The Highland Council Pension Fund

Annual Report and Annual Accounts
Aithris Chunntasan

2014 - 2015

Pensions Regulator Scheme Number: 10051259

ANNUAL REPORT AND ANNUAL ACCOUNTS 2014/15

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ANNUAL REPORT AND ANNUAL ACCOUNTS 2014/15

Management commentary

It is my pleasure to present the Annual Report and Annual Accounts of the Highland Council Pension Fund ("the Fund") for 2014/15.

The Fund is a Local Government Pension Scheme (LGPS), established to provide retirement and death benefits to employees within the scheme. The Fund provides benefits for those employees of the Highland Council, Comhairle Nan Eilean Siar and 31 other scheduled and admitted bodies that are active members of the Fund. More details on the Fund can be found in the About the Fund section on page 6.

The Fund has 12,148 Contributors, 8,085 Pensioners and 7,959 Deferred Pensioners.

Against a backdrop of continued uncertainty in the global economy, and volatility in the financial markets, the Fund had a positive year in terms of investment performance broadly in line with the benchmark, with the value of the Fund's net investment assets increasing by 13% to £1.433bn (2013/14 £1.268bn). More information on the economic and market environment during the year, and the Fund's investment performance, is set out later in this report on page 11.

Total contributions income received from employers and employees totalled £51.405m for the year, a slight increase on the previous year's £50.578m, mainly due to the accounting treatment for strain on fund costs.

Total benefits paid to scheme beneficiaries, in the form of pensions or other benefits, totalled £47.381m, compared to £43.101m for the previous year.

In terms of performance against the performance indicators set out in the Pensions Administration Strategy, there has been either an improvement, or the performance has remained constant for the majority of indicators. Full details of performance against these indicators can be found at page 10.

The Fund remains in a positive cash flow position, with benefits payable and other outgoings more than covered by the inflow of income from members and employers.

The Financial Statements for the Fund are prepared in accordance with International Financial Reporting Standards. The Fund is a separate entity from the Highland Council, and therefore its accounts are not included in the Council's Core Financial Statements. The Pension Fund Account and Net Assets Statement can be found on pages 32 and 33 respectively. There has been a change in the accounting treatment used by the Fund to reflect management expenses arising from the Fund's adoption of CIPFA's guidance (Accounting for Local Government Pension Scheme Management Costs). Previously management fees and investment transaction costs on pooled investments and private equity were deducted from the value of the investments. These fees are now separately identified and included in investment management expenses within the Fund account. The effect of this change was to increase investment management expenses and reduce profit and loss on disposal of investments and changes in values of investment previously reported in the Fund account for 2013/14 by £2.908 million.

The Highland Council is the administering authority for the Fund. Details of the remuneration of senior management is disclosed at Note19 of the accounts.

2014 Actuarial Valuation

Every three years, an independent actuary undertakes a valuation of the Pension Fund. The main purpose of the valuation is to review the financial position of the Fund and to determine the rate at which the employing bodies participating in the Fund should contribute in the future, to ensure that the existing assets and future contributions will be sufficient to meet future benefit payments from the Fund.

The triennial valuation, which is at 31 March 2014 for financial years 2015/16 to 2017/18 was concluded during early 2015. The results of the 2014 Valuation are that the funding level shows a slight decrease since the 2011 valuation (96.2% compared to 96.8%) and an increase in the deficit from £33m to £52m. This is due to a number of factors, but primarily because of the decrease in real gilt yields.

Alongside the completion of the Actuarial Valuation, the Funding Strategy Statement was updated and approved at Pensions Committee in February 2015. Key elements of this statement and a website link to the document can be found on page 6.

Funding and Investments over 2014/15

In the year to 31 March 2015, the Highland Council Pension Fund achieved a return on investments of +13.60% which was broadly in line with its customised benchmark of +14.40%. The main detractor was private equity which due to the nature of the investment will achieve returns towards the end of the investment. In the context of the general economy and market conditions which remain challenging; this level of performance is considered positive. Further information on performance can be found in the Investment Performance report on page 11.

Looking Ahead

Looking ahead, there are a number of challenges facing Local Government Pension Schemes:

- From 1st April 2015 the Local Government Scheme changes from a Final Salary Scheme to a Career Average Revalued Earnings (or CARE) scheme. A CARE scheme calculates pension using the formula:

  Pension = Membership x Accrual Rate x Pensionable Pay

  In a CARE scheme the pensionable pay for each year of membership is used, in order to calculate a pension amount for that particular year. That pension amount is then increased (revalued) each year in line with inflation. These individual pension amounts are then added together to arrive at the total pension payable from the scheme. The other significant change will be to link scheme pension age to State retirement age. Member benefits accrued to 31 March 2015 remain unchanged.

- The Public Service Pensions Act 2013 has led to changes in the governance requirements for Pension schemes. Consequently from 1 April 2015 a Pension Board will be in place. Some of the main functions of the Board are: to ensure compliance with the scheme regulations; to consider any matter relevant to the activities of the Fund including Pensions Committee reports; and to monitor investments. There is a statutory requirement for Board members to have knowledge and understanding of the rules of the scheme and the law relating to pensions. The Board will consist of 4 employer representatives and 4 union representatives.

- The on-going volatility and uncertainty in the global economy and investment markets, and linked to that the continuing regime of public sector austerity over the medium and quite possibly longer term have significant implications for the Fund and Fund employers. The potential for interest rate rises and therefore increasing Bond Yields is a particular concern and action is being taken to reduce portfolio durations and reduce risk.

In Conclusion

Our thanks and appreciation is extended to all Councillors and Officers for their continued input to the strong governance and management arrangements of the Fund.

Steve Barron Chief Executive	Derek Yule B.Com. CPFA. IRRV(Hons) Director of Finance	Dave Fallows Chairman Pensions Committee

24 September 2015

About the Fund

The Fund is part of the national Local Government Pension Scheme (LGPS). The LGPS was set up by the UK Government to provide retirement and death benefits for local government employees, and those employed in similar or related bodies, across the whole of the UK.

The Fund is constituted under legislation governing the Local Government Superannuation Scheme, the primary Act of governance is the Superannuation Act 1972. Detailed regulations for the Scheme are contained in the Local Government Pension Scheme (Scotland) Regulations 1998, the Local Government Pension Scheme (Management & Investment of Funds) Regulations 2010 and the Local Government Pension Scheme (Governance) (Scotland) Regulations 2015.

The Administering Authority (The Highland Council) runs The Highland Council Pension Fund, in effect the LGPS for the Highlands area, to make sure it:

- receives the proper amount of contributions from employees and employers, and any transfer payments;

  The Fund is built up by contributions from both employees and employing bodies, together with interest and dividends from investments, out of which defined pensions and other benefits are paid.

  Employees' contributions to the Fund are fixed by statute and contributions payable by employing bodies are fixed every three years following a report by an independent actuary who determines the level of contribution necessary to ensure that the Fund will be able to meet future benefits. A common contribution rate of 17.3% of payroll contributions was set by the Actuary for the period 1 April 2012 to 31 March 2015 in the Triennial Actuarial Valuation report 2011.

- invests the contributions appropriately, with the aim that the Fund's assets grow over time with investment income and capital growth;

  The Fund's assets are managed by appointed Investment Fund Managers. Once the cost of current benefits is met all surplus cash income is invested to meet future liabilities to employees within the Fund and deferred pension benefits.

- uses the assets to pay Fund benefits to the members (as and when they retire, for the rest of their lives), and to their dependants (as and when members die), as defined in the LGPS Regulations. Assets are also used to pay transfer values and administration costs.

Funding Strategy Statement

A Funding Strategy Statement, which summaries the Fund's approach to funding liabilities, has been prepared and describes the strategy of the Highland Council acting in its capacity of Administering Authority for the funding of the Highland Council Pension Fund.

http://www.highlandpensionfund.org/themes/highland/scheme%20documents/Funding%20Strategy%20Statement.pdf

Employees' benefits are guaranteed by the LGPS Regulations, and do not change with market values or employer contributions. Investment returns will help pay for some of the benefits, but with no guarantee as to the level of funding. Employees' contributions are fixed in the Regulations, at a level which covers only part of the cost of the benefits.

Therefore, employers need to pay the balance of the cost of delivering the benefits to members and their dependants.

The Funding Strategy Statement focuses on how employer liabilities are measured, the pace at which these liabilities are funded, and how employers or pools of employers pay for their own liabilities. This statement sets out how the Administering Authority has balanced the conflicting aims of:

- affordability of employer contributions,
- transparency of processes,
- stability of employers' contributions, and
- prudence in the funding basis.

There is also a regulatory requirement for the Fund to have a Funding Strategy Statement.

The Funding Strategy Statement provides detail of the key elements of the funding strategy, the regulatory framework, responsibilities of key parties, links to the Investment Strategy, key risks (financial, demographic, regulatory and governance), calculation of employer contributions and actuarial assumptions.

Statement of Investment Principles

A Statement of Investment Principles (SIP) details the policy governing the Fund's investments. A summary of the SIP is set out on page 15. The Fund's Annual Governance Statement and Governance Compliance Statement are set out later within this document (page 21 and page 25).

The Highland Council has delegated authority to the Pensions Committee to take decisions on behalf of the Pension Fund. The Investment Sub Committee is responsible for overseeing the management of the investments of the Fund and scrutinises the performance of the Fund's six investment managers. Both Committees meet quarterly, and on an ad hoc basis as required. The Investment Sub Committee also makes decisions in relation to the appointment/termination of managers and any other issues relating to the management of investments.

The Highland Council Pension Fund qualifies as an HMRC 'exempt approved scheme'.

Risk management

The Pensions Committee is responsible for the Fund's risk management policy and strategy and key risks are regularly reported to the Pensions Committee. The main risk facing the Fund is that in the long term its assets will fall short of its liabilities. These are considered in the Funding Strategy Statement. Note 16 to the accounts provides extensive consideration of the potential financial instrument risks to the Fund and how these are managed.

ANNUAL REPORT AND ANNUAL ACCOUNTS 2014/15

Members & Advisors

All councillors on the Pensions Committee have been appointed by The Highland Council and are outlined below.

Pensions Committee Membership as at 31 March 2015
Cllr Dave Fallows (Chairman)
Cllr David Alston
Cllr Kenneth MacLeod
Cllr Helen Carmichael
Cllr John Ford
Cllr Michael Green
Cllr Richard Laird
Cllr Bill Lobban
Cllr Alister MacKinnon
Cllr Thomas Maclennan
Cllr Ben Thompson

Non-Voting members
Cllr Angus Campbell (Comhairle nan Eilean Siar)
Ms Elaine Ward (representative for the other Employers)
Mr Ewen Macniven (scheme member representative)
Ms Liz MacKay (scheme member representative)

Investment Sub Committee Membership as at 31 March 2015
Cllr Alister MacKinnon (Chairman)
Cllr Helen Carmichael
Cllr John Ford
Cllr Richard Laird
Cllr Bill Lobban
Cllr Kenneth MacLeod
Cllr Ben Thompson

Non-Voting members
Cllr Angus Campbell (Comhairle nan Eilean Siar)
Ms Elaine Ward (representative for the other Employers)

On 12 March 2015, the Council approved governance changes arising from the requirements of the Public Services Pensions Act 2013 and the Local Government Pension Scheme (Governance)(Scotland) Regulations 2014 which were required to be implemented by 1 April 2015.

In addition to the Pensions Committee and Investment Sub Committee, there is a new Pensions Board in place which will consist of 2 Highland Council Elected Members, 1 representative from Comhairle nan Eilean Siar, 1 representative for the other Employers and 4 Trade Union representatives.

Pensions Board as at 1 April 2015
Cllr Carolyn Caddick, Highland Council
Mr Thomas MacLennan, Highland Council;
Ms Louise Leonard, representative for the other Employers;
Mr Angus Campbell, Comhairle nan Eilean Siar
Ms Liz MacKay, Unison,
Mr Domhnall Macdonald, Unison,
Mr Ewen Macniven, GMB,
Mr Alister Wemyss, Unite

Fund Custodian
The Northern Trust Company

Fund Bankers
Clydesdale Bank plc

Fund Investment Managers
Baillie Gifford & Co
Fidelity International
Legal & General Investment Management
Partners Group
Pyrford International
Schroder Property Investment Management Limited

Fund Actuary
Hymans Robertson

Investment Advisers
AON Hewitt

AVC Provider
Prudential

Admitted & Scheduled Bodies

Administering Authority
The Highland Council (also Scheduled Body)

Scheduled Bodies
1. The Highland Council
2. Comhairle Nan Eilean Siar
3. Highland and Western Isles Valuation Joint Board
4. Scottish Fire & Rescue
5. Highlands of Scotland Tourist Board
6. Western Isles Tourist Board
7. HITRANS
8. Inverness College
9. Lews Castle College
10. Scottish Police Authority
11. Scottish Police Service Authority
12. The North Highland College

Admitted Bodies
1. Bord Na Gaidhlig
2. Inverness Leisure
3. An Comunn Gaidhealach
4. Cromarty Firth Port Authority
5. Eden Court Theatre
6. Fujitsu ltd
7. Forth & Oban Limited
8. Hebridean Housing Partnership
9. Highland Blindcraft
10. Highland & Islands Enterprise (HIE)
11. Highland Opportunity Ltd
12. Highlife Highland
13. Inverness Harbour Trust
14. Morrison FM
15. NHS Highland
16. RS Occupational Health
17. Skills Development Scotland
18. Stornoway Port Authority
19. University of the Highlands & Islands
20. Vacman Limited
21. Sight Action

Administration Strategy and Performance

On 1 July 2012 the Fund implemented an Administration Strategy which can be found on the Fund's website.

http://www.highlandpensionfund.org/themes/highland/scheme%20documents/Administration%20Policy.pdf

The strategy sets outs the roles and responsibilities of both the Administering Authority and scheme employers, and includes a number of key processes and tasks to be benchmarked against expected results. Service level standards for the administering authority performance are based on industry standard Performance Indicators and are detailed in the following tables.

Administering Authority Performance

Task	Target	Number from 1/4/14 to 31/3/15	% completed within target	Previous Year Percentage
New Entrants	Issue Statutory Notice within 14 days of receipt of a new start notice (doesn't account for queries on information received)	1,627	87%	87%
Early Leaver	Issue entitlement notice within 2 months of leaving (affected by late notification of leaving / queries on information provided)	973	94%	89%
Retirements including deferred benefits coming into payment	(a). Benefits paid by date of entitlement	534	72%	82%
	(b) of the 152 cases out of 534 not paid by date of entitlement, measure if benefits have been paid within 5 days following receipt of final piece of information required to process retirement benefits	152	100%	n/a
Deaths in Service	Contact next of kin within 5 days of notification	18	100%	100%
Transfers in from out with fund	Issue statutory notice within 14 days of receipt of payment	63	100%	100%
Transfers of pension rights out with fund	Make payment within 14 days of receipt of election	53	100%	100%
Estimates	Issue within 10 days of request	619	100%	100%

Scheme Employer Performance - Target performance 90%

Standard	Number from 1/4/14 to 31/3/15	% on target	Previous year Percentage
New Start Notification – within 30 days of joining (or 10 days from first deduction if later)	1,627	93%	91%
Retirement information – to allow benefits to be paid on time	305	91%	90%
Early leaver notification – within 30 days of leaving (or 10 days after last deduction if later)	973	94%	93%
Death in Service notification – within 7 days of death	18	100%	100%
Year End Query responses – within 14 days	16 employers were issued with queries	100%	100%

Investment Performance Report

Economic and market background

Markets accommodated reductions in quantitative easing and despite various economic and political difficulties, global equity returns were strong over the 12 months to 31 March 2015.

There were various influences across the period. At the beginning of the year economic data in US and China indicated growth potential, the European Central Bank eased its monetary policy further and the Federal Reserve continued to taper its asset purchases and kept rate guidance unchanged. An increase in geopolitical tensions as the year progressed caused markets to become nervous. In Europe the threat of deflation became real, causing the European Central Bank to initiate the purchase of asset backed securities in an attempt to prevent deflation; a focus on increasing inflation continued into the remainder of the year.

In the second half of the year the biggest global influence was the significant reduction in the value of Brent crude oil which dropped below $60 per barrel, its lowest value since 2009. OPEC's decision not to cut production further when added to the impact of the US production increase along with general global growth concerns were major factors behind falling oil prices.

By the end of the period the markets were experiencing strong performance, driven by the loosening of monetary policy across the globe. The low oil price was putting downward pressure on inflation which gave head room for many international banks to reduce interest rates.

Equities – despite volatile conditions in the equity markets for much of the year, global equity returns in the final quarter improved, leading to this market performing well in the year. The MSCI All Country World Index returned 19.0% over the 12 months to 31 March 2015. The UK equity market returns have been impacted by political and economic conditions over the past 12 months and were overshadowed by other developed markets. The UK equity market returned 6.6%.

Bonds - UK fixed interest gilts provided a positive return gained mainly in the second half of the year as gilt yields lowered in line with the global trend: directly influenced by interest rate increases being deferred and low inflation. A similar trend was also seen in index-linked gilt yields.

Property - The UK commercial property market continues to perform well, particularly specialist funds in industrial and central London which were boosted by moderate levels of gearing. Conditions in the European sector have remained challenging but have improved slightly on previous years, providing some flexibility in this sector.

Private Equity – Although this market is also impacted by the current challenging economic environment, fundraising in private equity continued at reasonable levels over the year. Private equity fundraising in Europe was up significantly compared to last year with the most active geographic areas being UK and Ireland.

Pension Fund Investment Performance

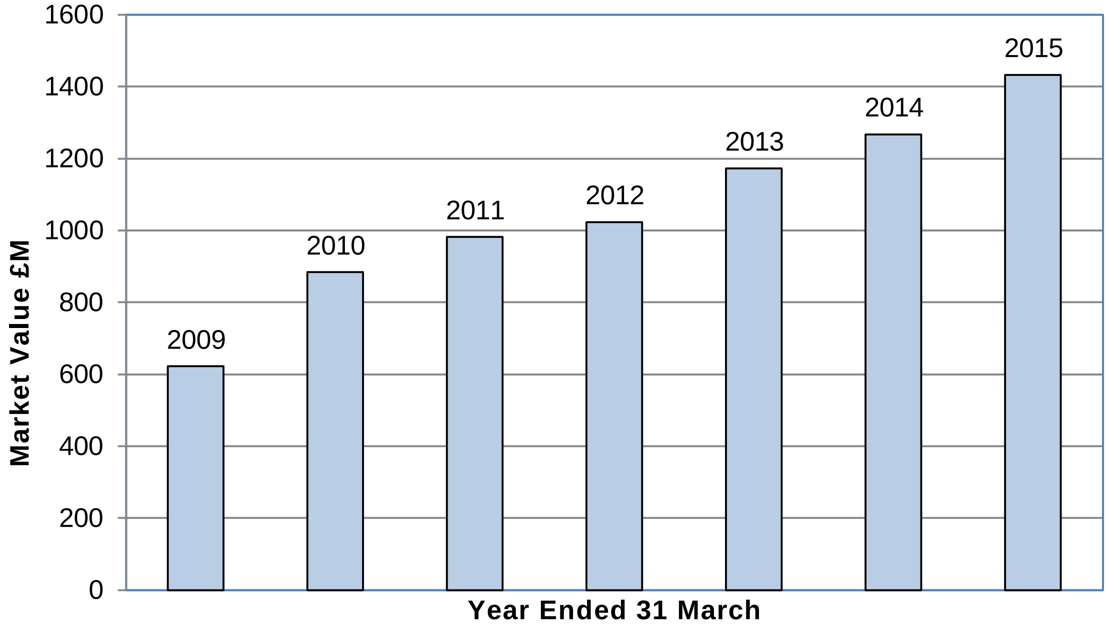
In the year to 31 March 2015, the Highland Council Pension Fund achieved a return on investments of +13.60% against its customised benchmark of +14.40%: 0.8% under performance against the benchmark. Although the general economy and market conditions remain challenging; the overall level of performance of the fund in the year was positive.

The market value of the Fund's net investment assets as at 31 March 2015 was £1.433bn up from £1.268bn at 31 March 2014.

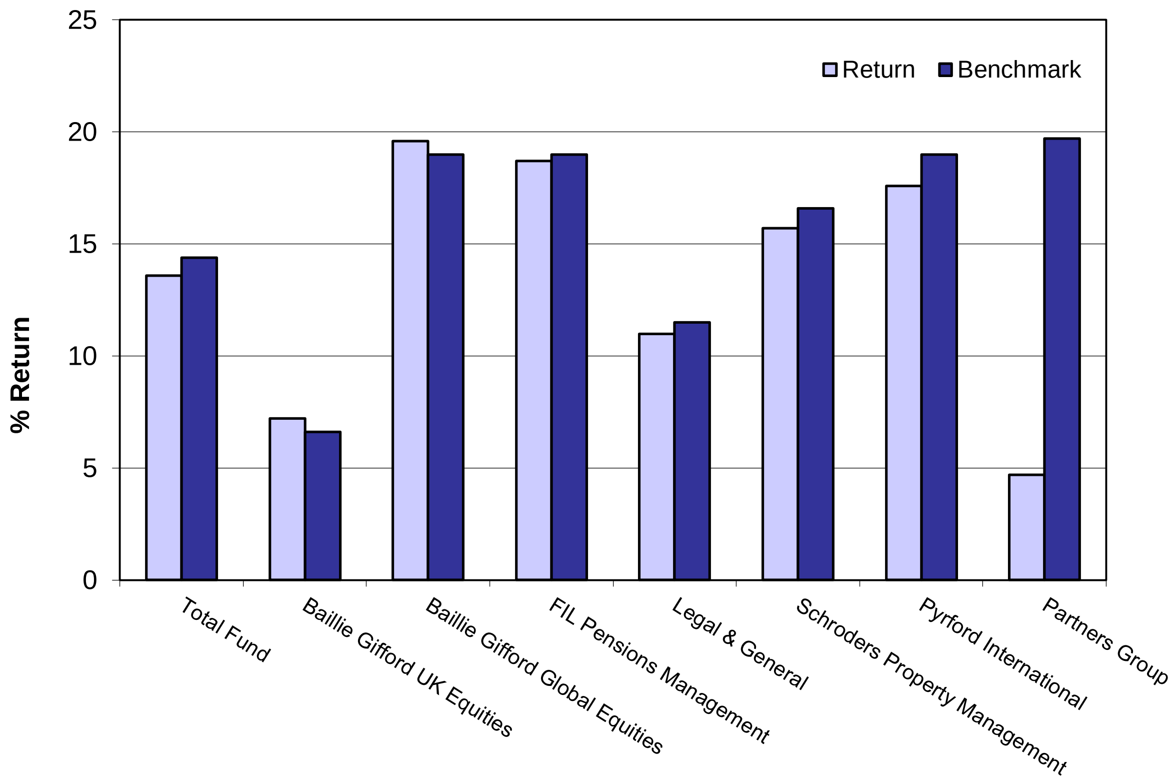
Overall the main contributors to the positive performance have been UK and Global equities, as a result of overall equity market performance (benchmark return) and strong manager stock selection and market out-performance (excess return). The main drag on the overall performance came from the private equity sector. Although Partners Group Global Value funds, as anticipated, have made a positive return in the early part of the yield curve, performance is significantly behind the set benchmark. The expectation is for this partnership to outperform the benchmark in its latter stages.

Details of the Fund's investments, analysed by investment category and by Fund manager are shown in the financial statements (note 14).

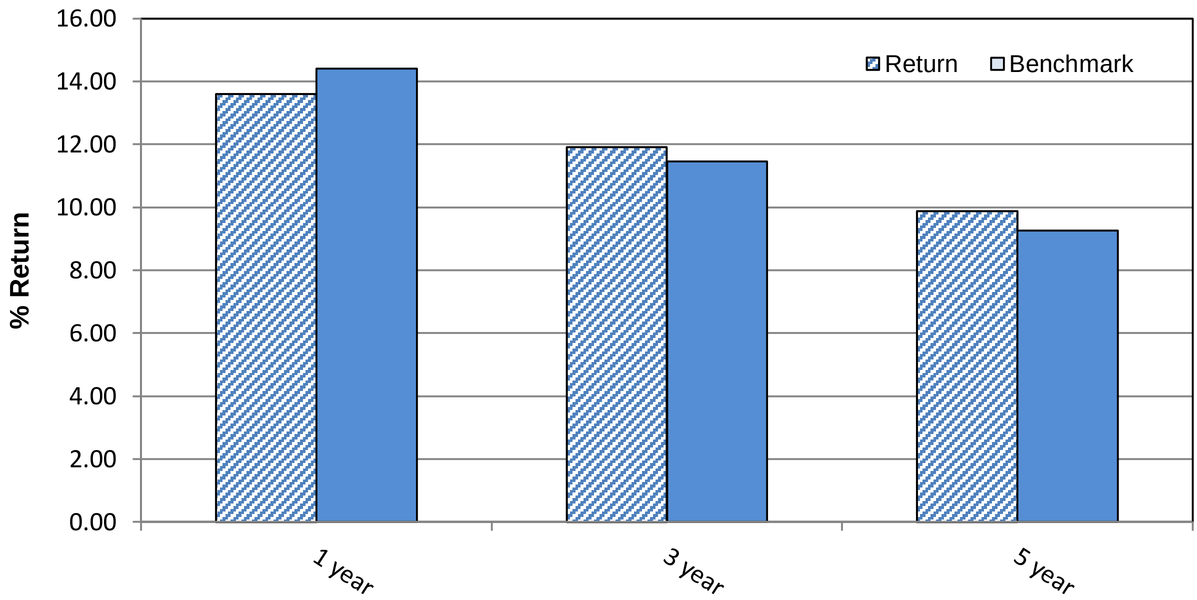
Six Year Movement in the Market Value of the Fund



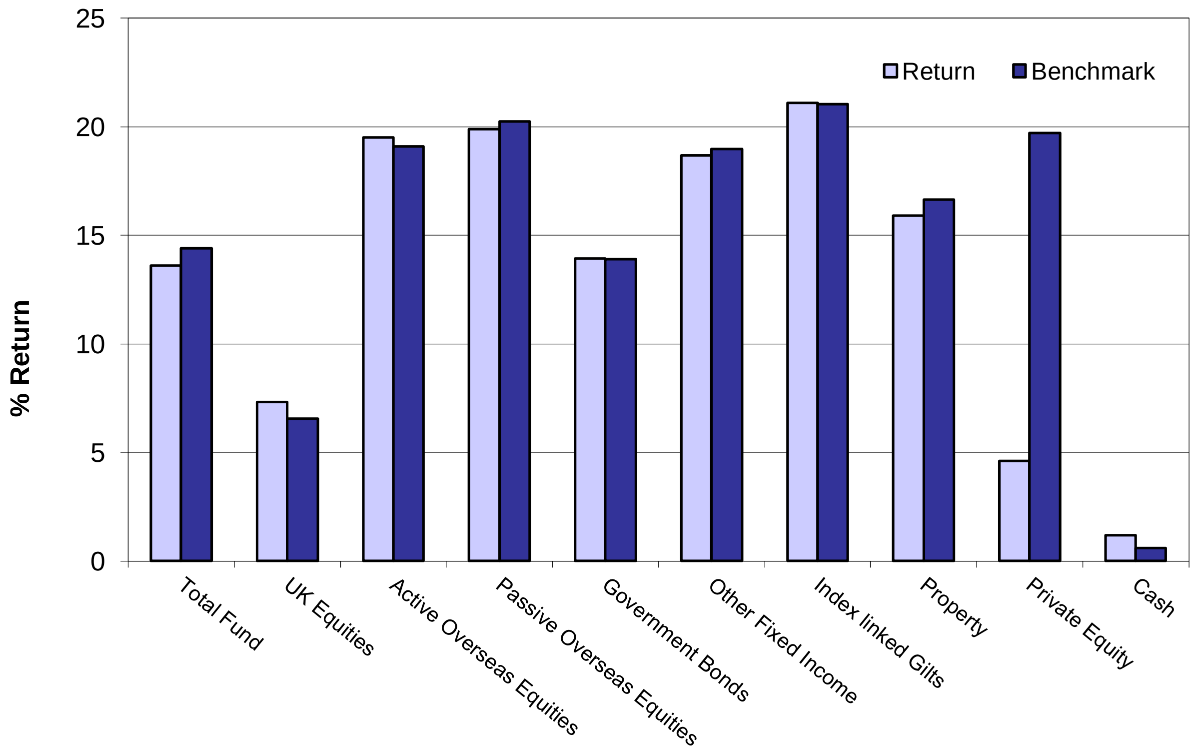
Annual Return by Fund Manager year ended 31 March 2015



Total Fund performance as at 31 March 2015



Returns by Asset Class as at 31 March 2015



Statement of Investment Principles – Summary

Background

The Highland Council is the administering authority of the Highland Council Pension Fund. Elected members recognise that they have fiduciary duties and responsibilities towards beneficiaries, employers and local tax payers that are similar to those holding the office of Trustee in the private sector.

Advisors

Independent Investment Managers, Investment Advisers, Actuaries and Performance Measurement Advisers are employed to give on-going expert advice and assistance in the managing of the Fund.

Funding Policy

The Fund is a defined benefit pension scheme which provides members with pensions and lump sums related to their final salaries. The fundamental objective is to meet these benefits on retirement, or the dependant's benefits on death before or after retirement.

The funding policy is directed to ensuring that in normal market conditions, all accrued benefits are fully covered by the actuarial value of the Fund's assets and that the appropriate level of contributions is agreed by the administering authority to meet the cost of future benefits accruing.

A Funding Strategy Statement for the Pension Fund has been prepared in accordance with Regulation 75A (1) of the Local Government Pension Scheme (Scotland) Regulations 1998 as amended by the Local Government Pension Scheme (Scotland) Amendment Regulations 2005. The Statement describes the strategy of the Highland Council in acting in its capacity as Administering Authority for the funding of the Highland Council Pension Fund. The Statement can be viewed at:
http://www.highlandpensionfund.org/themes/highland/scheme%20documents/Funding%20Strategy%20Statement.pdf

Investment Policy

The Fund's Investment Policy will be directed to ensuring that in normal market conditions, all accrued benefits are fully covered by the actuarial value of the Fund's assets and that an appropriate level of contributions is agreed by the administering authority to meet the cost of future employees' benefits accruing.

The long term investment objective of the Fund is to achieve a real rate of return of 3 to 4% per annum on average. With a target asset allocation whereby 75% of the Fund's investments are in active management and 25% in index tracking (passive), it is hoped that an efficient balance will be met between risk and return in light of liability profile and the funding level.

Asset Mix of Investments

The overall investment portfolio for the Fund is weighted to the equity market, both UK and Overseas and some Private Equity. However, the portfolio also has invested in Index-Linked Gilts, Property, UK Bonds, Overseas Bonds and Cash.

This diverse range of investments over 6 different Managers (5 active and 1 passive) is employed to minimise the effect of risk and enhance overall performance of the Fund for its Members. Each Manager, with the exception of the index tracking Manager, has full discretion in asset mix and stock selection, subject to the investment principles.

Monitoring

The Investment Sub Committee meets quarterly. Each of its Investment Managers attends these meetings on a rotational basis to monitor performance relative to performance targets and officers meet and discuss these with managers throughout the year.

Adoption of the strategic benchmark and the performance monitoring constrains the Investment Managers from deviating significantly from the intended approach. However, it also permits flexibility to manage the Fund in such a way as to enhance returns.

Risk

The Fund pursues a policy of lowering risk through diversification of both investments and investment managers. A management agreement is in place for each Investment Manager, which sets out the relevant benchmark performance target, asset allocation ranges, and any restrictions, as determined by the Fund.

Realisation of Investments

The majority of the investments held by the Fund are quoted on major stock markets and may be realised quickly if required. Property and private equity investment are relatively illiquid and together make up approximately 13% of the total Fund.

Underwriting

Managers are permitted to underwrite and sub underwrite stock issues on the basis that the subject stock is already held in the portfolio or that the Manager wishes to acquire a long term holding.

Social, Environmental and Ethical Considerations

The Fund recognises that social, environmental and ethical considerations are among the factors which Managers will take into account, where relevant, when selecting investments for purchase, retention or sale.

In general terms, this means that there is a group of socially responsible investment concerns which investors need to be aware of and which should be taken into consideration when the decision to invest is being made. This does not mean that the decision whether or not to invest depends entirely on the assessment of these factors but that they should be weighed in the balance along with all over relevant factors when decisions to buy, hold or sell investments are being made.

The Council has instructed the Investment Managers to take into account the key principles of socially responsible investment primarily through a policy of engagement with Companies that demonstrate appropriate observance of these principles.

Corporate Governance

The Fund ensures that the votes attached to its holdings in all UK quoted companies are exercised whenever practical. The Fund’s votes are exercised by its Investment

Managers in accordance with their own policies and practices and taking account of the Combined Code on Corporate Governance.

Custody

The Fund has a Global Custodian responsible for the safekeeping of all assets and execution of transactions. The Global Custodian also provides all the reporting data to the Council for performance monitoring and independent reconciliation purposes for each Investment Manager.

Stock Lending

The Fund has no stock released to a third party under a securities lending agreement at this time.

Compliance

Investment Managers and the Custodian will provide an annual statement to the Council confirming that they have given effect to the investment principles contained in this document so far as is reasonably practicable.

Adhering to guidance given by Scottish Ministers, The Fund is compliant with the six revised principles on investment decision making for occupational pension schemes, as set out in guidance published by the Chartered Institute of Public Finance and Accountancy in December 2009 called 'Investment Decision Making and Disclosure in the Local Government Pension Scheme: A Guide to the Application of the Myners Principles'.

A detailed version of this Statement of Investment Principles (SIP) expanding on the paragraphs above can be obtained from the address below:

Corporate Budgeting, Taxation and Treasury, Finance Service, Highland Council, Glenurquhart Road, Inverness, IV3 5NX or Treasury.Team@Highland.gov.uk

Strategic asset allocation

The Fund's strategic asset allocation targets are as follows. *It should be noted that there has been a strategic asset allocation review during 2014/15 so going forward the asset allocation will be revised slightly.*

Portfolio	**Target %**	**Actual %**	**Comment**
UK Equities	30.5*	30.9	18% Baillie Gifford – active 12.5% L&G – passive
Global Equities	32.0	36.4	15% Baillie Gifford – active 12% Pyrford – active 5% L&G – passive
Private Equity	5.0*	2.6	Partners Group - active
Property	10.0	10.3	Schroder – active fund of funds
Bonds	22.5	19.8	15% Fidelity– active 7.5% L&G – passive manager

* When private equity is fully funded.

Actuarial Position

Employers' contributions are assessed every three years by an independent actuary and expressed as a percentage of pensionable pay. The Common Rate of Contribution payable by each authority under Regulation 32 of the Local Government Pension Scheme (Administration) (Scotland) Regulations 2008 is 17.3% of pensionable pay on the basis of the last actuarial valuation as at 31 March 2011, applying to financial years 2012/13 – 2014/15.

The "Projected Unit Method" was used for employers open to new staff and the "Attained Age Method" was used for employers that are closed to new staff.

Individual employers' rates will vary from the common contribution rate depending on the demographic and actuarial factors particular to each employer. Full details of the contribution rates payable can be found in the 2011 actuarial valuation report and the funding strategy statement on the Pension Fund website.

http://www.highlandpensionfund.org/about-us/forms-and-publications.aspx

Demographic assumptions are used to estimate future consequences for the Fund. They take account of expected future trends (for instance future improvements in life expectancy) as well as the past experience in the Fund.

As at the 2011 actuarial valuation, the fund was assessed as 97% funded (2008 valuation: 98%). This corresponded to a deficit of £33m at that time (2008 valuation: deficit of £16.3m). The 2011 funding level had decreased marginally from 98% in March 2008 largely due to investment returns achieved by the Fund being less than were assessed at the previous valuation.

Looking forward to 2015/16, the rates of contribution will be based on the recently completed actuarial valuation as at 31 March 2014. The triennial valuation, which is at 31 March 2014 for financial years 2015/16 to 2017/18 was concluded during early 2015. The results of the 2014 Valuation are that the funding level shows a slight decrease since the 2011 valuation (96.2% compared to 96.8%) and an increase in the deficit from £33m to £52m. This is due to a number of factors, but primarily because of the decrease in real gilt yields. More information on the recent actuarial valuation can be found in the Actuary's statement (page 72).

For the purposes of the contribution rates set for financial year 2014/15. The following assumptions from the triennial Valuation completed in 2011 were used.

Financial assumptions

Financial assumptions are used to estimate the amount of benefits and contributions payable and to place a current value on these benefits and contributions. The key financial assumptions are:

Financial Assumptions	March 2011		March 2008	
	Nominal p.a.	Real (RPI) p.a.	Nominal p.a.	Real p.a.
Investment Return				
Equities/absolute return funds	6.9%	3.4%	7.4%	3.7%
Gilts	4.3%	0.8%	4.6%	0.9%
Bonds & Property	5.5%	2.0%	6.1%	2.4%
Discount Rate	6.4%	2.9%	6.9%	3.1%
Pay Increase	5.0%	1.5%	5.2%	1.5%
Price Inflation	3.5%	0.0%	3.7%	-
Pension Increases	3.0%	(0.5%)	3.7%	-

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The actuarial projection of the Market Value of the Fund's assets as at 31 March 2011 was £986m. The aim is to achieve 100% solvency over a period of 20 years and to provide stability in employer contribution rates by spreading any increases in rates.

Mortality assumptions

The key mortality assumptions are that all members will follow the mortality experience of a table which is based on the mortality assumptions underlying the 110% S1PA tables allowing for CMI projections, with a long term rate of 1%.

Future life expectancy based on the Actuary's fund-specific mortality review was:

Mortality assumption at age 65	Male	Female
Current pensioners	21.3	23.5
Future pensioners (assumed current age 45)	22.6	25.1

Commutation assumption

Half the members will commute their commutable pension for cash at retirement. Active members will retire one year later than they are first able to do so without reduction.

As noted above, revised contribution rates will apply from 1 April 2015 following the recently completed actuarial valuation as at 31 March 2014. The Actuary's Statement for 2014/15 is included in pages 72 and 73 of this report. Note that these differ to the updated assumptions in the Actuarial Position which are from the actuarial valuation as at 31 March 2011.

ANNUAL REPORT AND ANNUAL ACCOUNTS 2014/15

How to Contact Us

Website: http://www.highlandpensionfund.org/about-us/contact-details.aspx

Enquiries regarding Pension Fund Investments:

Corporate Budgeting, Taxation and Treasury
The Highland Council
Council Buildings
Glenurquhart Road
Inverness
IV3 5NX

Tel: 01463 702432
E-mail: treasury.team@highland.gov.uk

Enquiries regarding Pensions Contributions & Benefits:

Pensions Section
The Highland Council
Council Buildings
Glenurquhart Road
Inverness
IV3 5NX

Tel: 01463 702441
E-mail: pensions.section@highland.gov.uk
Website: www.highlandpensionfund.org

Annual Governance Statement

Scope of responsibility

The Highland Council acts as Administering Authority for the Highland Council Pension Fund. The Council is responsible for ensuring that its business is conducted in accordance with the law and proper standards, and that public money is safeguarded, properly accounted for, and used economically, efficiently and effectively. The Council has a statutory duty to make arrangements to secure best value under the Local Government in Scotland Act 2003.

In discharging this overall responsibility, the Council is responsible for putting in place proper arrangements for the governance of its affairs and facilitating the effective exercise of its functions. This includes arrangements for the management of risk.

The Council has approved and adopted a Local Code of Corporate Governance, which is consistent with the principles of the CIPFA/SOLACE framework 'Delivering Good Governance in Local Government. The Code is available on our website.

The Local Code of Corporate Governance evidence's the Council's commitment to achieving good governance and demonstrates how it complies with the governance standards recommended by CIPFA. The document is regularly reviewed and updated.

The purpose of the governance framework

The governance framework comprises the systems and processes, and cultures and values, by which the Council is directed and controlled, and the activities used to engage with and lead the community. It enables the Council to monitor the achievement of its strategic objectives and to consider whether those objectives have led to the delivery of appropriate, cost effective services.

The system of internal control is a significant part of that framework and is designed to manage risk to an acceptable level, and provide reasonable, but not absolute, assurance that policies, aims and objectives can be delivered. The system of internal control is based on an ongoing process designed to identify and prioritise the risks being realised and the impact should they be realised, and to manage them efficiently, effectively and economically.

The governance framework has been in place for the year ended 31 March 2015 and up to the date of approval of the Annual Accounts.

The governance framework

The Local Code is based upon the following six principles:

1. Focusing on the purpose of the Authority and on outcomes for the community and creating and implementing a vision for the local area
2. Members and officers working together to achieve a common purpose with clearly defined functions and roles
3. Promoting values for the Authority and demonstrating the values of good governance through upholding high standards of conduct and behaviour
4. Taking informed and transparent decisions which are subject to effective scrutiny and managing risk
5. Developing the capacity and capability of members and officers to be effective
6. Engaging with local people and other stakeholders to ensure robust public accountability

The Pension Fund has a separate Governance Policy Statement which is one of a number of key documents it must hold and this was last updated in May 2013. In addition, an annual Governance Compliance Statement is provided here; setting out the extent to which the governance arrangements comply with best practice for the management of the Pension Scheme. This shows that all principles, bar one which isn't applicable, are fully complied with. However, this will change as a result of the 2015 Regulations which are referred to below.

Revisions to the Council's Financial Regulations were approved by the Audit & Scrutiny Committee on 19/06/14. One of the revisions included the Director of Finance, who is the CFO for the Council, to have direct access to the Pensions Committee.

From 01/04/15 new governance arrangements come into place as a result of the Local Government Pension Scheme (Governance) (Scotland) Regulations 2015. Details of the changes were reported to the Highland Council on 12/03/15.

Review of effectiveness

The Highland Council has put in place appropriate management and reporting arrangements to enable it to satisfy itself that its approach to corporate governance is adequate and effective in practice. The Depute Chief Executive/Director of Corporate Development has been given responsibility for:

- overseeing the implementation of the Local Code of Corporate Governance and monitoring its operation
- reviewing the operation of the Local Code of Corporate Governance in practice
- reporting annually to the Council on compliance with the Local Code and any changes required to maintain it and ensure its effectiveness.

In fulfilling these duties, the Depute Chief Executive/Director of Corporate Development has taken into account the results of reviews of internal control that have been carried out by Internal Audit.

In addition, the Head of Audit and Risk Management reports annually to the Audit and Scrutiny Committee on the adequacy and effectiveness of the Local Code and the extent of compliance with it. The annual review of the 2013/14 Code of Corporate Governance was reported to Audit & Scrutiny Committee in March 2015, and provides the audit opinion of "Full Assurance".

The Internal Audit Service operates in accordance with the Public Sector Internal Standards (the Standards). Section 2450 of the Standards states that *"the annual Internal Audit opinion must conclude on the overall adequacy and effectiveness of the organisation's framework of governance, risk management and control. In addition, the annual report must incorporate:*

- *The opinion;*
- *The summary of work that supports that opinion; and*
- *A statement on conformance with the Standards and the results of the quality assurance and improvement programme"*.

The Head of Audit and Risk Management's responsibilities in this regard were discharged through the presentation of the Statement of Internal Control and Annual Report 2014/15 to the Audit and Scrutiny Committee on 18 June 2015.

The work undertaken by the Internal Audit Section during the year to 31 March 2015 consists of that undertaken directly for the Fund and indirectly where the Highland Council's financial systems are used. The 2014/15 plan comprised of the following two audits:

- A review of the systems of internal control for the financial year 2014/15 consisting of a high level review of the adequacy and effectiveness of the Fund's system of internal control and targeted testing of key controls to confirm that the main financial systems are operating as intended. No control issues have been identified from this work and the audit findings will be addressed in a separate report.
- An audit of Pension Fund Investments. Details of this audit were provided to the Pensions Committee on 24/09/15 including the audit opinion of "Full Assurance". The report contained two low grade recommendations and the corresponding management actions have been implemented as agreed.

Audit recommendations are action tracked to ensure that the management agreed actions have been satisfactorily implemented. The 2013/14 Statement of Internal Control and Annual Report referred to 2 actions (1 low grade and 1 medium grade) due to be implemented during that year that were been partially implemented as the risk register was reported to the Committee in August 2014 but the risk policy and risk management strategy have not been completed. However, these have been drafted and sent to officers for consultation. It is intended that the final version will be submitted for approval by the September 2015 meeting of the Pensions Committee.

On the basis of the work undertaken during the year, it is considered that the key systems operate in a sound manner and that there has been no fundamental breakdown in control resulting in material discrepancy. However as no system of control can provide absolute assurance against material loss, nor can Internal Audit give that assurance, it is the audit opinion that reasonable assurance can be placed upon the adequacy and effectiveness of the Council's internal control systems for the year to 31 March 2015.

We have been advised on the implications of the result of the review of the effectiveness of the governance framework by the Audit and Scrutiny Committee and that the arrangements continue to be regarded as fit for purpose in accordance with the governance framework. The areas already addressed and those to be specifically addressed with new actions planned are outlined below.

Significant Governance Issues

Payments issue

Two payments were made from the Highland Council bank accounts rather than Pension Fund bank accounts in error during the year. The first occurred when new BACS software was set up and the pensioner's payroll was erroneously linked to the Council's bank account number. The second was due to incorrect processing by the Council's IT provider. Both these errors were identified by the Council's Treasury team and arrangements were made to reimburse the council's bank account. In addition, processes have been put in place to prevent such errors recurring.

Intercompany

During 2014/15 significant progress was made in addressing issues at source causing the intercompany difference by amending automated coding in the payroll system and putting in a process to check payment amounts to the ledger before funds are transferred. As a result of this work, it was found that the previously unidentified debtor balance of £0.169m was attributable to the processing of VAT (£0.672) and a creditor balance attributable to 2013/14 transactions (£0.503m).

A project was set up in June 2015 with dedicated resource in order to fully analyse and investigate the intercompany balance. As part of this project, work is underway to set up a robust process for reviewing the intercompany basis using the new ledger system in 2015/16.

We are satisfied that this project will address the need for improvement that was identified in our review of effectiveness and will monitor its implementation and operation as part of our next annual review.

Steve Barron Chief Executive	Dave Fallows Chairman Pensions Committee

24 September 2015

On behalf of the members and senior officers of the Highland Council.

Governance Compliance Statement

The Regulations that govern the management of LGPS funds in Scotland require that a Governance Compliance Statement is published. The Governance Compliance Statement which sets out the extent, to which governance arrangements comply with best practice, is provided below.

The following arrangements were in place for financial year 2014/15, however from 1 April 2015, the Committee structure has been revised to comply with the Local Government Pension Scheme (Governance) (Scotland) Regulations 2015.

Principle	Full Compl -iance	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 Highland Council as administering authority has delegated all pension scheme matters to the Pensions Committee. In addition a small Investment Sub Committee has been established to enhance the Council's management and investment of the assets of the Pension Fund in accordance with the respective objectives and strategies of the Fund (Minute of The Highland Council 27 October 2011).
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 has two non-voting members representing other employers and two non-voting members representing scheme members. The Investment Sub Committee has two non-voting members representing other employers.
That where a secondary committee or panel has been established, the structure ensures effective communication across both levels.	Yes	The minutes of the Investment Sub Committee are presented to the Pensions Committee and there is significant commonality in the membership of the two committees.
That where a secondary committee or panel has been established, at least one seat of the main committee is allocated for a member from the secondary committee or panel.	Yes	The minutes of the Investment Sub Committee are presented to the Pensions Committee and there is significant commonality in the membership of the two committees.
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); • Scheme members (including deferred and pensioner scheme members)	Yes	As stated above there are employer and employee representatives on both Pension Fund Committees. The Fund's investment advisers regularly attend the Pension Investment Sub-Committee and the Fund's actuaries attend the Pension Committee when appropriate. In addition, Fund Managers attend the Investment Sub Committee on a

• Where appropriate, independent professional observers, and • Expert advisors (on an ad-hoc basis).		rotational basis.
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	All Pensions Committee members are provided with training, as well as access to papers in advance of Committee meetings and have the opportunity to contribute to the decision making process. *As noted above there are changes from 1 April 2015, whereby a Pensions Board has been set up. The Pensions Board which will be a bipartite body with an equal number of representatives from local government employers and relevant trade unions. There must be a minimum of 4 from each side. The Scheme Manager has to be satisfied that appointees to the Pension Board do not have a conflict of interest.*
Selection and Role of Lay Members		
That committee or panel members are made fully aware of the status, role and function that they are required to perform on either a main or secondary committee.	Yes	A comprehensive training programme including induction is in place. Training for Pension Committee & Investment Sub Committee members includes presentations from investment managers, Custodian, actuary and investment advisors. Attendance at meetings and training is monitored and reported.
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 Member's interests is a standard item on the agenda of both Pension Fund Committees.
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	The policy on voting rights is clearly stated in the remits of both Pension Fund Committees.
Training /Facility Time /Expenses		
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	There is a training, knowledge and skills policy in place which was approved by Pensions Committee in November 2013 and incorporates the CIPFA Code of Practice on Public Sector Pensions Knowledge and Skill (2011). The training policy recognises the importance of ensuring that it has the necessary resources to discharge its pension's administration responsibilities and that all staff and

		members charged with financial administration, governance and decision-making with regard to the pension scheme are fully equipped with the knowledge and skills to discharge the duties and responsibilities allocated to them.
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	All members are treated equally under the training policy regardless of whether or not they have voting rights.
That the administering authority considers the adoption of annual training plans for committee members and maintains a log of all such training.	Yes	Members receive training each year and this is monitored and reported.
Meeting Frequency		
That an administering authority's main committee or committees meet at least quarterly.	Yes	The Pensions Committee meets at least four times a year with the option to hold special meetings as necessary.
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 Investment Sub-Committee meets at least four times a year with the option to hold special meetings as necessary. The Investment Sub-Committee meetings will be timed so minutes can be presented to the Pensions Committee.
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.	N/A	There is a Scheme Members' representative on the Pensions Committee.
Access		
That subject to any rules in the council's constitution, all members of main and secondary committees or panels have equal access to committee papers, documents and advice that falls to be considered at meetings of the main committee.	Yes	All Members of both Pension Fund committees have full access to agendas, reports and minutes. Voting rights are restricted to Highland Council Elected Members.
Scope		
That administering authorities have taken steps to bring wider scheme issues within the scope of their governance arrangements.	Yes	The Pension Committee has an overview of investment, funding and member benefit matters.
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 interest in wanting to be part of those arrangements.	Yes	The Highland Council publishes governance documents and communicates regularly with employers and scheme members. http://www.highlandpensionfund.org/about-us/forms-and-publications.aspx

Statement of Responsibilities

The Authority's Responsibilities

The Highland Council, as the administering authority for the Highland Council Pension Fund, is required to:

- make arrangements for the proper administration of its financial affairs and to secure that the proper officer of the authority has responsibility for the administration of those affairs (section 95 of the Local Government (Scotland) Act 1973). In this authority that officer is the Director of Finance.
- manage its affairs, to secure economic, efficient and effective use of resources and safeguard its assets.
- Ensure that Annual Accounts are prepared in accordance with legislation (The Local Authority Accounts (Scotland) Regulations 2014), and so far as is compatible with that legislation in accordance with proper accounting practices (section 12 of the Local Government in Scotland Act 2003).
- Approve the Annual Accounts for signature.

I confirm that these Annual Accounts were approved for signature by the Pensions Committee on 24 September 2015.

Dave Fallows
Chairman
Pensions Committee

24 September 2015

The Director of Finance's Responsibilities

The Director of Finance is responsible for the preparation of the Pension Fund's statement of accounts in accordance with proper practices as set out in the CIPFA/ LASAAC *Code of Practice on Local Authority Accounting in the United Kingdom* (the Accounting Code).

In preparing this statement of accounts, the Director of Finance has:

- selected suitable accounting policies and applied them consistently
- made judgements and estimates that were reasonable and prudent
- complied with legislation
- complied with the local authority Accounting Code (in so far as it is compatible with legislation)

The Director of Finance has also:

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

I, the Director of Finance of Highland Council as Chief Finance Officer certify that the financial statements give a true and fair view of the financial transactions of the Fund for the year ended 31 March 2015.

Derek Yule
B.Com. CPFA. IRRV (Hons)
Director of Finance

24 September 2015

Independent Auditor's report

Independent auditor's report to the members of The Highland Council as administering body for the Highland Council Pension Fund and the Accounts Commission for Scotland

I certify that I have audited the financial statements of the Highland Council Pension Fund for the year ended 31 March 2015 under Part VII of the Local Government (Scotland) Act 1973. The financial statements comprise the Pension Fund Account, the Net Assets Statement and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union, and as interpreted and adapted by the Code of Practice on Local Authority Accounting in the United Kingdom 2014/15 (the 2014/15 Code).

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

Respective responsibilities of the Director of Finance and auditor

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

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Fund's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Director of Finance; and the overall presentation of the financial statements. In addition, I read all the financial and non-financial information in the Annual Report and Annual Accounts to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by me in the course of performing the audit. If I become aware of any apparent material misstatements, irregularities, or inconsistencies I consider the implications for my report.

Opinion on financial statements

In my opinion the financial statements:

- give a true and fair view in accordance with applicable law and the 2014/15 Code of the financial transactions of the Highland Council Pension Fund during the year ended 31 March 2015, and of the amount and disposition at that date of its assets and liabilities;
- have been properly prepared in accordance with IFRSs as adopted by the European Union, as interpreted and adapted by the 2014/15 Code; and
- have been prepared in accordance with the requirements of the Local Government (Scotland) Act 1973, The Local Authority Accounts (Scotland) Regulations 2014, and the Local Government in Scotland Act 2003.

Opinion on other prescribed matter

In my opinion the information given in the Management Commentary for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which I am required to report by exception

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

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

I have nothing to report in respect of these matters.

Stephen Boyle
Assistant Director
Audit Scotland
4th Floor South Suite
The Athenaeum Building
8 Nelson Mandela Place
GLASGOW
G2 1BT

24 September 2015

Pension Fund Account

2013/14 £000 Restated*		Notes	**2014/15 £000**
	Dealings with members, employers and others directly involved in the scheme		
50,578	Contributions receivable	7	51,405
2,184	Transfers in from other pension funds	8	2,189
(43,101)	Benefits payable	9	(47,381)
(2,784)	Payments to and on account of leavers	10	(2,001)
6,877	**Net additions from dealings with members**		**4,212**
(6,367)	**Management expenses**	11	**(7,511)**
	Returns on Investments		
25,097	Investment income	12	28,496
64,885	Profit and losses on disposal of investments and changes in values of investments	14.1	148,050
(205)	Taxes on income	13	(186)
89,777	Net Return on Investments		**176,360**
90,287	**Net increase in the net assets available for benefits during the year**		**173,061**
1,185,446	Opening net assets as at the start of the year		1,275,733
1,275,733	**Closing net assets as at the end of the year**		**1,448,794**

*****The results for the year ended 31 March 2014 have been restated to reflect a change in the accounting policy on investment management expenses. This change has the effect of increasing the change in market value of investment by £2.098m and increasing investment management expenses by £2.098m. There is no change in the net returns on investment. See note 25 for details.

Net Assets Statement as at 31 March 2015

As at 31/03/14 £000		Notes	**As at 31/03/15 £000**
1,251,750	Investment assets	14.1	1,407,571
13,803	Cash deposits	14.1	26,004
2,621	Investment income due	14.1	3,192
2,112	Amounts receivable for sales	14.1	171
(1,799)	Investment liabilities	14.1	(3,837)
1,268,487	**Total net investment assets**	14.1	**1,433,101**
	Long term assets		
	Long term debtors	22	567
	Current assets		
6,884	Short term debtors	21	5,572
6,842	Bank accounts		13,952
	Less current liabilities		
(6,480)	Sundry creditors	23	(4,398)
7,246	**Net current assets**		**15,126**
1,275,733	**Closing net assets as at the end of the year available to fund benefits at the period end**[1]		**1,448,794**

The unaudited statement of accounts was issued on 18 June 2015 and the audited statement of accounts was authorised for issue on 24 September 2015.

Derek Yule
B.Com. CPFA.
IRRV(Hons)
Director of Finance
24 September 2015

[1] The Fund's financial statements do not take account of liabilities to pay pensions and other benefits after the period end. The actuarial present value of promised retirement benefits is disclosed at Note 17.

Accounting Policies and Notes to Accounts

1. Description of Fund

The Highland Council is the administering authority of the Highland Council Pension Fund ("the Fund") and is the reporting entity for the Fund.

For further information, reference should be made to the "Management Commentary" on page 3 and "About the Fund" section on page 6 of this document.

General

The Fund is governed as a Local Government Superannuation Scheme, the primary legislation being the Superannuation Act 1972.

2. Basis of preparation

The Pension Fund Accounts have been prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2014/15 which is based upon International Reporting Standards (IFRS) as amended for the UK public sector.

The accounts summarise the transactions of the Fund and report on the net assets available to pay pension benefits. The accounts do not take account of obligations to pay pensions and benefits which fall due after the end of the financial year. The actuarial present value of the promised retirement benefits, valued on an International Accounting Standard (IAS) 19 basis is disclosed at Note 17 of these accounts.

3. Summary of Significant Accounting Policies

Fund account – revenue recognition

a. Contribution income

Normal contributions, both from the members and from the employer, are accounted for on an accruals basis at the percentage rate recommended by the fund actuary in the payroll period to which they relate.

Employer deficit funding contributions are accounted for on the due dates on which they are payable under the schedule of contributions set by the scheme actuary or on receipt if earlier than the due date.

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

b. Transfer to and from other schemes

Transfer values represent the amounts received and paid during the year for members who have either joined or left the Fund during the financial year and are calculated in accordance with the Local government Pension Scheme Regulations (see Notes 8 and 10).

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 (see below) to purchase scheme benefits are accounted for on a receipts basis and are included in Transfers in (see Note 8).

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

c. Investment income

i) Interest income

Interest income is recognised in the Fund account as it accrues, using the effective interest rate of the financial instrument as at the date of acquisition or origination. Income includes the amortisation of any discount or premium, transactions costs (where material) 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 investment income due.

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 investment income due.

iv) Property-related income

The Fund does not invest directly in property. All property investments are on a ‘fund of funds’ basis.

v) Movement in the net market value of investments

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

Fund account – expense items

d. Benefits payable

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

e. Taxation

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

f. Management expenses

The Code does not require any breakdown of pension fund administrative expenses. However, in the interests of greater transparency, the Fund discloses its pension fund management expenses in accordance with the CIPFA guidance *Accounting for Local Government Pension Scheme Management Costs*.

- Administrative expenses

All administrative expenses are accounted for on an accruals basis. All staff costs of the pension administration team are charged direct to the Fund. Associated management, accommodation and other overheads are apportioned to this activity and charged as expenses to the Fund.

- Oversight and governance costs

All oversight and governance expenses are accounted for on an accruals basis. All staff costs associated with governance and oversight are charged direct to the Fund. Associated management, accommodation and other overheads are apportioned to this activity and charged as expenses to the Fund.

- 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.

In advance of preparing the year end a request is made to all Investment Managers for their fee to the end of March 2015 or an estimated fees accrual figure.

The cost of obtaining investment advice from external advisers is included in the investment manager charges and as above a request is sent to all external advisers for their fee to the end of March 2015 or an estimated fees accrual figure.

A proportion of the Council's costs representing management time spent by officers on investment management are also charged to the Fund.

For private equity fees and Fund of Fund, the relevant Fund Managers provided information on underlying fees to the end of March 2015 or a basis for estimating these fees.

Net Assets Statement

g. Financial assets

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

The values of investments as shown in the net assets statement have been determined as follows:

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

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

iii) Unquoted investments

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

- Unquoted holdings in private equity funds have been included at the Fund managers' valuation adjusted for cash movements since the last valuation date. Unquoted Fund investments are valued at fair value as determined by the Directors or General Partner. The valuations provided by the general partners or managers typically reflect the fair value of the Company's capital account balance of each Fund investment, including unrealised gains and losses, as reported in the Financial Statements of the respective Fund. Private equity investments are typically illiquid and resale is restricted. These valuations are used by the Custodian for reporting purposes.

iv) Pooled investment vehicles

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

h. Foreign currency transactions

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

i. Derivatives

The Fund uses derivative financial instruments to manage its exposure to specific risks arising from its investment activities. The Fund does not hold derivatives for speculative purposes.

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

The value of futures contracts is determined using exchange prices at the reporting date. Amounts due from or owed to the broker are the amounts outstanding in respect of the initial margin and variation margin.

The future value of forward currency contracts is based on market forward exchange rates at the year-end date and determined as the gain or loss that would arise if the outstanding contract were matched at the year-end with an equal and opposite contract.

j. Cash and cash equivalents

Cash comprises cash in hand and demand deposits and includes amounts held by the Fund's external managers. 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.

k. Financial liabilities

The Fund recognises financial liabilities at fair value as at the reporting date. A financial liability is recognised in the net asset statement on the date the Fund becomes party to the liability. From this date any gains or losses arising from changes in the fair value of the liability are recognised by the Fund.

l. Actuarial present value of promised retirement benefits
The actuarial present value of promised retirement benefits is assessed on a triennial basis by the scheme actuary in accordance with the requirements of IAS 19 and relevant actuarial standards (Code Para 6.5.2.8).

As permitted under IAS 26 the Fund has opted to disclose the actuarial present value of the promised retirement benefits by way of a note to the Net Assets Statement (Note 17).

m. Additional voluntary contributions
The Highland Council Pension Fund provides an additional voluntary contributions (AVC) scheme for its members, the assets of which are invested separately from those of the Fund. The Fund has appointed Prudential as its AVC provider. AVCs are paid to the AVC provider 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 their movements in the year.

AVCs are not included in the accounts in accordance with section 4 (2) (b) of the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010 (Statutory Instrument 2010/233). However, Note 18 provides AVC figures for information purposes only.

4. Critical Judgements in Applying Accounting Policies

Unquoted private equity investments
It is important to recognise the highly subjective nature of determining the fair value of private equity investments. They are inherently based on forward-looking estimates and judgements involving many factors. Unquoted private equities are valued by the investment managers using guidelines set out by the British Venture Capital Association. The value of unquoted private equities at 31 March 2015 was £37.2m and prior year comparator (£20.3m).

Pension fund liability
The pension fund liability is calculated every three years by the appointed actuary, with annual updates in the intervening years. The methodology used is in line with accepted guidelines and in accordance with IAS 19. Assumptions underpinning the valuations are agreed with the actuary and are summarised in the Actuarial Position (Note 17). This estimate is subject to significant variances based on changes to the underlying assumptions.

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

This Statement of Accounts contains estimated figures that are based on assumptions made by the Fund about the future or that are otherwise uncertain. Estimates are made taking into account historical experience, current trends and other relevant factors. However, because outcomes cannot be determined with certainty, actual results could be materially different from the assumptions and estimates.

The items in the Financial Statements at 31 March 2015 for which there is a significant risk of material adjustment in the forthcoming financial year are as follows:

Item	Uncertainties	Effect if actual results differ from assumptions
Actuarial present value of promised retirement benefits	Estimation of the net liability to pay pensions depends on a number of complex judgements relating to the discount rate used, the rate at which salaries are projected to increase, changes in retirement ages, mortality rates and expected returns on pension fund assets. A firm of consulting actuaries is engaged to provide the Fund with expert advice about the assumptions to be applied.	The effects on the net pension liability of changes in individual assumptions can be measured. For instance, a 0.5% decrease in the discount rate assumption would result in an increase to employer liability of 10% (£199m). 1 year increase in member life expectancy would result in an increase in the employer liabilities of 3% (£59.6m).
Private equity	Private equity investments are valued at fair value in accordance with British Venture Capital Association guidelines. These investments are not publicly listed and as such there is a degree of estimation involved in the valuation.	The total private equity investments in the financial statements are £37.2m. There is a risk that this investment may be under or overstated in the accounts.

6. Events after the Balance Sheet Date

The unaudited statement of accounts was issued on 18 June 2015 and the audited statement of accounts was authorised for issue on 24 September 2015. Events taking place after this date are not reflected in the accounts or notes. There have been no events since 31 March 2015, and up to the date these accounts were authorised that require any adjustment to these accounts.

7. Contributions Receivable

By category	2013/14	**2014/15**
	£000	**£000**
Members' pension contributions	12,291	12,427
Employers' pension contributions	38,287	38,978
Total contributions	**50,578**	**51,405**

As Highland Council Pension Fund had a deficit at the last actuarial valuation in 2011, the employers were required to make a contribution towards restoring the funding position in excess of the amount required to fund the on-going accrual of benefits. The table below shows an estimate of the split between normal contributions (required to fund the accrual of benefits for current service) and the amount attributable to deficit funding. This estimate is calculated based on a future service contribution rate excluding deficit contribution of 16.3% (as stated in the actuarial valuation at 31 March 2011). The Strain on the Fund is the cost to the Fund of the early release of Pension Benefits. These costs are payable by the Employer. The contribution rates that have been certified by the Actuary have been set to fund each employer's share of the deficiency in the Fund over the next 20 years. The outcome of the 2011 valuation resulted in revised contribution rates for years 2012/13 onwards.

As a result of the 2014 valuation, the future service contribution rate excluding deficit contributions has increased to 18.8% primarily due to the decrease in the real gilt yields which has increased both the employer future service rate and the past service adjustment. The outcome of the 2014 valuation will result in revised contribution rates for the next three financial years until 2017/18.

Analysis of Contributions by Authority

2013/14		**2014/15**			
		Highland Council	**Scheduled Bodies**	**Admitted Bodies**	**Totals**
£000		£000	£000	£000	£000
35,290	Normal contribution	19,763	8,224	7,665	35,652
1,521	Deficit funding	403	159	149	711
36,811		20,166	8,383	7,814	36,363
1,476	Strain on Fund	974	1,491	150	2,615
38,287	Employer's contributions	21,140	9,874	7,964	38,978
12,291	Members' pension contributions	6,781	2,859	2,787	12,427
50,578	**Total contributions**	**27,921**	**12,733**	**10,751**	**51,405**

Number of Contributors and Pensioners

2014/15	**Contributors**	**Pensioners**	**Deferred Pensioners**
Highland Council	6,984	5,887	5,493
Scheduled Bodies	2,771	1,702	1,787
Admitted Bodies	2,393	496	679
Total	**12,148**	**8,085**	**7,959**
2013/14			
Highland Council	6,781	5,659	5,513
Scheduled Bodies	2,647	1,625	1,726
Admitted Bodies	2,422	381	593
Total	**11,850**	**7,665**	**7,832**

8. Transfers in from other Pension Funds

	2013/14	**2014/15**
	£000	**£000**
Group transfers	-	-
Individual transfers	2,184	2,189
	2,184	**2,189**

9. Benefits payable

By category	2013/14	2014/15
	£000	£000
Pensions	(32,844)	(35,363)
Lump sum retirement benefits	(9,063)	(9,644)
Lump sum death benefits	(1,194)	(2,374)
	(43,101)	**(47,381)**

By authority	2013/14	2014/15
	£000	£000
Highland Council	(30,069)	(32,461)
Scheduled Bodies	(8,361)	(9,834)
Admitted Bodies	(4,671)	(5,086)
	(43,101)	**(47,381)**

10. Payments to and on account of leavers

	2013/14	2014/15
	£000	**£000**
Refunds to members leaving service	(118)	(142)
Payments for members joining state scheme	(93)	(104)
Group transfers	(92)	-
Individual transfers	(2,481)	(1,755)
	(2,784)	**(2,001)**

At the year-end there are potential liabilities of a further £0.223m (£0.817m 2013/14) in respect of individuals transferring out of the pension fund upon whom the Fund is awaiting final decisions. No provision has been made for these potential liabilities within the statement of accounts.

11. Management expenses

	31 March 2014	**31 March 2015**
	£000	**£000**
Administrative expenses	(898)	(887)
Oversight and Governance costs	(285)	(417)
Investment Management expenses	(5,184)	(6,207)
	(6,367)	**(7,511)**

Administrative costs	31 March 2014 £000	**31 March 2015 £000**
Administrative costs	(136)	(159)
Employee costs	(755)	(723)
Other administration	(7)	(5)
	(898)	**(887)**

Oversight and governance costs	31 March 2014 £000	**31 March 2015 £000**
Actuarial fees	(38)	(102)
External Audit fees	(33)	(49)
Internal Audit fees	(9)	(17)
Investment advisor fees	(57)	(109)
Tax advisor fees	(16)	(4)
Legal fees	(5)	(2)
Performance management	(24)	(21)
Employee costs	(88)	(96)
Sundry costs	(15)	(17)
	(285)	**(417)**

Investment management expenses	31 March 2014 £000	**31 March 2015 £000**
External management fees invoiced	(2,613)	(2,828)
External management fees deducted from capital	(1,798)	(2,723)
Custodian fees	(115)	(70)
Investment expenses	(358)	(256)
Transaction costs	(300)	(330)
	(5,184)	**(6,207)**

Following a change in accounting policy, the expenses for 2013/14 have been restated to account for costs that were deducted from capital and therefore impacted the change in market value of investments reported in the Fund Account. See note 25 for details of prior year adjustment. The related costs are included above as external management fees deducted from capital. Investment transaction costs that were previously added to the cost of purchases or deducted from the proceeds are now accounted for as expenses and shown above in transaction costs.

Any indirect costs incurred through the bid-offer spread on some pooled investment vehicles are reflected in the cost of investment acquisitions or in the proceeds of investment sales.

12. Analysis of investment income

	31 March 2014	**31 March 2015**
	£000	**£000**
Dividends from equities	15,034	15,969
Income from pooled investments	9,389	12,185
Interest on cash deposits	250	193
Private equity income	347	139
Other investments	77	10
	25,097	**28,496**

13. Taxes on income

	31 March 2014	**31 March 2015**
	£000	**£000**
Withholding tax – fixed interest securities	-	-
Withholding tax - equities	(205)	(186)
Withholding tax – pooled	-	-
	(205)	**(186)**

14. Investment assets

14.1. Reconciliation of movements in investments and derivatives

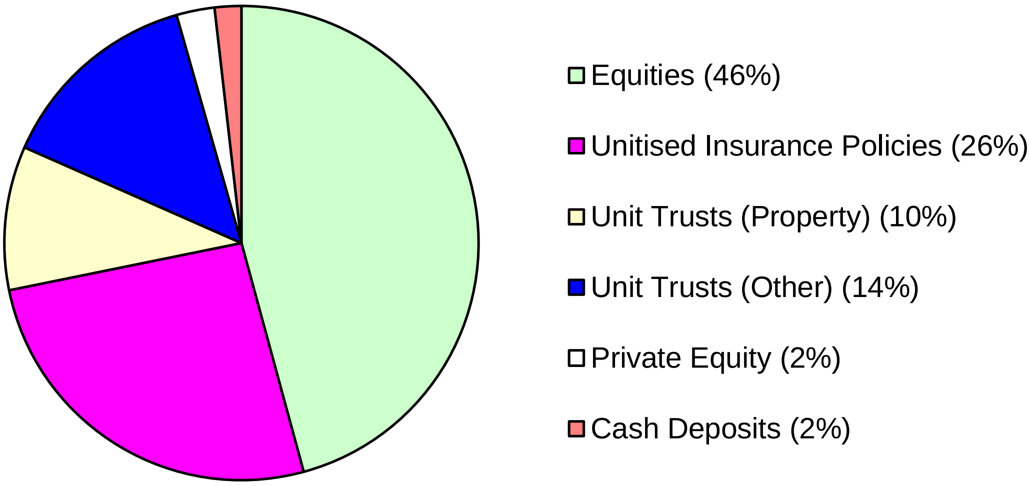
2014/15 **Classifications**	**Market value at 1 April 2014**	**Purchases at cost & derivative payments**	**Sales proceeds & derivative receipts**	**Change in market value**	**Market value at 31 March 2015**
	£000	**£000**	**£000**	**£000**	**£000**
Investment assets					
Equities	582,181	97,357	(86,144)	62,766	656,160
Unitised insurance policies	359,454	-	(25,000)	38,780	373,234
Unit trusts (property)	120,045	14,988	(8,321)	13,838	140,550
Unit trusts (other)	169,682	10,271	(3,341)	23,796	200,408
Private equity	20,263	17,669	(915)	202	37,219
Currency forwards	125	-	-	(125)	-
Investment liabilities	-				
Currency Forwards	(305)	-	-	(487)	(792)
	1,251,445	140,285	(123,721)	138,770	1,406,779
Other investment balances					
Cash deposits	13,803	-	-	12,201	26,004
Investment income due	2,621	-	-	571	3,192
Amounts receivable for sales	2,112	-	-	(1,941)	171
Amounts payable for purchases	(1,494)	-	-	(1,551)	(3,045)
Total net investment assets	1,268,487	140,285	(123,721)	148,050	1,433,101

2013/14 **Classifications** **Restated**	**Market value at 1 April 2013**	**Purchases at cost & derivative payments**	**Sales proceeds & derivative receipts**	**Change in market value**	**Market value at 31 March 2014**
	£000	**£000**	**£000**	**£000**	**£000**
Investment assets					
Equities	539,803	80,885	(77,874)	39,367	582,181
Unitised insurance policies	339,994	-	-	19,460	359,454
Unit trusts (property)	91,199	24,715	(3,974)	8,105	120,045
Unit trusts (other)	171,508	5,896	(5,505)	(2,217)	169,682
Private equity	12,982	7,364	(1,089)	1,006	20,263
Currency forwards	457	-	-	(332)	125
Investment liabilities					
Currency forwards	-	-	-	(305)	(305)
	1,155,943	118,860	(88,442)	65,084	1,251,445
Other investment balances					
Cash deposits	17,117	-	-	(3,314)	13,803
Investment income due	2,921	-	-	(300)	2,621
Amounts receivable for sales	1,143	-	-	969	2,112
Amounts payable for purchases	(3,940)	-	-	2,446	(1,494)
Total net investment assets	1,173,184	118,860	(88,442)	64,885	1,268,487

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

Following a change in accounting policy transaction costs are no longer included in the cost of purchases and sales proceeds. As a result, the figures for 2013/14 have been restated, information on transaction costs can now be found in note 11 on investment management expenses. Any indirect costs incurred through the bid-offer spread on some pooled investment vehicles are reflected in the cost of investment acquisitions and in the proceeds from sales and are therefore included in the tables above.

14.2. Analysis of investments



2013/14		**Portfolio Distribution UK & overseas**	**2014/15**	
UK	Overseas		**UK**	**Overseas**
£000	£000	**Investment assets**	**£000**	**£000**
254,812	327,369	Equities	285,704	370,456
302,188	57,266	Unitised insurance policies	310,470	62,764
111,664	8,381	Unit trusts (property)	135,185	5,365
169,682	-	Unit trusts (other)	200,408	-
-	20,263	Private equity	-	37,219
-	125	Currency forwards	-	-
12,904	899	Cash deposits	25,796	208
1,364	1,257	Investment income due	1,705	1,487
-	2,112	Amounts receivable for sales	-	171
852,614	**417,672**		**959,268**	**477,670**
		Investment liabilities		
-	(305)	Currency forwards	-	(792)
-	(1,494)	Amounts payable for purchases	(2,085)	(960)
852,614	**415,873**	**Net total**	**957,183**	**475,918**
	1,268,487	**Total UK & overseas**		**1,433,101**

2013/14 Quoted £000	2013/14 Unquoted £000	Portfolio Distribution – (Quoted / Unquoted)	2014/15 Quoted £000	2014/15 Unquoted £000
		Investment assets		
582,181	-	Equities	656,160	-
359,454	-	Unitised insurance policies	373,234	-
120,045	-	Unit trusts (property)	140,550	-
169,682	-	Unit trusts (other)	200,408	-
-	20,263	Private equity	-	37,219
-	125	Currency forwards	-	-
-	13,803	Cash deposits	-	26,004
2,621	-	Investment income due	3,192	-
-	2,112	Amounts receivable for sales	-	171
1,233,983	**36,303**		**1,373,544**	**63,394**
		Investment liabilities		
-	(305)	Currency forwards	-	(792)
-	(1,494)	Amounts payable for purchases	-	(3,045)
1,233,983	**34,504**	**Net total**	**1,373,544**	**59,557**
	1,268,487	**Total quoted & unquoted**		**1,433,101**

14.3. Funds under External Management

The Market Value of the assets (at 1 April 2014 and 31 March 2015) which were under the management of fund managers and the proportion managed by each manager are below.

2013/14 Market Value £000	2013/14 % of Fund	Manager Analysis	2014/15 Market Value £000	2014/15 % of Fund
457,183	36.0	Baillie Gifford (UK and global equity)	507,680	35.4
151,785	12.0	Pyrford (global equity)	178,629	12.5
159,213	12.6	Fidelity (bond fund)	189,337	13.2
359,457	28.3	Legal and General (equity and bonds)	373,237	26.0
31	-	Legal and General (transition)	-	-
120,507	9.5	Schroders (property fund)	146,937	10.3
20,311	1.6	Partners Group (private equity)	37,281	2.6
1,268,487	**100.0**	**Combined Fund**	**1,433,101**	**100.0**

14.4. Top 10 Equity Holdings by Market Value

Holding at 31 March 2015	Market Value £000	% of Total Equity Investments	Classification
Prudential	18,359	1.76	Insurance
British American Tobacco	12,599	1.21	Tobacco
Legal & General	11,469	1.10	Insurance
Ashtead Group	10,385	1.00	Industrial good & services
St James's Place	9,708	0.93	Insurance
Bunzl	8,977	0.86	Support Services
Nestle	8,638	0.83	Food producers
Royal Caribbean Cruises	8,528	0.82	Travel and Leisure
Naspers	8,247	0.79	Media
HSBC	7,333	0.70	Banks
Total	**104,243**	**10.00**	

14.5. Holdings exceeding 5% by total net assets

The Fund holds the following investments that exceed 5% of the net assets available for benefits.

Fund Manager & Category	Market Value at 31 March 2014	% of total net assets	Market Value at 31 March 2015	% of total net assets
	£000	%	£000	%
Fidelity UK Inst Stg Core Plus	79,710	6.2	95,012	6.6
Legal & General (UK Equity Index)	217,606	17.1	216,330	15.0
Fidelity Instl UK Agg Bond	79,504	6.2	94,325	6.5
Total net assets available for benefits	1,275,733		**1,448,794**	

14.6. Derivatives - Summary of Contracts at 31 March 2015

Settlement	Currency bought	Local value	Currency sold	Local value	Asset value	Liability value
		000		000	£000	£000
One to six months	GBP	17,987	CHF	(26,836)		(787)
Up to one month	GBP	57	USD	(38)	-	-
Up to one month	GBP	34	USD	(51)	-	-
Up to one month	GBP	50	DKK	(516)	-	-
Up to one month	USD	709	GBP	(480)	-	(3)
Up to one month	GBP	11	CHF	(16)	-	-
Up to one month	USD	432	GBP	(292)	-	(2)
Up to one month	GBP	33	USD	(49)	-	-
Up to one month	USD	136	GBP	(92)	-	-
					-	(792)
Net forward currency contracts at 31 March 2015						**(792)**
Prior year comparative						
Open forward currency contracts at 31 March 2014					**125**	**(305)**
Net forward currency contracts at 31 March 2014						**(180)**

Investment Managers Pyrford International and Baillie Gifford hold short term currency forwards for the Fund. The use of these forward foreign currency contracts is in line with the investment management agreement between the Fund and these Fund Managers.

This currency hedging is in place to reduce the extent to which the Fund is exposed to certain currency movements. These investments are used to ensure that cash can remain invested short term in equities. The sale of currency forwards, traded over the counter (OTC), is undertaken in order to hedge foreign currency exposure risk back to the portfolio's base currency of GBP.

14.7. Stock lending

As at 31 March 2015, no stock was released to a third party under a securities lending agreement.

15. Financial Instruments

15.1. 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 carrying amount of financial asset and liabilities by category and net assets statement heading. No financial assets were reclassified during the accounting period.

31 March 2015	**Fair value through profit & loss**	**Loans & receivables**	**Financial liabilities at amortised cost**	**Total**
	£000	**£000**	**£000**	**£000**
Financial assets				
Equities	656,160	-	-	656,160
Unitised insurance policies	373,234	-	-	373,234
Unit trusts (property)	140,550	-	-	140,550
Unit trusts (other)	200,408	-	-	200,408
Private equity	37,219	-	-	37,219
Derivative contracts – currency forwards	-	-	-	-
Cash deposits	-	26,004	-	26,004
Investment income due	3,192	-	-	3,192
Long term debtors		567		567
Amounts receivable for sales	171	-	-	171
Short term debtors	-	5,572	-	5,572
Bank	-	13,952	-	13,952
	1,410,934	**46,095**	**-**	**1,457,029**
Financial liabilities				
Derivative contracts - equity futures offsets	-	-	-	-
Derivative contracts – currency forwards	(792)	-	-	(792)
Amounts payable for purchases	(3,045)	-	-	(3,045)
Creditors		-	(4,398)	(4,398)
Closing net assets	**1,407,097**	**46,095**	**(4,398)**	**1,448,794**

31 March 2014	Fair Value through profit & loss	Loans & receivables	Financial liabilities at amortised cost	Total
	£000	£000	£000	£000
Financial assets				
Equities	582,181	-	-	582,181
Unitised insurance policies	359,454	-	-	359,454
Unit trusts (property)	120,045	-	-	120,045
Unit trusts (other)	169,682	-	-	169,682
Private equity	20,263	-	-	20,263
Derivative contracts - currency forwards	125	-	-	125
Cash deposits	-	13,803	-	13,803
Investment income due	2,621	-	-	2,621
Amounts receivable for sales	2,112	-	-	2,112
Debtors	-	6,884	-	6,884
Bank	-	6,842	-	6,842
	1,256,483	**27,529**	**-**	**1,284,012**
Financial liabilities				
Derivative contracts - equity futures	-	-	-	-
Derivative contracts - currency forwards	(305)	-	-	(305)
Amounts payable for purchases	(1,494)	-	-	(1,494)
Creditors	-	-	(6,480)	(6,480)
Closing net assets	**1,254,684**	**27,529**	**(6,480)**	**1,275,733**

15.2. Net gains and losses on financial instruments

	31 March 2014	**31 March 2015**
	£000	**£000**
Financial assets		
Fair value through profit and loss	65,084	138,770
Loans and receivables	668	10,831
Financial liabilities measured at amortised cost	-	-
Financial liabilities	-	-
Fair value through profit and loss	-	-
Loans and receivables	-	-
Financial liabilities measured at amortised cost	(867)	(1,551)
Total	**64,885**	**148,050**

15.3. Fair value of financial instruments and liabilities

The following table summarises the carrying values of the financial assets and financial liabilities by class of instrument compared with their fair value.

2013/14			**2014/15**	
Carrying value	Fair value		**Carrying value**	**Fair value**
£000	£000	**Financial assets**	**£000**	**£000**
919,233	1,256,483	Fair value through profit and loss	973,551	1,410,934
27,529	27,529	Loans and receivables	46,095	46,095
946,762	**1,284,012**	**Total financial assets**	**1,019,646**	**1,457,029**
		Financial liabilities		
(1,803)	(1,799)	Fair value through profit and loss	(3,837)	(3,837)
(6,480)	(6,480)	Financial liabilities measured at amortised cost	(4,398)	(4,398)
(8,283)	**(8,279)**	**Total financial liabilities**	**(8,235)**	**(8,235)**
938,479	**1,275,733**		**1,011,411**	**1,448,794**

The Fund has not entered into any financial guarantees that are required to be accounted for as financial instruments.

15.4. 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, quoted fixed securities, quoted index linked securities and unit trusts.

Listed investments are shown at bid prices. The bid value of the instrument 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.

Values at 31 March 2015	Quoted market price	Using observable input	With significant unobservable inputs	
	Level 1	**Level 2**	**Level 3**	**Total**
Financial assets	£000	£000	£000	£000
Financial assets at fair value through profit and loss	1,233,144	140, 571	37,219	1,410,934
Loans and receivables	46,095	-	-	46,095
Total financial assets	**1,279,410**	**140, 571**	**37,219**	**1,457,029**
Financial liabilities				
Financial liabilities at fair value through profit and loss	(3,837)	-	-	(3,837)
Financial liabilities at amortised cost	(4,398)	-	-	(4,398)
Total financial liabilities	**(8,235)**	**-**	**-**	**(8,235)**
Net financial assets	**1,271,004**	**140,571**	**37,219**	**1,448,794**

Values at 31 March 2014				
	Level 1	**Level 2**	**Level 3**	**Total**
Financial assets	£000	£000	£000	£000
Financial assets at fair value through profit and loss	1,116,175	120,045	20,263	1,256,483
Loans and receivables	27,529	-		27,529
Total financial assets	**1,143,704**	**120,045**	**20,263**	**1,284,012**
Financial liabilities				
Financial liabilities at fair value through profit and loss	(1,799)	-	-	(1,799)
Financial liabilities at amortised cost	(6,480)	-	-	(6,480)
Total financial liabilities	**(8,279)**	**-**	-	**(8,279)**
Net financial assets	**1,135,425**	**120,045**	**20,263**	**1,275,733**

16. The Nature and Extent of Risks Arising from Financial Instruments

Risk and risk management

The Fund's primary long-term risk is that the Fund's assets will fall short of its liabilities (i.e. promised benefit payable to members). Therefore the aim of investment risk management is to minimise the risk of an overall reduction in the value of the Fund and to maximise the opportunity for gains across the whole Fund portfolio. The Fund achieves this through asset diversification to reduce exposure to market risk (price risk, currency risk and interest rate risk) and credit risk to an acceptable level. In addition, the Fund manages its liquidity risk to ensure there is sufficient liquidity to meet the Fund's forecast cash flows. The Fund manages these investment risks as part of its overall pension fund risk management programme.

The Pensions Committee is responsible for the Fund's risk management strategy. There is a risk register in place which follows the CIPFA guidance on 'Managing risk in the LGPS'. This is regularly reviewed and significant risks are reported to the Pensions Committee.

Market risk

Market risk is the risk of loss from fluctuations in equity and commodity prices, interest and foreign exchange rates and credit spreads. The Fund is exposed to market risk from its investment activities, particularly through its equity holdings. The level of risk exposure depends on market conditions, expectations of future price and yield movements and the asset mix.

The objective of the Fund's risk management strategy is to identify, manage and control market risk exposure within acceptable parameters, whilst optimising the return on risk.

In general, excessive volatility in market risk is managed through the diversification of the portfolio in terms of geographical and industry sectors and individual securities. To mitigate market risk, the Fund and its investment advisors undertake appropriate monitoring of market conditions and benchmark analysis.

The Fund manages these risks by ensuring that specific risk exposure is limited by applying risk-weighted maximum exposures to individual investments.

Equity futures contracts and exchange traded option contracts on individual securities may also be used to manage market risk on equity investments. It is possible for over-the-counter equity derivative contracts to be used in exceptional circumstances to manage specific aspects of market risk.

Other price risk

Other price risk represents the risk that the value of a financial instrument will fluctuate as a result of changes in market prices (other than those arising from interest rate risk or foreign exchange risk), whether those changes are caused by factors specific to the individual instruments or its issuer or factors affecting all such instruments in the market.

The Fund is exposed to share and derivative price risk. This arises from investments held by the Fund for which the future price is uncertain. All securities investments present a risk of loss of capital. Except for shares sold short, the maximum risk resulting from financial instruments is determined by the fair value of the financial instruments. Possible losses from shares sold short are unlimited.

The Fund's investment managers mitigate this price risk through diversification and the selection of securities and other financial instruments is monitored by the Fund to ensure it is within limits specified in the fund investment strategy.

Other price risk – sensitivity analysis

Following analysis of historical data and expected investment return movement during the financial year, in consultation with the Fund's investment advisors, the Fund has determined that the following movements in market price risk are reasonably possible for the 2015/16 reporting period

Asset type	**Potential market movement (+/-)%**	**Potential market movement (+/-)%**
	2013/14	**2014/15**
UK equities	20.0	17.0
Global equities (excluding UK)	20.5	20.0
UK fixed income unit trusts	9.0	9.0
Corporate bonds (medium term)	9.0	9.0
UK fixed gilts (medium term)	11.0	11.0
UK index linked gilts (medium term)	9.0	9.0
Property	14.5	12.5
Private Equity	26.0	25.0
Cash	-	-

The potential price changes disclosed above are broadly consistent with a one-standard deviation movement in the value of the assets. The sensitivities are consistent with the assumptions contained in the investment advisors' most recent review. The Fund's investment advisors suggest that the approach to modelling market price risk should take account of the diversification of assets in the Fund. This approach is different to that outlined in the CIPFA recommended code of practice, where the sum of all potential changes in asset class values are taken to determine the impact on the total value of the Fund. Consequently the total Fund volatility takes into account the expected interactions between the different asset classes shown, based on the underlying volatilities and correlations of the assets, in line with mean variance portfolio theory.

Had the market price of the Fund investments increased/decreased in line with the above, the change in the net assets available to pay benefits in the market price would have been as follows (the prior year comparator is shown on page 57):

Asset type	Value as at 31 March 2015	Percentage change	Value on increase	Value on decrease
	£000	%	£000	£000
Cash and cash equivalents	26,004	0.0	26,004	26,004
Investment portfolio assets:				
UK equities	285,704	17.0	334,274	237,134
Global equities (excluding UK)	370,456	20.0	444,548	296,365
UK fixed income unit trusts	385,177	9.0	419,843	350,511
Corporate bonds (medium term)	94,325	9.0	102,814	85,836
UK fixed gilts (medium term)	55,940	11.0	62,093	49,787
UK index linked gilts (medium term)	38,200	9.0	41,638	34,762
Property	140,550	12.5	158,119	122,981
Private equity	37,219	25.0	46,524	27,914
Net currency forwards	(792)	0.0	(792)	(792)
Investment income due	3,192	0.0	3,192	3,192
Amounts receivable for sales	171	0.0	171	171
Amounts payable for purchases	(3,045)	0.0	(3,045)	(3,045)
Net investment assets	**1,433,101**		**1,635,383**	**1,230,820**

Asset type	Value as at 31 March 2014	Percentage change	Value on increase	Value on decrease
	£000	%	£000	£000
Cash and cash equivalents	13,803	0.0	13,803	13,803
Investment portfolio assets:				
UK equities	254,812	20.0	305,774	203,850
Global equities (excluding UK)	327,369	20.5	394,480	260,258
UK fixed income unit trusts	365,051	9.0	397,906	332,196
Corporate bonds (medium term)	79,504	9.0	86,659	72,349
UK fixed gilts (medium term)	50,504	11.0	56,059	44,949
UK index linked gilts (medium term)	34,077	9.0	37,144	31,010
Property	120,045	14.5	137,452	102,638
Private equity	20,263	26.0	25,531	14,995
Net currency forwards	(180)	0.0	(180)	(180)
Investment income due	2,621	0.0	2,621	2,621
Amounts receivable for sales	2,112	0.0	2,112	2,112
Amounts payable for purchases	(1,494)	0.0	(1,494)	(1,494)
Net investment assets	**1,268,487**		**1,457,867**	**1,079,107**

Interest rate risk

The Fund invests in financial assets for the primary purpose of obtaining a return on investments. These investments are subject to interest rate risks, which represent the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

The Fund's interest rate risk is routinely monitored by the Fund and its investment advisors in accordance with the Fund's risk management strategy, including monitoring the exposure to interest rates and assessment of actual interest rates against the relevant benchmarks.

The Fund's direct exposure to interest rate movements as at 31 March 2015 and 31 March 2014 is set out below. These disclosures present interest rate risk based on the underlying financial assets at fair value:

Asset type	As at 31 March 2014	As at 31 March 2015
	£000	£000
Cash deposits	13,803	26,004
Cash and cash equivalents	6,842	13,952
Legal & General fixed interest gilts	50,504	55,939
Legal & General index linked gilts	34,077	38,200
Fidelity unit trust equity	79,710	95,012
Fidelity unit trust bonds	79,504	94,325
Total	**264,440**	**323,432**

Interest rate risk sensitivity analysis

The Fund recognises that interest rates can vary and can affect both income to the fund and the value of the net assets available to pay benefits.

The Fund's investment advisors suggest that a 100 basis point (BPS) movement in interest rates is appropriate for carrying out the interest rate sensitivity analysis.

The analysis that follows assumes that all other variables, in particular exchange rates, remain constant, and shows the effect in the year on the net assets available to pay benefits of a +/- 100 BPS (1%) change in interest rates:

Asset type	Carrying amount as at 31 March 2015	Change in year in the net assets available to pay benefits	
		+100 BPS	-100 BPS
	£000	£000	£000
Cash deposits	26,004	260	(260)
Cash and cash equivalents	13,952	139	(139)
Legal & General fixed interest gilts	55,939	559	(559)
Legal & General index linked gilts	38,200	382	(382)
Fidelity unit trust equity	95,012	950	(950)
Fidelity unit trust bonds	94,325	943	(943)
Total change in assets available	**323,432**	**3,233**	**(3,233)**

Asset type	Carrying amount as at 31 March 2014	Change in year in the net assets available to pay benefits	
		+100 BPS	-100 BPS
	£000	£000	£000
Cash deposits	13,803	138	(138)
Cash and cash equivalents	6,842	68	(68)
Legal & General fixed interest gilts	50,504	505	(505)
Legal & General index linked gilts	34,077	341	(341)
Fidelity unit trust equity	79,710	797	(797)
Fidelity unit trust bonds	79,504	795	(795)
Total change in assets available	**264,440**	**2,644**	**(2,644)**

Currency risk

Currency risk represents the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. The Fund is exposed to currency risk on financial instruments that are denominated in any currency other than the functional currency of the Fund (£ Sterling).

The Fund's currency rate is routinely monitored by the Council and its investment advisors in accordance with the Fund's risk management strategy, including monitoring the range of exposure to currency fluctuations.

The following table summarises the Fund's currency exposure as at 31 March 2015 and as at the previous period end:

Currency exposure – asset type	Asset value as at 31 March 2014	Asset value as at 31 March 2015
	£000	£000
Overseas quoted securities	327,369	370,456
Overseas unit trusts	57,266	62,764
Overseas property fund	8,381	5,365
Overseas unquoted private equity	20,263	37,219
Total overseas assets	**413,279**	**475,804**

Currency risk - sensitivity analysis

A 13% fluctuation in the currency is considered reasonable based on the Fund advisor's analysis of long-term historical movements in the month-end exchange rates over a rolling 36-month period. This analysis assumes that all other variables, in particular interest rates, remain constant.

A 13% strengthening/weakening of the pound against the various currencies in which the Fund holds investments would increase/decrease the net assets available to pay benefits as follows:

Currency exposure - asset type	**Asset value as at 31 March 2015**	**Change to net assets available to pay benefits**	
		+13%	**-13%**
	£000	**£000**	**£000**
Overseas quoted securities	370,456	418,615	322,297
Overseas unit trusts	62,764	70,923	54,605
Overseas property fund	5,365	6,062	4,668
Overseas unquoted private equity	37,219	42,057	32,381
Total change in assets available	**475,804**	**537,657**	**413,951**

Currency exposure - asset type	**Asset value as at 31 March 2014**	**Change to net assets available to pay benefits**	
		+13%	**-13%**
	£000	**£000**	**£000**
Overseas quoted securities	327,369	369,927	284,811
Overseas unit trusts	57,266	64,711	49,821
Overseas property fund	8,381	9,471	7,291
Overseas unquoted private equity	20,263	22,897	17,629
Total change in assets available	**413,279**	**467,006**	**359,552**

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 value of investments generally reflects an assessment of credit in their pricing and consequently the risk of loss is implicitly provided for in the carrying value of the Fund's financial assets and liabilities.

In essence the Fund's entire investment portfolio is exposed to some form of credit risk, with the exception of the derivatives positions, where the risk equates to the net market value of a positive derivative position. However the selection of high quality counterparties, brokers and financial institutions minimises credit risk that may occur through the failure to settle a transaction in a timely manner.

Contractual credit risk is represented by the net payment or receipt that remains outstanding and the cost of replacing the derivative position in the event of a counterparty default. The residual risk is minimal due to the various insurance policies held by the exchanges to cover defaulting counterparties.

None of the investment managers of the Pension Fund have a mandate to specifically manage cash and so cash is generally held by the Custodian and invested in Money Market Funds (Sterling, Euro and US Dollar Funds). The Northern Trust Money Market Funds are triple A rated. In addition, the Fund's surplus cash from scheme member's contributions is managed as part of the administering authority's treasury management function. Prior to transfer to the Fund's investment managers, cash surpluses, are deposited with the Pension Fund's bank and the Royal Bank of Scotland thus minimising credit risk. The Fund had the following cash holdings at the year end.

	Moody's credit rating	£000
Northern Trust Global Investment – liquidity funds	AAA	25,865
Northern Trust Cash deposits	A1	139
		26,004

The following are cash balances are held and managed in accordance with the Highland Council Treasury Strategy Statement.

	£000
Clydesdale accounts	7,236
HCPF RBS Call Account	6,716
	13,952

Liquidity Risk

Liquidity risk represents the risk that the Fund will not meet its financial obligations as they fall due. The Council therefore takes steps to ensure that the Pension Fund has adequate cash resources to meet its commitments.

Following the triennial valuation at 31 March 2011 the Fund's actuary was asked to assess the projected cash flows of the Fund assuming a variety of possible maturity profiles. This study concluded that, provided the investment income yield remains at current levels, then the time when assets need to be sold to meet benefit payments still looks a long way off. The actuary stated that there is no need to review investment strategy in the short term in any significant way although the cash flow position should continue to be monitored.

Refinancing Risk

The key risk is 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 does not have any financial instruments that have a refinancing risk as part of its treasury management and investment strategies.

17. Actuarial Present Value of Promised Retirement Benefits

CIPFA's Code of Practice on Local Authority Accounting 2014/15 requires administering authorities of LGPS funds that prepare pension fund accounts to disclose what IAS 26 refers to as the actuarial present value of promised retirement benefits.

The actuarial present value of promised retirement benefits is to be calculated similarly to the defined benefit obligation under IA19. There are three options for its disclosure in pension fund accounts:

- showing the figure in the Net Assets Statement, in which case it requires the statement to disclose the resulting surplus or deficit;
- as a note to the accounts; or
- by reference to this information in an accompanying actuarial report.

If an actuarial valuation has not been prepared as at the date of the financial statements as is the case, IAS 26 requires the most recent valuation to be used as a base and the date of the valuation disclosed. The valuation should be carried out using assumptions in line with IAS 19 and not the Pension Fund's funding assumptions.

Assumptions underpinning the valuations are agreed with the actuary and are summarised in the Actuarial Position (page 18). This estimate is subject to significant variances based on changes to the underlying assumptions.

The actuarial present value of promised retirement benefits is as follows:

Net Pension Asset as at	**31 March 2015 £m**	**31 March 2014 £m**	**31 March 2013 £m**
Present Value of Promised Retirement Benefits*	1,988	1,779	1,557

Liabilities have been projected using a roll forward approximation from the latest formal funding valuation as at 31 March 2014.

The Actuary estimates that the liability at 31 March 2015 comprises of £1,081m in respect of employee members, £291m in respect of deferred pensioners and £616m in respect of pensioners. The approximation involved in the roll forward model means that the split of scheme liabilities between the three classes of member may not be reliable. However, the Actuary is satisfied the aggregate liability is a reasonable estimate of the actuarial present value of benefit promises. The Actuary has not made any allowance for unfunded benefits.

Assumptions

The assumptions used are those adopted for the Administering Authority's IAS 19 report as required by the Code of Practice. These are given below. The Actuary estimates that the impact of the change of assumptions to 31 March 2015 is to increase the actuarial present value by £237m.

Financial Assumptions

The financial assumptions used for the purposes of the actuarial calculations are calculated on an IAS 19 basis and therefore differ from the results of the 2014 triennial funding valuation (see Actuarial Statement page 72) because IAS 19 stipulates a discount rate rather than a rate which reflects market values. The Financial Assumptions are as follows:

Assumptions as at	**31 March 2015**		**31 March 2014**		**31 March 2013**	
	%p.a.	**Real**	**%p.a.**	**Real**	**%p.a.**	**Real**
Inflation/Pensions Increase Rate	2.4%	-0.9%	2.6%	-0.8%	2.6%	-0.8%
Salary Increase Rate	4.3%*	1.0%	4.9%	1.5%	4.8%	1.4%
Discount Rate	3.2%	0.2%	4.1%	-0.7%	4.5%	1.1%

*Salary increases are assumed to be 1% p.a. until 31 March 2015 reverting to the long term assumption shown thereafter.

Discount rate

IAS19 states that the discount rate used to place a value on the liabilities should be "determined by reference to market yields at the end of the reporting period on high quality corporate bonds". It further states that "the currency and term of the corporate bonds shall be consistent with the currency and estimated term of the post-employment benefit obligations". To that end the Actuary previously recommended a single discount rate for all LGPS employers broadly equivalent to the yield available on a basket of AA rated bonds with a duration similar to that of a 'typical' LGPS employer.

The Actuary's approach to setting the discount rate as at 31 March 2015 follows the same principles to those adopted at 31 March 2014. However it has changed in one main way; where at 31 March 2014 a Corporate Bond yield curve was constructed based solely on the constituents of the iBoxx £ Corporate AA index using the UBS delta curve fitting methodology, at 31 March 2015 the Actuary has adopted an approach whereby a Corporate Bond yield curve is constructed in the following manner:

- Use the UBS corporate bond curve (derived by applying the UBS delta curve fitting methodology to the constituents of the iBoxx £ Corporates AA index) for durations up to 8 years.
- From 12 years onwards use a gilts curve plus a long term average credit spread of 0.9% p.a.
- Interpolate between the two approaches for durations between 8 and 12 years.

Separate discount rates are then set (and corresponding RPI/CPI inflation assumptions – see below) for individual employers, dependent on their own weighted average duration. Each employer is allocated to a duration category, as defined below:

Weighted average duration	Discount rate category
Less than 17 years	Short
Between 17 and 23 years	Medium
More than 23 years	Long

Retail price inflation assumption

This assumption is typically derived from yields available on fixed interest and index linked government bonds, and should be consistent with the derivation of the discount rate.

For consistency with the assessment described in paragraph above, the Actuary's recommended RPI inflation assumption for each discount rate category defined above has been identified at appropriate durations from the Bank of England implied inflation curve as at 31 March 2015.

Pension increase assumption

In the LGPS pension increases are linked to the rate of CPI as opposed to RPI. As a market in CPI linked bonds does not exist, the Actuary needs to estimate the long term gap between RPI and CPI in order to derive a CPI assumption for FRS17/IAS19 purposes.

In the past the Actuary has estimated that CPI would be approximately 0.8% below RPI. This was based on their estimate of the 'formula effect'. The Office for National Statistics (ONS) publishes the size of the actual formula effect on a monthly basis and over the last four years it has varied between 0.8% and 1.0%. Based on this evidence and as a result of discussions the Actuary has had with the accounting firm PWC as part of PWC's independent review of the assumptions made by all actuaries involved in valuing local government pension schemes, the Actuary is increasing their assumed RPI-CPI gap to 0.9% p.a. at 31 March 2015. This will lead to a reduction in the assumed rate of CPI (all else being equal).

Salary increase assumption

The Actuary has taken into account the Government's public sector pay restraints (originally announced in June 2010 and extended as per the November 2011 announcement). The Actuary's recommended salary increase assumption is therefore 1% p.a. until 31 March 2015, reverting to RPI plus 1.5% p.a. thereafter, plus an allowance for promotional increases.

Longevity assumptions

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

	Males	Females
Current Pensioners	22.5 years	24.1 years
Future Pensioners*	24.7 years	26.8 years

18. Additional Voluntary Contributions (AVCs)

The AVC facility is provided by the Prudential Assurance Company Limited and is a money purchase arrangement where members have the choice to invest in a range of low, medium and high risk investment funds. In accordance with regulation 5 [2] [C] of the Pension Scheme (Management and Investment of Funds) Regulations 1998 [S1 1998 No. 1831], these figures do not form part of the accounts of the Pension Fund and are stated for information only.

2013/14 £000		**2014/15 £000**
10,134	Opening Value	10,040
1	Correction Work	0
1,262	Contributions Invested	1,235
427	Interest, Bonuses & Transfers	586
(1,784)	Sale of Investments	(1,372)
10,040	**Closing Value**	**10,489**

19. Related Parties

The Highland Council Pension Fund is administered by the Highland Council. As a result there is a strong relationship between the Council and the Fund. The Council is also the largest employer in the Fund

With effect from 01 April 2011 the Pension Fund opened and maintained its own separate bank accounts. The Council's Treasury Management team manage surplus cash balances prior to transmission of funds to the Fund Managers for investment.

The following Senior Officer of the Highland Council held a key position in the financial management of the Pension Fund during the financial year to 31 March 2015.

Name	**Resp**	**Pension Contributions in year to**		**Accrued Pension Benefits as at 31.03.15**		**Difference in Accrued Pension benefits compared to March 2015**
		31/03/14	**31/03/15**			
Derek Yule	Director of Finance	£19,171	£19,362	Pension Lump Sum	£49,264 £115,521	£2,263

Pension receipts and payments are transacted using the Highland Council financial systems and the Fund's banking arrangements. Throughout the year, the Fund maintains a cash balance for this purpose which is listed as Bank accounts in the net assets statement.

Contributions of £29.797m were paid by the Highland Council to the Fund during 2014/15 and central administration costs of £1.004m (£0.790m 2013/14) were recharged to the Fund.

As at 31 March 2015, the Pension Fund had a net intercompany creditor of £2.687m representing sums due to the Highland Council. These balances cover a range of activity including debtor and creditors arising from recharges to the Pension Fund. In addition, there is also a long term debtor of £0.225m for strain on fund amounts.

20. Contingent assets, liabilities and contractual commitments

Contingent assets

During 2006/07, the Highland Council Pension Fund joined a group litigation to recover tax credits on overseas dividends and foreign income dividends. The estimated claim, gross of fees is £1.7m. As at 31 March 2015, these claims are still active although many of the tax authorities are resisting claims thus delaying the recovery process.

During 2009/10, KPMG were contracted to submit 'EU Fokus Bank' claims for recovery of withholding tax with an estimated value of £1.3m gross of fees. An additional revised contract was agreed in April 2012 with KPMG to continue with the claim although the Fund opted not to pursue a top up claim in Germany as this was not financially viable. Spain issued repayments during 2014/15 of €0.014m.

Contingent liabilities

As at 31 March 2015 there is a contingent liability of £0.502m (£0.713m 2013/14) for frozen refunds representing 2,310 (2,887 2013/14) frozen refund records.

Contractual commitment

During 2013/14, the Fund appointed a private equity investment manager, and made an initial €50m commitment. In order to achieve the target asset allocation of 5% for private equity in financial year 2014/15, a further €80m commitment was made to another fund operated by the same private equity investment manager. It will take several years for these commitments to be drawn down on a phased basis. As at 31 March 2015, €29.885m of the €50m commitment (60%) and €11.057m of the €80m (13%) has been made.

21. Debtors

2013/14 £000	Debtors	2014/15 £000
1,011	Contributions due - employees	995
3,965	Contributions due - employers	3,107*
	Strain on fund costs	861
	Transfer values receivable	58
1,908	Short term debtors	551
6,884	**Total debtors**	**5,572**

*****contributions due amount includes a debtor for £0.199m for the termination value for the Highlands and Islands Structural Fund Partnership.

Analysis of debtors

2013/14 £000	Debtors	2014/15 £000
19	Central government bodies	559
4,710	Other local authorities	3,048
406	NHS bodies	404
2	Public corporations and trading funds	0
1,747	Other entities and individuals	1,561
6,884		**5,572**

22. Long term debtors

2013/14 £000	Debtors	2014/15 £000
-	Central government bodies	182
-	Other local authorities	329
-	NHS bodies	21
-	Public corporations and trading funds	0
-	Other entities and individuals	35
		567

23. Creditors

2013/14 £000	Creditors	2014/15 £000
(6,342)	Sundry creditors	(4,018)
-	Transfer values payable (leavers)	(77)
(138)	Benefits payable	(303)
(6,480)		**(4,398)**

Analysis of creditors

2013/14 £000	Creditors	2014/15 £000
(40)	Central government bodies	(456)
(5,567)	Other local authorities	(2,703)
-	NHS bodies	(1)
(873)	Other entities and individuals	(1,238)
(6,480)		**(4,398)**

24. Accounting Standards 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.

Accounting Standards not yet adopted are:
- IFRS 13 Fair Value Measurement (May 2011)
- IFRIC 21 Levies and
- Annual Improvements to IFRS 2011 – 2013 Cycle.

The code requires implementation from 1 April 2015 and therefore no impact on the 2014-15 financial statements.

IFRS 13 replaces the guidance on fair value measurement in existing IFRS accounting literature with a single standard. IFRIC 21 provides guidance on when to recognise a liability for a levy imposed by a government, both for levies that are accounted for in accordance with IAS 37 “Provisions, Contingent Liabilities and Contingent Assets” and those where the timing and amount of the levy is certain. IFRS improvements are generally minor, principally providing clarification. Overall these new or amended standards are not expected to have a significant impact on the financial statements.

25. Prior year adjustment

The cost of administering the Local Government Pension Scheme in the UK has come under increasing scrutiny in recent year. In order to improve cost transparency, CIPFA issued guidance (Accounting for local government pension scheme management costs) which requires a change in accounting for management fees. This means that investment management costs that are deducted from the value of an investment are now recognised as a cost in the Fund Account rather than as a reduction in the change in market value of investments. Investment transactions costs that are added to an investment purchase price or deducted from the proceeds of a sale are also now recognised as a cost in the Fund account other than as a reduction in the change in market value of investments.

As a result of the above changes the results for the year ended 31 March 2014 have been restated. The change has the effect of increasing the change in market value of investments by £2.098m and increasing management expenses by £2.098m. The changes are reported in the Fund account but there is no change to the net increase in the Fund for the year ended 31 March 2014 of £90.287m. The adjustments can be summarised as follows:

	£000	£000	£000
Fund account 2013/14	Per 2013/14 audited accounts	Changes made	Fund account as restated
Profit and losses on disposal of investments and change in market values of investment	62,787	2,098	64,885

The CIPFA guidance required a new category of management expenses (oversight and governance costs). In addition, definitions were provided of the costs that should be included in each category. As a result, some costs were re-categorised alongside the adjustment for external management fees deducted from capital (£1.798m) and transaction costs £0.3m).

Administrative Costs	1,081	(183)	898
Oversight and Governance Costs	-	285	285
Investment management expenses	3,188	1,996	5,184
Management Expenses	**4,269**	**2,098**	**6,367**

Training, Knowledge and Skills - Policy Statement

On 14 November 2013, the Highland Council Pension Committee formally adopted the CIPFA Knowledge and Skills Framework for public sector pension's finance.

In adopting that framework, the Committee agreed the following training policy statement:

1. The Pensions Committee recognises the importance of ensuring that is has the necessary resources to discharge its pension's administration responsibilities and that all staff and members charged with financial administration, governance and decision-making with regard to the pension scheme are fully equipped with the knowledge and skills to discharge the duties and responsibilities allocated to them.

2. It therefore seeks to utilise individuals who are both capable and experienced and it will provide and/or arrange training for staff and members of the pensions decision-making and governance bodies to enable them to acquire and maintain an appropriate level of expertise, knowledge and skills.

The Pensions Committee also agreed to delegate responsibility for implementation to the Director of Finance, and that there would be annual reporting on the Pension Fund's training policy and its implementation.

For the year ended 31 March 2015, a number of strategic training needs were identified and fulfilled in relation to the reform of the Local Government Pension Scheme in 2015, and the actuarial valuation taking place during 2014.

The table below summarises how training needs were fulfilled during the year.

Cipfa Framework Core Competency Area	Training Specifics	Training Event	Attendees
Pensions accounting & audit standards	CIPFA Pensions Network- presentation from Audit Scotland	09/09/14: CIPFA Pensions Network Workshops	Council officers (2)
	Presentation by Lothian PF on changes to reporting of management fees in PF accounts	12/12/14:Investment Governance Group	Council officer
Investment performance & risk management Financial markets & products knowledge	CIPFA Pensions Network – presentation from Baillie Gifford	09/09/14: CIPFA Pensions Network Workshops	Council officers (2)
	CIPFA Investment Governance Group – presentation on RAFI indices.	26/11/14: Investment and Governance Group	Council officers (2)
	Covered key asset classes and potential asset classes focussing on fixed income (property debt)	24/04/14: Investment Strategy workshop run by Aon Hewitt	Council officers (3) Members (2)
Pensions legislative & governance context Actuarial methods, standards & practices	Legal background and context, implications for scheme member pensions, benchmarking, actuarial valuation 2014, economic outlook Update on LGPS 2015 reform Overview of 2014 Actuarial Valuation process	09/09/14: CIPFA Pensions Network Workshops	Council officers (2)
	Legislative training for Pensions senior staff	Training provided by Local Government Association	Council officers (5)

The specific training events set out above are supplemented by additional knowledge and skills acquired through other ‘on the job’ activities including; participation in working groups, attendance at meetings, general reading and research e.g. agenda reports and presentations, investment manager reports and briefings, magazines and other periodicals, online reading etc.

Actuary's Statement as at 31 March 2015

HYMANS ROBERTSON LLP

This statement has been prepared in accordance with Regulation 31A (1) (d) of the Local Government Pension Scheme (Scotland) (Administration) Regulations 2008, and Chapter 6 of the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the UK 2014/15. It has been prepared at the request of the Administering Authority of the Fund for the purpose of complying with the aforementioned regulation.

Description of Funding Policy

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

- to ensure the long-term solvency of the Fund, using a prudent long term view. This will ensure that sufficient funds are available to meet all members'/dependants' benefits as they fall due for payment;
- to ensure that employer contribution rates are reasonably stable where appropriate;
- to minimise the long-term cash contributions which employers need to pay to the Fund, by recognising the link between assets and liabilities and adopting an investment strategy which balances risk and return;
- to reflect the different characteristics of different employers in determining contribution rates; and
- to use reasonable measures to reduce the risk to other employers and ultimately to the Council Tax payer from an employer defaulting on its pension obligations.

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. For employers whose covenant was considered by the Administering Authority to be sufficiently strong, contributions have been stabilised below the theoretical rate required to return their portion of the Fund to full funding over 20 years if the valuation assumptions are borne out. Asset-liability modelling has been carried out which demonstrate that if these contribution rates are paid and future contribution changes are constrained as set out in the FSS, there is still around a 75% chance that the Fund will return to full funding over 20 years.

Funding Position as at the last formal funding valuation

The most recent actuarial valuation carried out under Regulation 32 of the Local Government Pension Scheme (Scotland) (Administration) Regulations 2008 was as at 31 March 2014. This valuation revealed that the Fund's assets, which at 31 March 2014 were valued at £1,279 million, were sufficient to meet 96% of the liabilities (i.e. the present value of promised retirement benefits) accrued up to that date. The resulting deficit at the 2014 valuation was £52 million. Individual employers' contributions for the period 1 April 2015 to 31 March 2018 were set in accordance with the Fund's funding policy as set out in its FSS.

Principal Actuarial Assumptions and Method used to value the liabilities

Full details of the methods and assumptions used are described in the valuation report dated 24 March 2015.

Method

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

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

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

Financial assumptions	**31 March 2014**	
	% p.a. Nominal	**% p.a. Real(CPI)**
Discount rate	5.30%	2.60%
Pay increases	4.50%	1.80%
Price inflation/Pension increases	2.70%	-

The key demographic assumption was the allowance made for longevity. The life expectancy assumptions are based on the Fund's VitaCurves with improvements in line with the CMI 2012 model, assuming the current rate of improvements has reached a peak and will converge to a long term rate of 1.25% p.a. Based on these assumptions, the average future life expectancies at age 65 are as follows:

	Males	**Females**
Current Pensioners	22.5 years	24.1 years
Future Pensioners*	24.7 years	26.8 years

*Currently aged 45

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

Experience over the period since April 2014
Experience has been worse than expected over the year to 31 March 2015 (excluding the effect of any membership movements). Real bond yields have fallen dramatically and the effect of this has been only partially offset by the effect of strong asset returns, meaning that funding levels are likely to have worsened and deficits increased over this period.

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

Robert Bilton

Robert Bilton
FFA Fellow of the Institute and Faculty of Actuaries
For and on behalf of Hymans Robertson LLP
5 June 2015