

Local Government Pension Funds: 2016/17 Accounting update

Peter Worth

Director

Worth Technical Accounting Solutions

This session will cover:

- Changes to example pension fund accounts for 2016/17
- Current developments

2016/17 example accounts

Main changes are:

- Management costs
- Fair Value
- Key personnel disclosures



Management costs guidance

2014 guidance was re-published in June 2016 following extensive consultation with practitioners and stakeholders
Incorporated into example accounts for 2016/17

Builds on the general principles established in 2014 with:

- more detailed accounting guidance
- worked examples for practitioners

Guidance only – recommended, but not mandated by Code



Management expenses

Suggested disclosure note 1

Note 11: Management expenses

2015/16		2016/17
£000		£000
1,548	Administrative costs	1,460
11,615	Investment management expenses	10,925
845	Oversight and governance costs	885
14,008		13,270

Investment costs

Suggested disclosure note 2

Note 11 a: Investment management expenses

2015/16	2016/17
£000	£000
835 Transaction costs	987
5,975 Management fees	4,520
2,215 Performance related fees	2,415
190 Custody fees	215
9,215	8,137

No further analysis of administrative, oversight and governance or transaction costs is required if these are not significant

Investment costs - recognition

Cost is defined as “ an amount that has to be paid to buy or obtain something”...and a **liability** as “ being legally responsible for something”...

- Code does not permit netting off costs against income
- Guidance reinforces this by disclosing investment costs and investment income separately
- Liaise with Fund Managers to identify fees/costs deducted at source (especially for pooled investments and venture funds)
- **But** be careful not to end up accounting for costs that were never your responsibility to pay in the first place!

Back to basics – consider:

- Am I legally responsible for these costs?
- What is the corresponding entry in the fund manager's accounts?
- Do I have control over whether or not these costs are incurred?

IFRS 13 Fair value measurement

“Fair value” underpins IFRS and the Code **BUT** has been poorly defined in the past **OR** taken to mean different things at different times in different reporting standards

IFRS 13 aims to provide a consistent definition with additional disclosures to explain the valuation techniques applied

...the “**highest and best price**”...that can be obtained in the “**most advantageous market**”...

Adopted as a Code requirement for principal authorities from 2015/16, and for LGPS from 2016/17

LGPS and Fair Value

All pension fund investments are revalued every year with the change in value taken to the Fund Account



Current assets and liabilities are outside the scope of IFRS 13



There should be no difference between “carrying” and “fair” value for **most** LGPS assets and liabilities



But some specific valuation issues might arise if the LGPS has directly held property, artefacts or shares

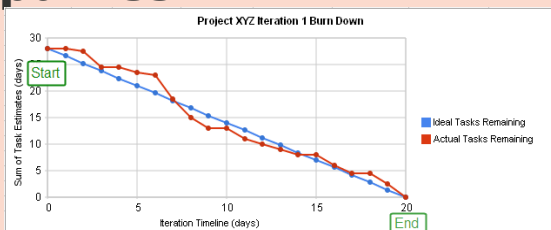
“Highest and best” value - 3 specific areas

Directly held land and property



Consider whether a higher price could be obtained by amalgamating adjacent sites, removing covenants or changing current use

Shares in unquoted companies



Usually valued on a going concern basis **BUT** if company has saleable assets (stock, buildings, equipment or intellectual property) a breakup valuation may achieve a higher price

Art and Antiques



Basis of valuation should be specialist auction sale NOT house clearance or out of date insurance value

IFRS 13 - Extra disclosures

Extended from 2015/16:

- ✓ Valuation method for each asset class
- ✓ Analysis by level 1-3 hierarchy now includes financial assets which are not financial instruments (eg directly held property or shares)
- ✓ Transfers between levels of fair value hierarchy

New for Level 3 investments only:

- ✓ Quantitative data on significant inputs
- ✓ Sensitivity analysis for investment valuations
- ✓ Reconciliation of opening to closing balances
- ✓ Analysis between realised and unrealised gains/losses in the Fund Account

Asset type	Level	Valuation Basis	Observable and unobservable inputs	Key sensitivities
Quoted Bonds	1	Market bid price based on current yields	N/A	N/A
Pooled investments – overseas unit trusts	2	Closing bid price where bid and offer prices are published. Closing single price where single price published	NAV-based pricing set on a forward pricing basis	N/A
Directly held property	3	Valued at fair value at year-end using the investment method by John Smith FRICS in accordance with RICS guidelines	Existing lease terms & rentals Independent market research Tenant covenant strength Estimated vacancy levels Estimated rental growth Discount rate	Significant changes to rental growth, vacancy levels or discount rate could affect valuations

- Much of this detail was previously in accounting policies
- Refer to PRAG guidance published May 2016 for suggested classification of investments into Level 1 to 3 hierarchies

Fair Value disclosures (2)

Level 3 assets	Valuation range +/-	Value at 31 March 2017 £000	Valuation increase £000	Valuation decrease £000
Freehold property	5%	3,565	3,775	3,415
Unquoted equity	10%	49,898	54,888	44,908
Hedge funds	15%	420,480	483,552	357,408

- Similar to sensitivity disclosures in financial instrument risks
- Liaise with Fund Managers to clarify basis of valuation, sensitivity range and any changes made in year

Level 3 investments	Unquoted overseas equities £000	Overseas unit trusts £000	Private equity £000	Property £000
Market Value 1 April 2016	0	491,527	269,770	0
Transfers into level 3	3,465	0	73,432	364,001
Transfers out of level 3	0	(481,527)	0	0
Purchases and payments	1,973	0	226,335	18,548
Sales	(5,314)	0	(185,628)	(42,397)
Unrealised gains (losses)	2,263	0	28,658	87
Realised gains (losses)	1,208	0	7,963	0
Market Value 31 March 2017	3,595	0	420,480	340,239

- Based on information provided by custodian
- Links to disclosure note on change in market value of investments

Other changes

- 2016/17 Code has aligned investment asset classification and descriptions with Pension SoRP – “Bonds” have replaced “fixed interest securities”
- Code requires separate disclosure of members allowances, audit fees and taxation where significant AND where LGPS costs can be separately identified
- Key management personnel disclosure now required by para 3.9.4.2 of Code

Key management personnel compensation

Who?

“chief officers, elected members....having authority and responsibility for planning, directing and controlling the activities....” [Code 3.9.2.2]

- **Different people for pension fund and Council - but may overlap**
- **May also include pensions panel members if remunerated**

Compensation includes:

- a) Short-term employee benefits eg pay, NI, annual leave
- b) Post-employment benefits eg pension
- c) Other long-term post-employment benefits
- d) Termination benefits
- e) Performance related pay and bonuses

Disclose in total and for each category – no names required

Key management compensation –in practice

2015/16 £000		2016/17 £000
51	Short term benefits	43
43	Post employment benefits	51
2	Other long term benefits	3
20	Termination benefits	30
116	Total	127

Action:

- **Identify Key Personnel early**
- **Identify possible benefits**
- **Engage actuary to value post – employment benefits**

Current developments

- Faster closedown
- IFRS 9 Financial Instruments

Faster Closedown

Why bother?

- provides more timely and relevant information to stakeholders
- statutory requirement (in England)
- audit starts and finishes earlier
- helps to drive other service improvements
- frees up resources to focus on other tasks
- staff get a summer holiday!



Faster Closedown

Legislative changes

2015 Accounts and Audit Regulations :

- 2017/18 accounts prepared by 31 May 2018
- Audit completed by 31 July

2017/18 proposed changes:

- LGPS accounts to be taken out of Council's Statement
- Annual report will become sole reporting document
- Questions?
 - Publication of annual report brought forward to 31 May?
 - Implementation date?

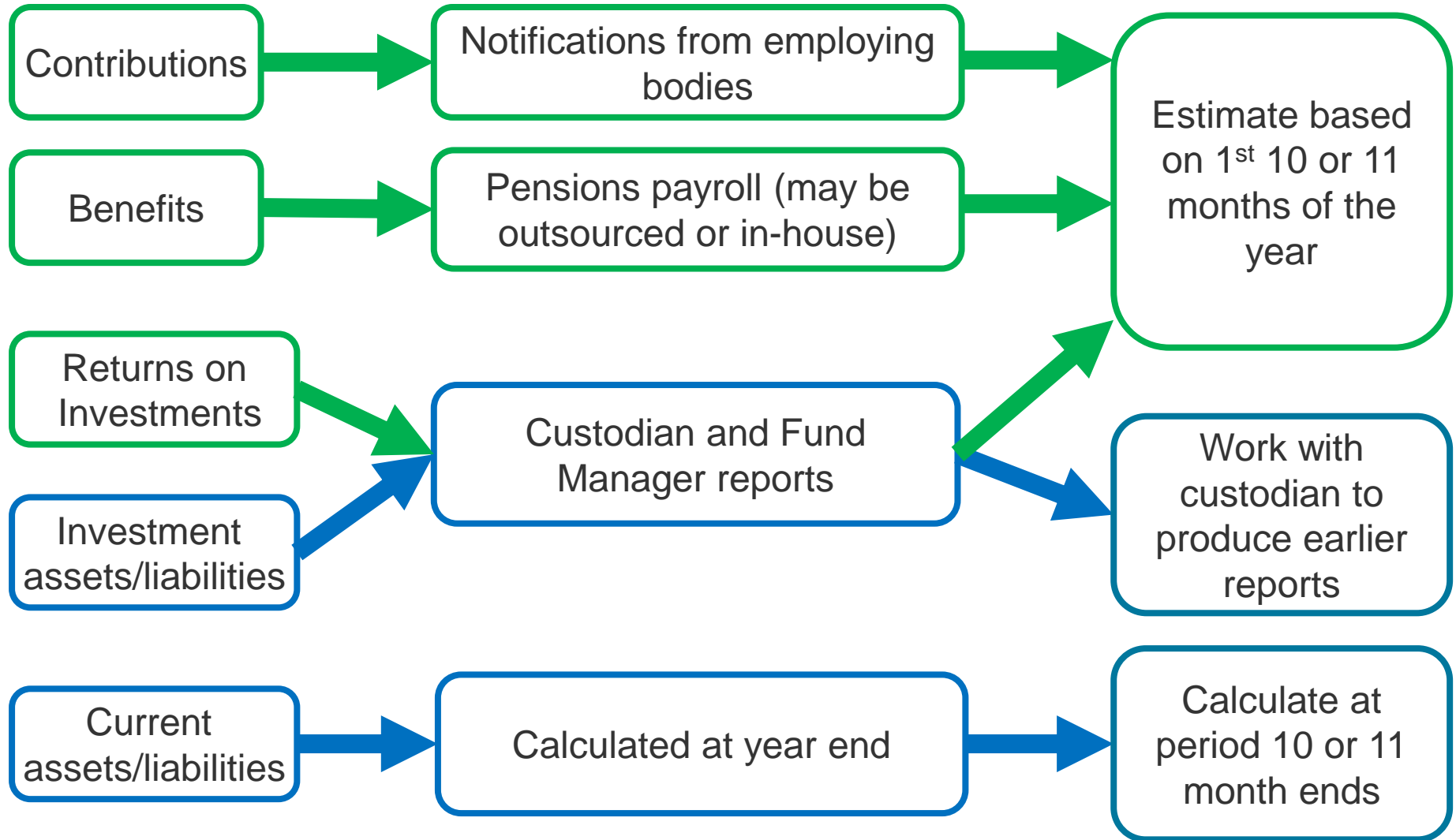


What this means in practice

- ✓ Better organisation - begin with end date and plan backwards
- ✓ Practice in-year with quarterly “mini-closedowns”
- ✓ Share the workload
- ✓ Prioritise closedown so deadlines are achieved
- ✓ Streamline the process
 - Ensure ledger codes are fit for purpose
 - Close on estimates
- ✓ Manage the audit process
 - clear working papers
 - in-built and demonstrable QA
- ✓ Quicker production of annual report

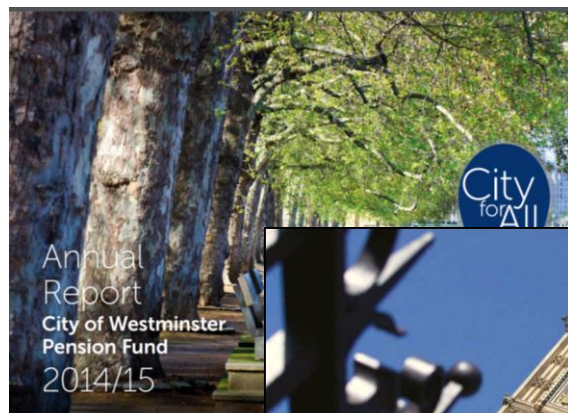


Estimation techniques



Annual report publication

- ✓ Start early
- ✓ De-couple strategic documents and financial years
- ✓ Use CIPFA guidance to identify what you want, from whom and when
- ✓ Ensure documents needed are kept up to date
- ✓ Allow time for Member/s151 input and approval



Draft to audit 1 May 2015
Published 18 May 2015



Draft to audit 9 April 2016
Published 14 July 2016



IFRS 9 Financial Instruments

Approved by IASB July 2014:

- New classification categories for financial instruments
- Simplified hedge fund accounting
- **Current methods of accounting for realised/unrealised gains and losses to be replaced with an annual charge for expected credit loss impairments**
- Some additional disclosure requirements

**Current expectation is that IFRS 9 will be adopted
as a Code requirement for 2018/19**

IFRS 9 – expected credit losses

Accounting will move from an “incurred loss” to an “expected loss” basis, reflected as an annual charge in the accounts

This earlier recognition of **possible** (as opposed to **actual**) impairments will be recognised based on:

- Current credit risk
- Any significant increase in credit risk expected over the next 12 months
- Any objective evidence of impairment

Estimation process will be based on annual reviews of investments and will require:

- **Exercise of judgement by senior management**
- **Advice from experts (fund managers)**
- **Record keeping to track losses as they are recognised in the accounts**

Any questions?



Local Government Pension Funds: Accounting update

Peter Worth

Director

Worth Technical Accounting Solutions

Email to: peter@worth-tas.co.uk