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# Local Government Pension Funds: 2016/17 Accounting update

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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 £000 | | 2016/17 £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 £000 | | 2016/17 £000 |
|---|---|---|
| 9,615 | Management fees | 8,935 |
| 1,815 | Performance related fees | 1,820 |
| 150 | Custody fees | 145 |
| 35 | Transactions costs | 25 |
| **11,615** | | **10,925** |

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 responsibility 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

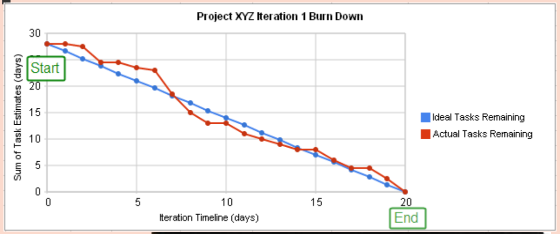
All pension fund investments are revalued every year with the change in value taken to the Fund Account

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)
- ✓ 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

# Fair Value disclosures (1)



| 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.<br>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<br>Independent market research<br>Tenant covenant strength<br>Estimated vacancy levels<br>Estimated rental growth<br>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 |
|---|---|---|---|---|
| Pooled investments – hedge & property funds | 10% | 49,898 | 54,888 | 44,908 |
| Freehold property | 10% | 340,239 | 374,263 | 306,215 |
| Unquoted overseas equity | 5% | 3,595 | 3,775 | 3,415 |
| Private equity | 15% | 420,480 | 483,552 | 357,408 |
| **Total** | | **814,212** | **916,478** | **711,946** |

- **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**

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# Fair Value disclosures (3)

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| Level 3 investments | Unquoted overseas equities | Overseas unit trusts | Private equity | Property |
|---|---|---|---|---|
| | £000 | £000 | £000 | £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 | (491,527) | 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 drives other service improvements
- frees up resources to focus on other tasks
- staff get a summer holiday!

# Faster Closedown

**Legislative changes**

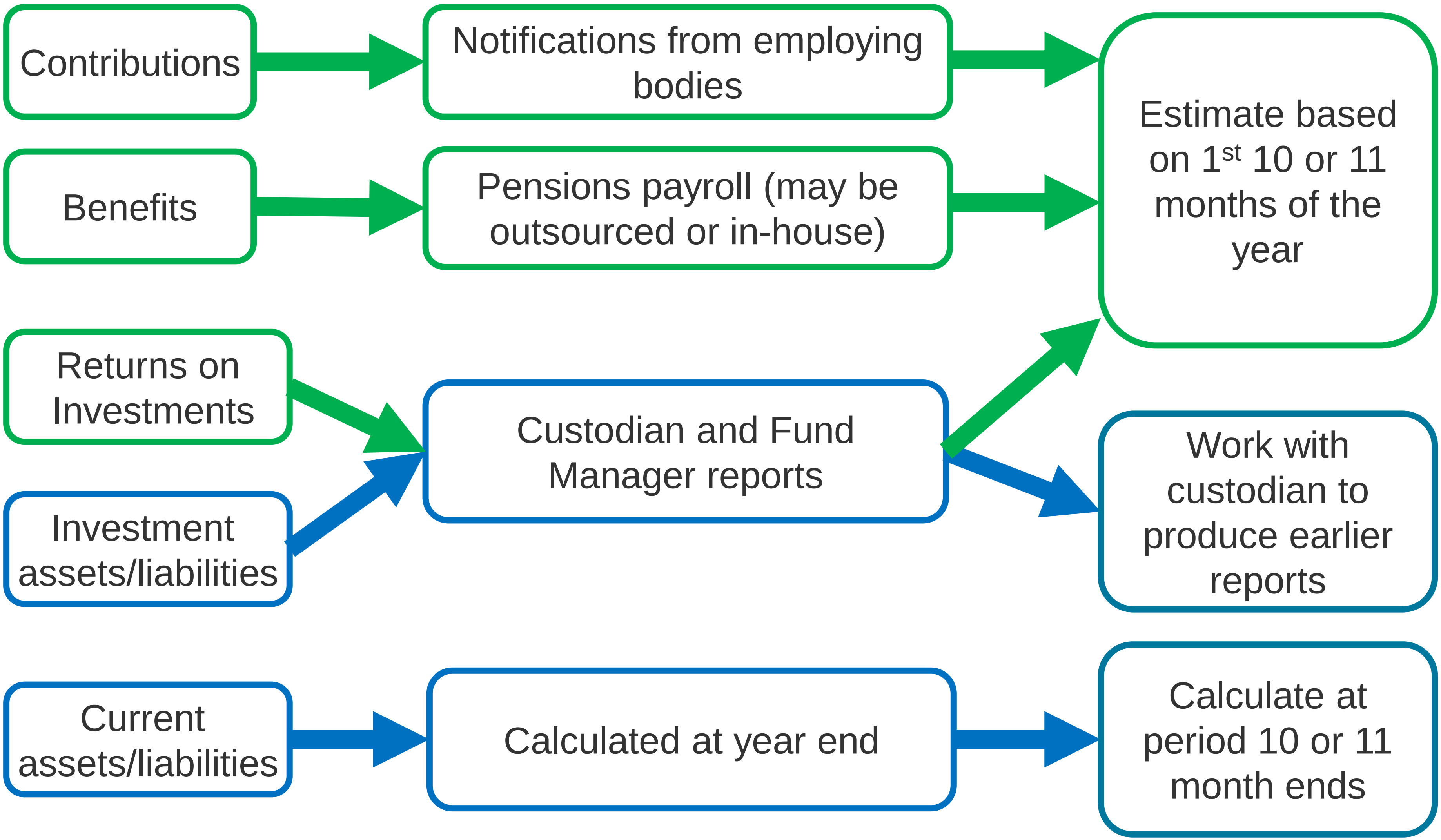
2015 Accounts and Audit Regulations :
- 2017/18 accounts prepared by 31 May 2018
- Audit completed by 31 July

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?

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# Local Government Pension Funds: Accounting update

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