success

4.1 Appropriate changes are implemented to ensure that the LPF control environment and governance and risk management frameworks are adequately designed and operate effectively.

Financial impact

5.1 No direct financial impact.

Risk, policy, compliance, and governance impact

6.1 Appropriate changes are implemented to ensure that the LPF control environment and governance and risk management frameworks are adequately designed and operate effectively.

Equalities impact

7.1 No direct impact.

Sustainability impact

8.1 No direct impact.

Consultation and engagement

9.1 None.

Background reading/external references

10.1 Public Sector Internal Audit Standards

Lesley Newdall

Chief Internal Auditor

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Links

Coalition pledges	
Council outcomes	
Single Outcome Agreement	
Appendices	Appendix 1 – Internal Audit Annual Opinion Definitions Appendix 2 - Limitations and responsibilities of internal audit and management responsibilities Appendix 3 - LPF reviews completed between 1 April 2017 and 31 March 2018 Appendix 4 - Status of LPF Internal Audit Findings

Appendix 1 – Internal Audit Annual Opinion Definitions

The PSIAS require the provision of an annual Internal Audit opinion, but do not provide any methodology or guidance detailing how the opinion should be defined. We have adopted the approach set out below to form an opinion for Lothian Pension Fund.

We consider that there are 4 possible opinion types that could apply to LPF. These are detailed below:

1 Adequate *An adequate and appropriate control environment and governance and risk management framework l is in place enabling the risks to achieving organisation objectives to be managed*	**2 Generally adequate but with enhancements required** *Areas of weakness and non-compliance in the control environment and governance and risk management framework that that may put the achievement of organisational objectives at risk*
3 Significant enhancements required *Significant areas of weakness and non-compliance in the control environment and governance and risk management framework that puts the achievement of organisational objectives at risk*	**Inadequate** *The framework of control and governance and risk management framework is inadequate with a substantial risk of system failure resulting in the likely failure to achieve organisational objectives.*

Professional judgement is exercised in determining the appropriate opinion, and it should be noted that in giving an opinion, assurance provided can never be absolute.

Appendix 2 - Limitations and responsibilities of internal audit and management responsibilities

Limitations and responsibilities of internal audit

The opinion is based solely on the internal audit work performed for the financial year 1 April 2017 to 31 March 2018. Work completed was based on the terms of reference agreed with management for each review. However, where other matters have come to our attention, that are considered relevant, they have been taken into account when finalising our reports and the annual opinion.

There may be additional weaknesses in the LPF control environment and governance and risk management frameworks that were not identified as they were not included in the 2017/18 LPF annual internal audit plan; were excluded from the scope of individual reviews; or were not brought to Internal Audit's attention. Consequently, management and the Committee should be aware that the opinion may have differed if these areas had been included, or brought to Internal Audit's attention.

Control environments, no matter how well designed and operated, are affected by inherent limitations. These include the possibility of poor judgment in decision-making; human error; control processes being deliberately circumvented by employees and others; management overriding controls; and the impact of unplanned events.

Future periods

The assessment of controls relating to the Council is for the year ended 31 March 2017. Historic evaluation of effectiveness may not be relevant to future periods due to the risk that:

- the design of controls may become inadequate because of changes in operating environment, law, regulation or other; or
- the degree of compliance with policies and procedures may deteriorate.

Responsibilities of Management and Internal Audit

It is Management's responsibility to develop and effective control environments and governance and risk management frameworks that are designed to prevent and detect irregularities and fraud. Internal audit work should not be regarded as a substitute for Management's responsibilities for the design and operation of these controls.

Internal Audit endeavours to plan its work so that it has a reasonable expectation of detecting significant control weaknesses and, if detected, performs additional work directed towards identification of potential fraud or other irregularities. However, internal audit procedures alone, even when performed with due professional care, do not guarantee that fraud will be detected. Consequently, internal audit reviews should not be relied upon to detect and disclose all fraud, defalcations or other irregularities that may exist.

Appendix 3 - LPF reviews completed in 2016/17 and 2017/18

2017/18 Annual Plan	**Findings**			
Review	**High**	**Medium**	**Low**	**Advisory**
Information Governance	-	2	3	1
Review of IT Business Resilience and Disaster Recovery	2	-	-	-
* Information Security Due Diligence for Payroll Outsourcing	1	-	1	-
Pensions Tax Lifetime and Annual Allowances	1	1	-	-
Total Findings Raised	**4**	**3**	**4**	**1**
Total 16/17 (3 reports)	*1*	*2*	*4*	-

* This was an additional review added to the plan at the request of LPF.

2016/17 Annual Plan	**Findings**			
Review	**High**	**Medium**	**Low**	**Advisory**
Internally managed investments	-	-	3	-
Third party ICT supplier risk	1	1	-	-
LPF group governance and HR arrangements	-	1	1	-
Total 16/17	**1**	**2**	**4**	**-**
Total 15/16 (3 reports)	-	*4*	*5*	-

Appendix 4 - Status of LPF Internal Audit Findings

Review	**High**	**Medium**	**Low**	**Status**
Information Governance	-	1	-	Overdue
IT Business Resilience and Disaster Recovery	1	-	-	Not yet due - due for final completion by 30 June 18. Two supporting management actions have missed their implementation dates
	1	-	-	Overdue
Pensions Payroll Outsourcing	1	-	-	Not yet due – completion date is 9 April 2018
	-	-	1	Not yet due – completion date is 29 June 2018.
Pensions Tax	1	-	-	Not yet due – completion date is 31 May 2018
	-	1	-	Not yet due – final completion date is 31 March 2019, with one management action due by 30 August 2018.
Total	**4**	**2**	**1**	**One High and one Medium rated findings were overdue at 31 March 2017**
Total 15/16	-	*2*	-	*One medium rated finding was overdue at 31 March 2016 and has now been closed*

Note: The IA definition of an overdue finding is any finding where all agreed management actions have not been implemented by the final date agreed by management and recorded in Internal Audit reports.

Appendix 3

The City of Edinburgh Council

Statement on the system of internal financial control

1. This statement is given in respect of the internal financial controls operated by The City of Edinburgh Council. As the Council's designated section 95 officer as defined under the provisions of the Local Government (Scotland) Act 1973, I acknowledge my responsibility for ensuring that an appropriate system of internal financial control is in place and its on-going effectiveness regularly reviewed.

2. The system of control can provide reasonable, but not absolute, assurance that material control weaknesses or irregularities do not exist, and that there is no unacceptable risk of material error, loss, fraud or breach of legislation. Consequently, the Council continually seeks to improve the effectiveness of its systems of internal control so that irregularities are either prevented or detected within an acceptable period of time. Tracking of agreed internal audit actions forms a standing item on the Council Leadership and Senior Management Team agendas, with progress also regularly reported to the Governance, Risk and Best Value Committee. In view of recent staffing reductions and various resulting changes in respective responsibilities, the self-attestation exercise undertaken early in 2018 has also been helpful in assessing the extent to which improvements have been embedded within service areas, highlighting a need for further action in some areas to implement and sustain the required controls.

3. The effectiveness of the Council's internal financial control framework as a whole is subject to annual review by its external auditors, with the principal findings of the most recent annual assessment reported to the Governance, Risk and Best Value Committee in September 2017.

4. The Internal Audit section operates in accordance with the Chartered Institute of Public Finance and Accountancy's United Kingdom Public Sector Internal Audit Standards (although some instance of non-compliance during the year have been noted). The Section undertakes an annual programme based on an agreed audit strategy. The plan is based on formal assessments of risk and audit needs which are reviewed regularly to reflect evolving risks and changes within the Council. During 2017/18, the section reported to the Head of Legal and Risk. It also has, however, unfettered access to the Chief Executive, Executive Directors, Heads of Service (including the Head of Finance) and elected members of the Council when required.

5. The Chief Internal Auditor has provided an assurance statement that includes her opinion on the adequacy and effectiveness of the system of internal financial control. This opinion, based on internal audit work undertaken during the year, has highlighted a need for significant enhancements to the control environment and associated governance and risk management frameworks. The control improvements implicit in this opinion will be examined and corresponding required improvements as they relate to financial systems implemented as a matter of urgency.

6. The existing system of internal financial control is based on a framework of regular management information, financial rules and regulations, administrative procedures (including segregation of

duties), management supervision and a scheme of delegation and accountability. The system is maintained and developed by Council management and includes:

- comprehensive budgeting systems;
- preparation and regular review of periodic reports that measure actual financial performance against budgeted net expenditure. For 2017/18, building on recent years' improvements, extensive senior management team, Council Leadership Team and elected member scrutiny resulted in the delivery of the majority of approved savings, with the main exception being Health and Social Care where the urgent need for radical new demand management approaches has again been highlighted. An internal audit review of the Council's savings development and monitoring processes undertaken in 2016/17 noted a number of areas of good practice, with no recommendations for improvement made;
- agreement of targets against which financial and operational performance can be assessed. Key amongst these financial targets is the achievement of a balanced Council-wide outturn, with the provisional year-end position for 2017/18 showing that net expenditure has been maintained within budgeted levels for the eleventh successive year;
- clearly-defined capital and other expenditure guidelines communicated to services and set out in the Finance Rules which were refreshed in October 2017. The Financial Regulations were also reviewed in June 2017 and a further refresh is planned for consideration in June 2018;
- an approved long-term financial strategy and plan, updates in respect of which are regularly discussed at CLT and reported to the Finance and Resources Committee, with the next such update planned for consideration on 12 June;
- formal project management disciplines as supported and promoted through the Strategy and Insight section, including senior Finance representation on all major project boards and assurance review panels; and
- formal governance arrangements operated within both subsidiary and associated companies, complemented by a strengthened Council observer role and consolidation and active consideration by senior Council officers of a consistent suite of key operational documentation for its principal companies. Service Level Agreements have also been agreed during the year for all finance-related services provided to some external bodies and account will be taken of all relevant recommendations contained within the recently-published Accounts Commission national report in this area.

7. My review of the effectiveness of the internal financial control system is informed by:

- assurance certificates on internal control received from all Executive Directors of Council, service areas and relevant service heads;
- regular senior management-level consideration of progress in implementing internal audit recommendations, including self-attestation of previous actions where relevant;
- governance arrangements in place for subsidiary and associated companies and an ongoing assessment of the effectiveness of these arrangements;
- the work of managers within the Council;
- the work of internal audit; and

- external audit reports, in particular the independent annual report on the Council's financial statements and internal control framework.

8. The Council's financial management arrangements conform with the governance requirements of the CIPFA Statement on the Role of the Chief Financial Officer (2010) as set out in the Application Note to Delivering Good Governance in Local Government Framework, an opinion confirmed by Audit Scotland as part of the 2015/16 financial statements audit. Having reviewed the framework, it is therefore my opinion that although a degree of assurance can be placed upon the adequacy and effectiveness of the Group's systems of internal control, further improvements, including embedding of actions taken in response to previous recommendations, are clearly required.

9. I have, nonetheless, overseen the improvements put in place in response to Finance-specific recommendations made by internal and external audit work during the year, with improvement apparent in both timeliness of implementation and embedding of previously-agreed actions. This said, the extent of change and reduction in overall resources underpinning the Council's Transformation Programme has reinforced the importance of robust, documented and well-understood procedures for key system controls and, in light of the follow-up audit undertaken in April 2018, a priority in 2018/19 will therefore be to consolidate these improvements, identify any further required actions and gain necessary assurance by regularly assessing their effectiveness.

10. I have furthermore co-ordinated work refreshing as necessary the Council's long-term financial planning arrangements, recognising the need to keep these matters under regular review. Following consideration of a budget framework update report by the Finance and Resources Committee on 12 June, I will re-impress upon members the need for the Change Strategy to signal a fundamental step change in what the Council does (including service prioritisation), and how it does it, if it is to secure financial sustainability going forward.

Hugh Dunn
Head of Finance
4 June 2018

Appendix 4

Annual Report 2018
of
Lothian Pension Fund,
Lothian Buses Pension Fund
and
Scottish Homes Pension Fund

"Statement on the system of internal financial control

for the year ended 31 March 2018"

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 Acting Executive Director of Resources serves as the Section 95 Officer for all of the Council's accounting arrangements, including those of the Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund. For the Pension Funds, however, this Section 95 responsibility has been delegated to the Chief Finance Officer, Lothian Pension Fund.

In compliance with standard accounting practice, the Chief Finance Officer, Lothian Pension Fund, is required to provide the Chief Executive with a statement of the effectiveness of the internal financial control system of the Funds for the year ended 31 March 2018.

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. Accordingly, the "Statement on the system of internal financial control" by Hugh Dunn, Head of Finance, City of Edinburgh Council, dated 04 June 2018, refers.

Within this overall control framework, specific arrangements for the Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund are detailed in the Annual Governance Statement. These include:

- identifying the objectives of the Funds in Funding Strategy Statement, Statement of Investment Principles and Service Plan;
- a systematic approach to monitoring service performance by the Pensions Committee, Pensions Audit Sub-Committee, senior officers and stakeholders, including the Pension Board and Independent Professional Observer;
- a structured programme to ensure that Pension Committee members have the required standard of knowledge and understanding of Local Government Pension Scheme matters;
- operating within clearly established investment guidelines defined by the Local Government Pension Scheme Investment Regulations and the Funds' Statements of Investment Principles;
- compliance with the CIPFA Principles for Investment Decision Making and Disclosure in the Local Government Pension Scheme;
- with the exception of managed funds, unlisted investments and property, all investments are held under custody by a global custodian. The Funds benefit from the custodian's extensive internal control framework;
- benchmarking of services in terms of standards and cost against other Local Government Pension Scheme funds;

- LPFE and LPFI operating within their respective constitutional documentation and the relevant company regulations;
- LPFI operating within the relevant governance policies and procedures to ensure compliance with the Financial Conduct Authority regulations

The Chief Internal Auditor has provided an "Internal Audit Annual Report and Opinion for the year ended 31 March 2018", in accordance with the requirement set out in the Public Sector Internal Audit Standards. This opinion, based on internal audit work undertaken during the year, has highlighted a need for enhancements to the control environment and associated governance and risk management frameworks. Requisite actions are being progressed to secure such control improvements.

In light of the above, it is my opinion that reasonable assurance can be placed upon the adequacy and effectiveness of the system of internal financial control for the LPF Group in administering the Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund.

John Burns, FCMA CGMA
Chief Finance Officer,
Lothian Pension Fund

04 June 2018