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Horizon Scanning: Future Changes for Local Government Pension Funds

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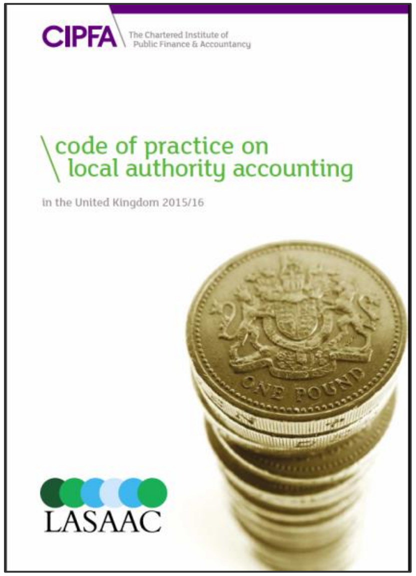
Worth Technical Accounting Solutions

- Code and IFRS changes
- Guidance on management costs
- Accounts and Audit Regulation changes

Code and IFRS changes

- IFRS13 – fair value measurement
- Management costs guidance



IFRS 13 Fair value measurement

Fair value underpins many IFRS **BUT** inconsistent or unclear requirements leads to diversity in practice and lack of comparability between financial information

IFRS 13 applies to all assets and liabilities where fair value measurement is required. It aims to provide:

- consistent definition of fair value based on exit price
- a clear framework for measuring fair value
- additional disclosures to explain the valuation techniques applied

Applies prospectively from 1 April 2015 :

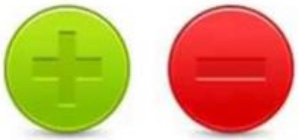
- a Code requirement for principal authorities in 2015/16
- **BUT** not specifically referred to in LGPS example accounts or disclosure checklist for 2015/16

Fair value - what is it?

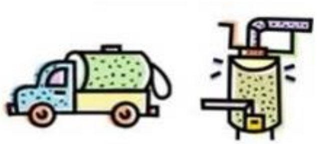
the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date

NEED TO DETERMINE

1. Asset/liability to be valued



2. Highest and best use



3. Principal / most advantageous market

London Stock Exchange

4. Valuation technique to be used

LGPS Financial Instruments – valuation

Pension Fund investments are revalued every year with the change in value taken to the Fund Account

Current assets and liabilities are valued at amortised cost – outside scope of IFRS 13

All pension fund investments including directly held property are carried in the Net Asset Statement at Fair Value

No difference between “carrying value” and “fair value” for **most** LGPS assets and liabilities

But there may be some exceptions

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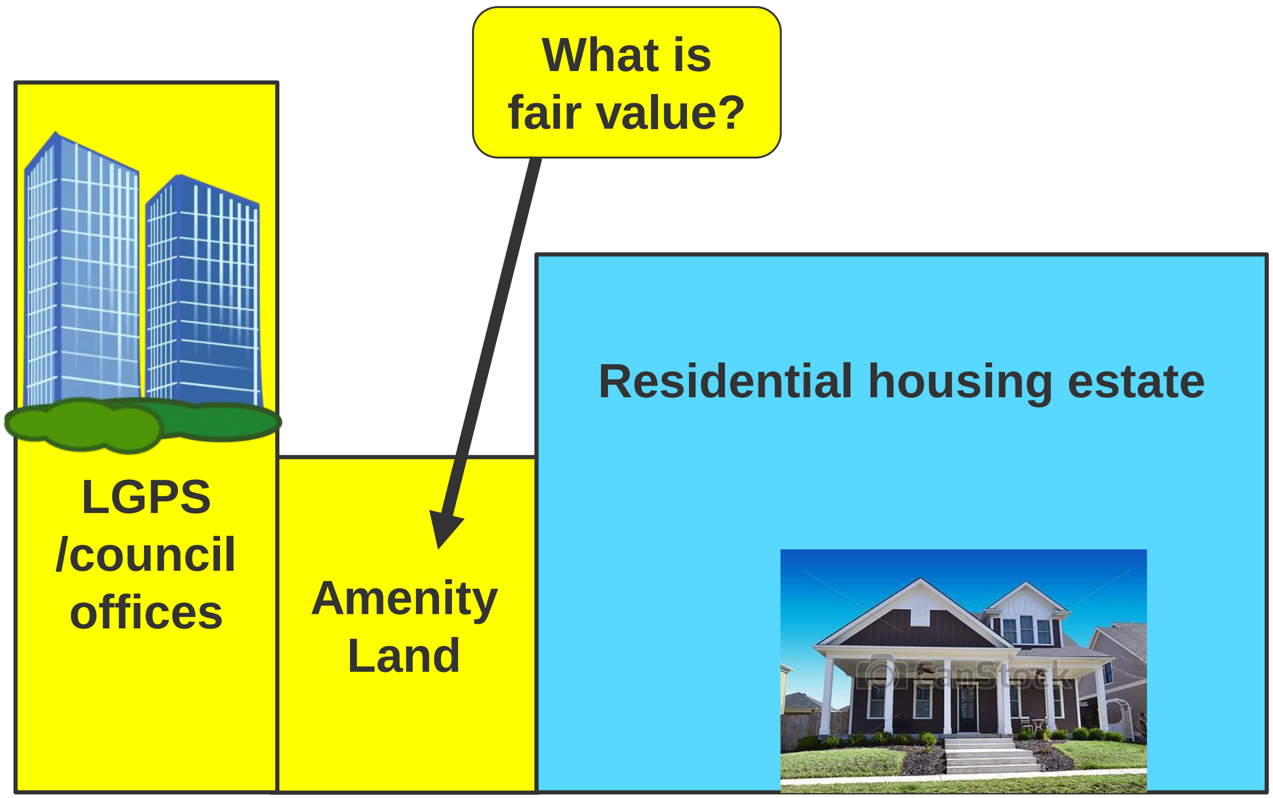
3 specific areas where IFRS 13 might apply

Directly held property	Consider “best use” and “most advantageous market” requirements
Shares in unquoted limited companies	Usually valued on a going concern basis BUT if company has net liabilities + saleable assets, breakup valuation might be more appropriate
Art and Antiques	Basis of valuation should = replacement cost at specialist auction sale NOT car boot or house clearance sale price

IFRS 13 – practical issues (1)

- Directly held property owned and occupied by LGPS
- Undeveloped brownfield site to rear of buildings currently not used **BUT** adjoins exclusive housing estate



IFRS 13 – practical issues (2)

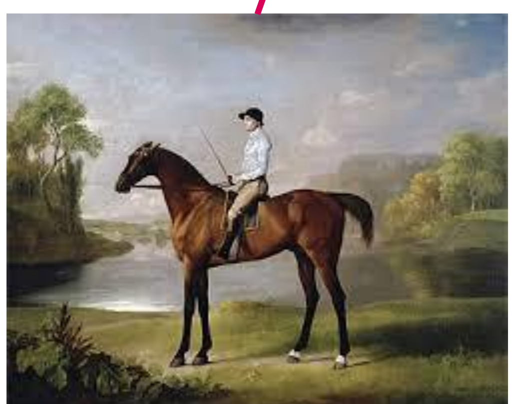
- LGPS has a 10% shareholding in TrainWreck Ltd
- The company has net assets of £100k
- Intangible assets include patents for a new type of rolling stock, which competitors are keen to purchase for £700k
- What is the fair value of the shareholding under IFRS13?

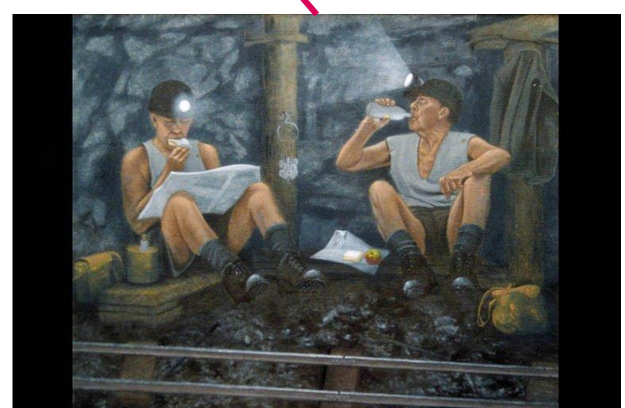
	£000		£000
Intangible assets	500	Bank overdraft	200
PPE	300	Long terms loans	400
Trade debtors	200	Creditors	200
		Share Capital	100
Total Assets	**1000**	**Total liabilities**	**900**

IFRS13 – practical issues (3)

- Star Wars toys and Clarice Cliff Pottery achieve best prices at specialist auction sales

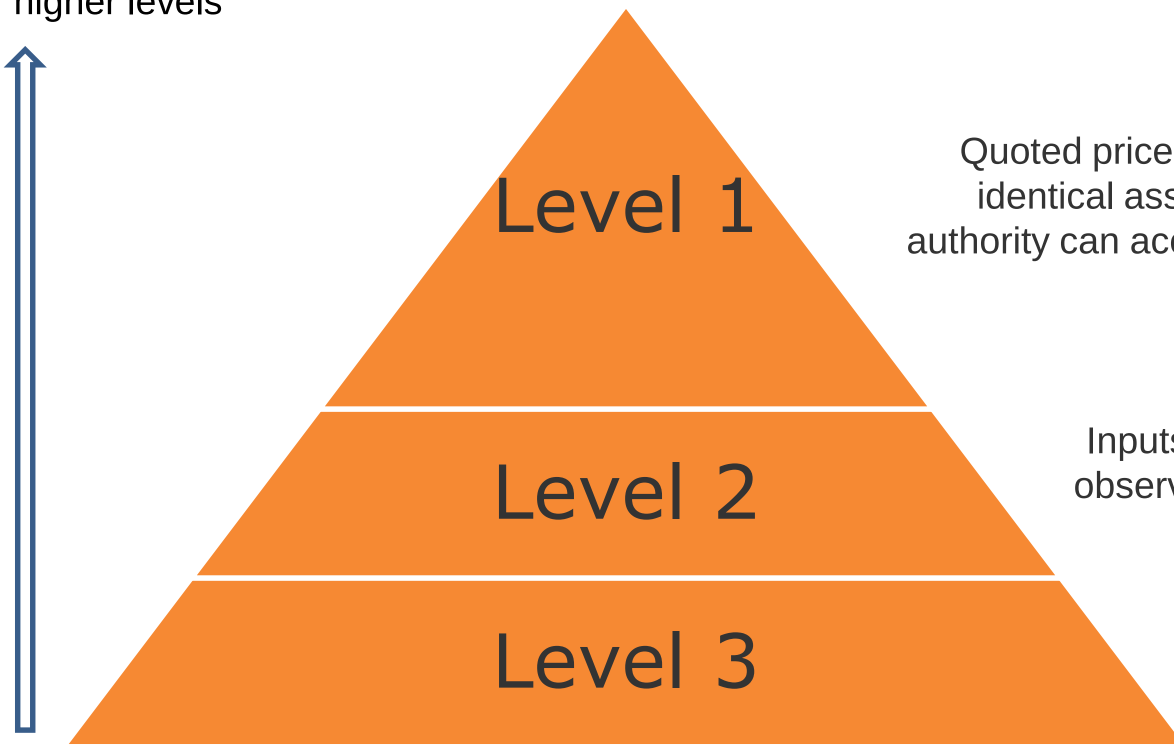
- Stubbs horses and “pitman” paintings sell best in particular geographical areas





Remember fair value hierarchy……

Maximise use of higher levels



Quoted prices in active markets for identical assets/liabilities that the authority can access at the measurement date

Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly

Unobservable inputs for the asset or liability

….and valuation techniques

Market approach

- Uses prices and other relevant information generated by market transactions for identical/comparable assets/liabilities or groups of assets and liabilities

Cost approach

- Current replacement cost
- Assumes fair value is cost to acquire or build a comparable substitute asset

Income approach

- Converts future cashflows into net present value

Extra disclosures required

- Transfers between levels of fair value hierarchy PLUS reasons for transfers and accounting policies
- For level 3 measurements
  - Quantitative information on significant unobservable inputs
  - Reconciliation of opening to closing balances showing movements in year
- Description of valuation process used and any changes
- Narrative and quantitative description of sensitivity to changes in valuation methods and market conditions
- Distinguish unrealised gains/losses from realised gains/losses in the Fund Account

Management costs guidance

2014 guidance has been updated and is currently out to consultation with practitioners and stakeholders

May change following consultation and review **BUT** aims to provide a clearer focus on existing Code principles of:

- Recognition
- Measurement and
- Disclosure

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 investment costs against income
- 2014 guidance reinforces this but permits different interpretations of how to account for “fund of fund” management costs
- This does not mean 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?
- Am I carrying the risks associated with these investments?
- Do I have control over whether or not these costs are incurred?

Investment costs - measurement

Transaction Costs	Flat rate fee charged quarterly or half yearly	• Match payments to the correct financial year • Accrue for payments due not yet made
Management Fees	Linked to fund value	• Accrue for any payments due not yet paid based on performance to date
Performance related fees	Only paid when a specified level of performance is achieved	• Make provision for fees earned to date using estimation techniques • When contract ends, release provision and replace with accrual for expected amount

The key to recognition **and** measurement is understanding the contract!

Investment costs - disclosure (1)

Management expenses disclosure note

Note 11: Management expenses

20X4/X5		20X5/X6
£000		£000
3,948	Administration expenses	4,248
9,215	Investment management expenses (see Note 11a)	8,137
845	Oversight and governance costs	885
14,008		**13,270**

Investment costs - disclosure (2)

New disclosure note analysing investment costs

Note 11a: Investment management expenses

20X4/X5		20X5/X6
£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**

But no further analysis of administrative, oversight and governance or transaction costs as these are not significant for most LG pension funds

Accounts and Audit Regulations

SI 2015 No 234 – earlier closure from 2017/18:

- Draft accounts by 31 May
- Audit completed by 31 July

What this means in practice

- ✓ Better planning and organisation
- ✓ Prioritising closedown so deadlines are achieved
- ✓ Better use of estimation techniques
- ✓ Quicker production of annual report
- ✓ Managing the audit process
- ✓ Better audit trail

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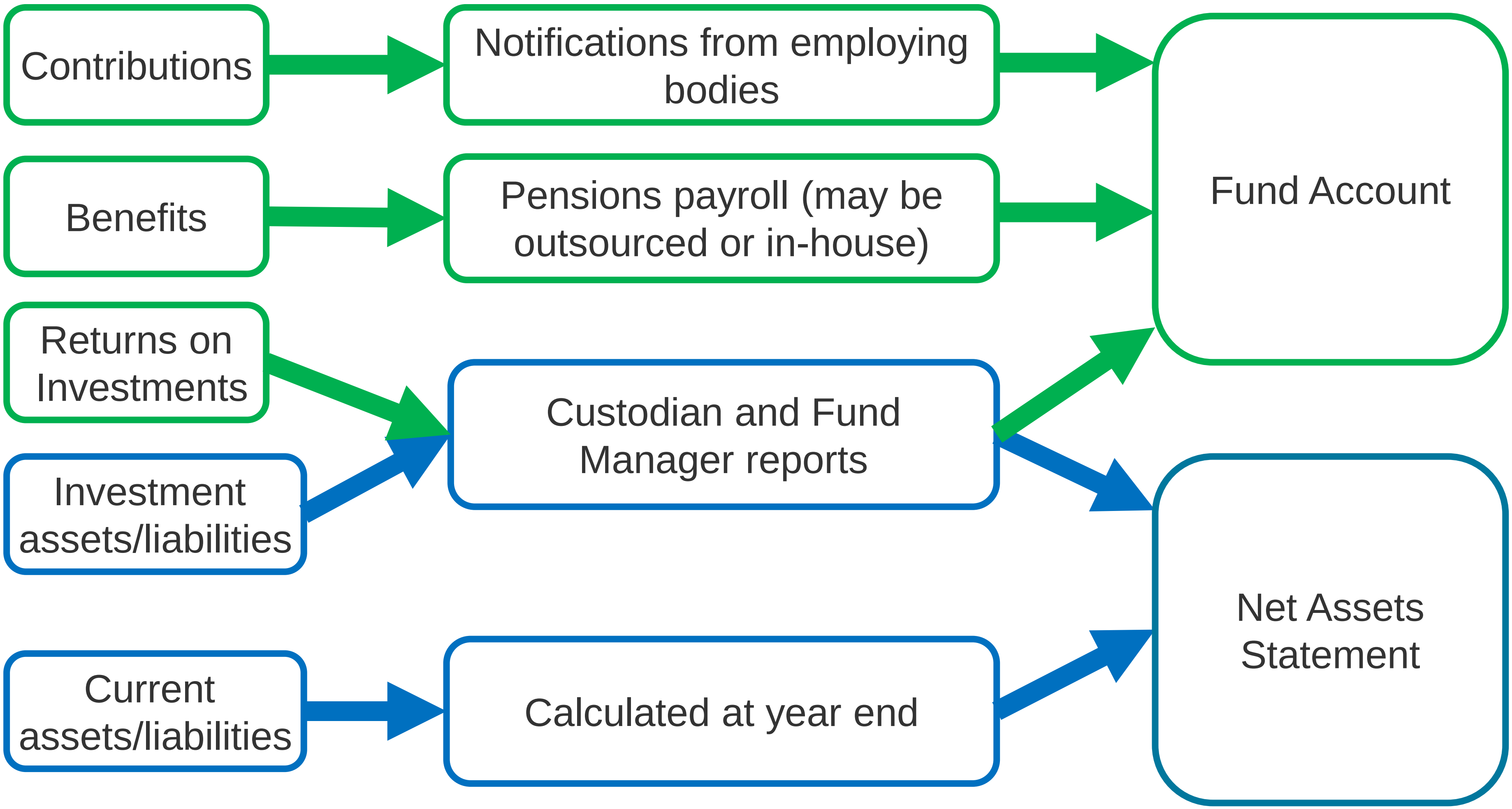
Information sources



Annual reports - publication

- ✓ Start early
- ✓ De-couple strategies from 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

Annual reports – horizon scanning

- DCLG:
  - plan to remove pension fund accounts from administering authority's financial statements
  - make annual report primary reporting route for pension fund
  - BUT legislation not yet drafted

- Issues arising:
  - Timescales unclear – effective from 2016/17 or 2017/18?
  - Publication deadline date unclear - probably 31 July

Any questions?

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