

Preparing Local Government Pension Fund accounts and annual reports

2018/19

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What we're going to cover today

- Setting the scene
- The Fund Account
- Net Assets Statement
- Financial Instruments
- Other disclosure notes
- Annual reports

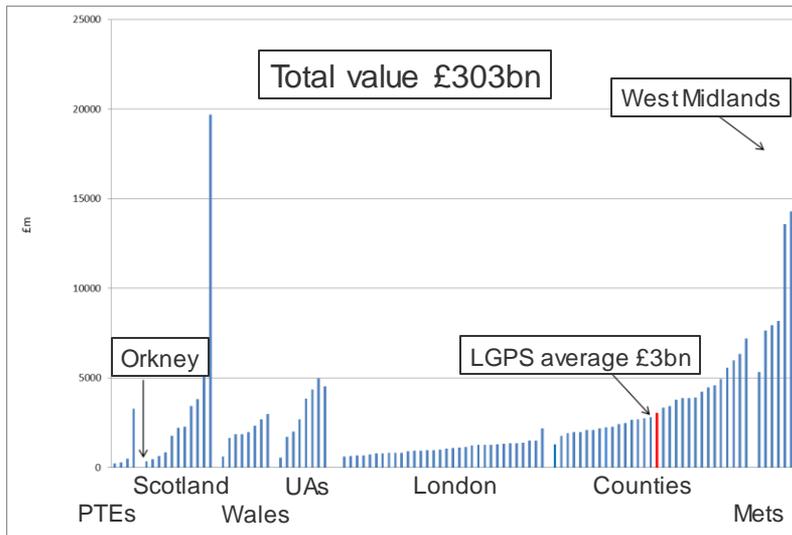


Setting the scene

- Overview of LGPS in England, Wales and Scotland
- Key information flows
- Financial Reporting Framework
- 2018/19 Code changes affecting LGPS

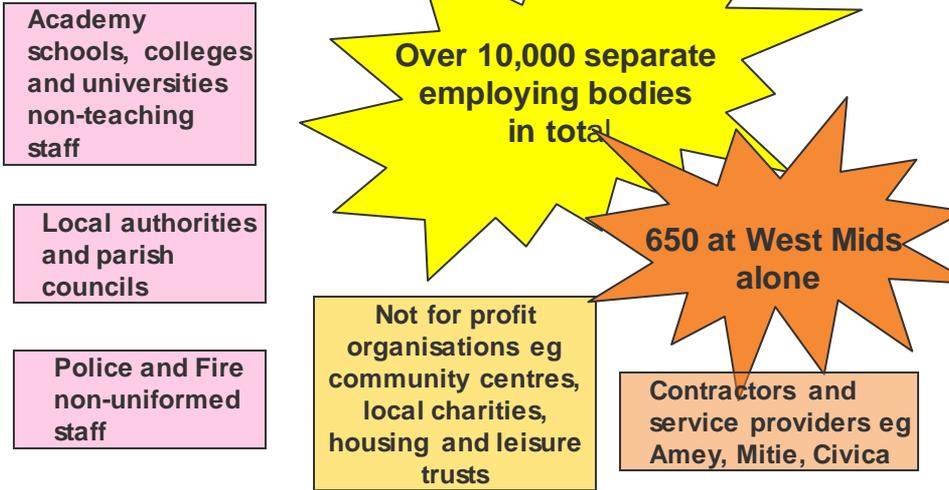


2 schemes, 102 Funds

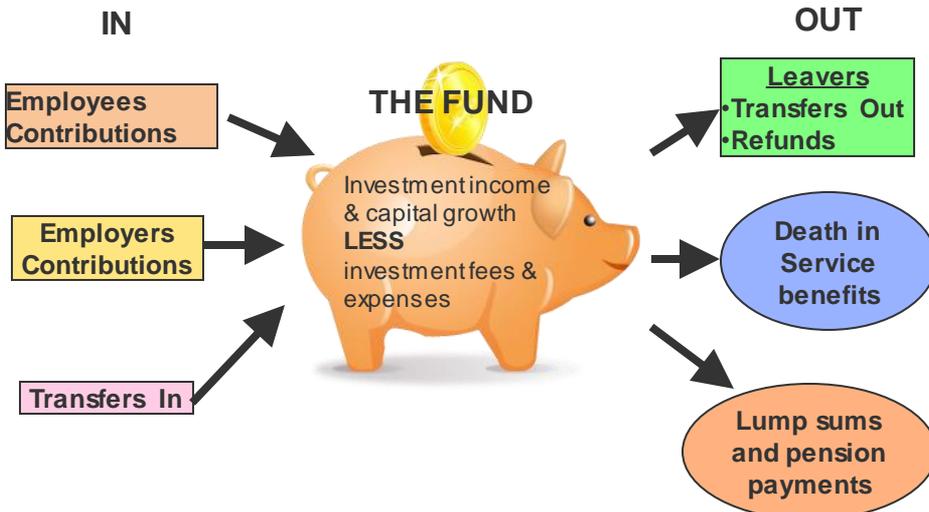


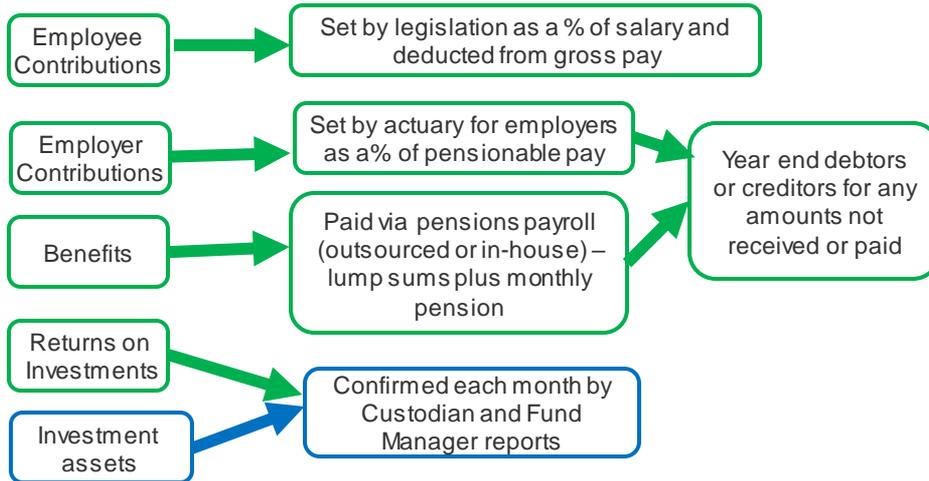
Source: LGPS audited accounts 2016/17

Employer profile



LGPS overview - cash flows





Internal controls report

Report on internal controls in place at service organisations eg custodians, fund managers, outsourced services

- Produced by external or internal auditor for 3rd parties
- Report sets out work done, period covered and results

Review exceptions raised:

- Do these need reporting to the Pensions Panel or including in the Governance Compliance Statement?
- Is additional work required to confirm assertions in the accounts?



Financial reporting framework

- Accounts must be prepared in line with the **current** version of the CIPFA Code of Practice ("the Code")
- Based on International Accounting Standards **BUT**
- adapted to reflect LGPS Regulations and other specific requirements for local government /LGPS
- Accounts are **NOT** based on the Pension SoRP, which is prepared under UK GAAP



2018/19 Code and LGPS example accounts

LGPS example accounts, including disclosure and consistency checklist, have now been published and are available from CIPFA website



2018/19 Code changes affecting pension funds

- IFRS 9 implementation (Code Chapter 7)
- Separate disclosure of gains and losses from derecognition of assets at amortised cost (para 7.3.2.14)
- Move away from “prescriptive” accounting policies (para 3.4.2.87)
- Deletion of the analyses of debtors and creditors across public sector bodies (paras 5.2.6.3 and 8.1.6.2)

The Fund Account – Dealings with Members

- Contributions due
- Benefits payable
- Transfers in and out
- Refunds
- Pension Strain
- Funding level disclosures



2017/18 £000		Notes	2018/19 £000
	Dealings with members, employers and others directly involved in the fund		
(193,229)	Contributions	7	(215,976)
(34,464)	Transfers in from other pension funds	8	(25,238)
(227,693)			(241,214)
226,858	Benefits	9	232,580
23,536	Payments to and on account of leavers	10	48,896
250,394			281,476
22,701	Net (additions)/withdrawals from dealings with members		40,262
14,008	Management expenses	11	13,270
36,709	Net additions/withdrawals including fund management expenses		53,532
	Returns on investments		
(39,167)	Investment income	12	(52,660)
604	Taxes on income		773
(820,896)	Profit and losses on disposal of investments and changes in the value of investments	14A	(300,444)
(859,459)	Net return on investments		(952,331)
(822,750)	Net (increase)/decrease in the net assets available for benefits during the year		(298,799)
(3,375,060)	Opening net assets of the scheme		(4,197,810)
(4,197,810)	Closing net assets of the scheme		(4,496,609)

Contributions receivable

Employers' contributions – should include

- Normal (% of gross salary paybill)
- Augmentation
- Deficit funding



Employees' contributions

- Banded rates depending on salary
- Include added years Additional Voluntary Contributions only

Include in Fund Account :Added years AVCs

Exclude from Fund Account: money purchase AVCs(memorandum disclosure note)

Pensions

- pension entitlement depends on when you joined
- payable monthly following date of retirement
- usual PAYE rules apply

Lump sums on retirement

- usually tax free
- may be called "retirement grant"
- part of pension may be commuted into lump sum

Death benefits

- may be called "death grant" – also tax free
- remember survivors' pension entitlement

! Accounting is always based on actual date of retirement or death

! Keep abreast of who is in which scheme and what their entitlements are

CONTRIBUTIONS

NOTE 7: CONTRIBUTIONS RECEIVABLE²⁵

By category		2017/18	2018/19
		£000	£000
	Employers' contributions	41,819	54,798
	Employers' contributions:		
	Normal contributions	101,750	105,600
	Deficit recovery contributions	46,650	50,625
	Augmentation contributions	3,019	5,043
	Total employers' contributions	151,419	161,268
	Total contributions receivable	193,229	215,976

By type of employer

2017/18		2018/19	
£000		£000	
60,306	Administering authority	61,804	
81,457	Scheduled bodies	86,572	
51,466	Admitted bodies	67,600	
193,229		215,976	

BENEFITS

NOTE 9: BENEFITS PAYABLE²⁷

By category		2017/18	2018/19
		£000	£000
185,417	Pensions	185,417	189,193
38,864	Commutation and lump sum retirement benefits	38,864	38,625
2,577	Lump sum death benefits	2,577	4,762
226,858		226,858	232,580

By type of employer

2017/18		2018/19	
£000		£000	
80,511	Administering authority	80,286	
101,186	Scheduled bodies	109,186	
45,161	Admitted bodies	43,108	
226,858		232,580	

Termination Benefits

Employing bodies seeking to reduce staffing levels have a variety of options available:

Discretionary Benefits – paid by the employer NOT the pension fund

- Increased redundancy payments (but statutory limits apply)
- Discretionary compensation (up to 2 years pay)

Early termination of employment – paid for by pension fund BUT causes strain on the fund

- Flexible retirement post 55 years old (pension abated)
- 55+ on grounds of business efficiency
- Ill health retirement

Where employee is receiving “packaged” termination benefits ensure payment is split and correctly accounted for

Pension fund strain - what is it?



Pay retirement benefits early

Enhanced retirement benefits



Loss of ees & ers contributions



Loss of investment return

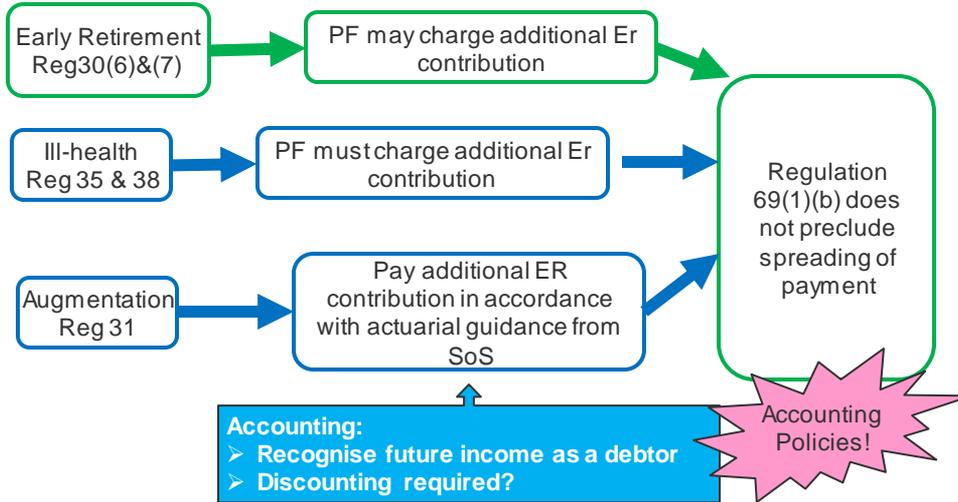


“Pension Strain”

3 options for employers:

1. Do nothing – wait until next triennial funding and pay employer contributions based on % advised by actuary
2. Pay additional employer’s contribution in-year
3. Pay additional employer’s contribution spread over more than 1 year

When are additional ER contributions payable?



Disclosure requirements

Triennial funding assessment:

At the 2016 actuarial valuation, the Fund was assessed as 91% funded (86% at the March 2013 valuation). This corresponded to a deficit of £480m (2013 valuation: £487m) at that time. Contribution increases will be phased in over the three-year period ending 31 March 2020 for both scheme employers and admitted bodies. The primary contribution rate (i.e. the rate which all employers in the Fund pay) is as follows.

Year	Employers' contribution rate
2016/17	14.1%
2017/18	14.7%
2018/19	15.3%
2019/20	16.1%

Also disclose key assumptions and discount rates used for each valuation

IAS 19 valuation:

31 March 2018		31 March 2019
£000		£000
(4,564)	Present value of promised retirement benefits	(4,965)
4,198	Fair value of scheme assets (bid value)	4,497
(366)	Net Liability	(468)

	Individual	Bulk
Example	Employee transfers to another LGPS employer	Group of employees transferring to another body eg LSVT or leisure trust
Accounting	Cash	Accrual
Valuation	Standard formula	Actuarial valuation

NOTE 8: TRANSFERS IN FROM OTHER PENSION FUNDS²⁶

2017/18		2018/19
£000		£000
6,457	Group transfers	516
28,007	Individual transfers	24,722
34,464		25,238

Disclose accounting policy + basis of material estimates and valuations

Include:

- Refund of contributions
- Purchase of annuities

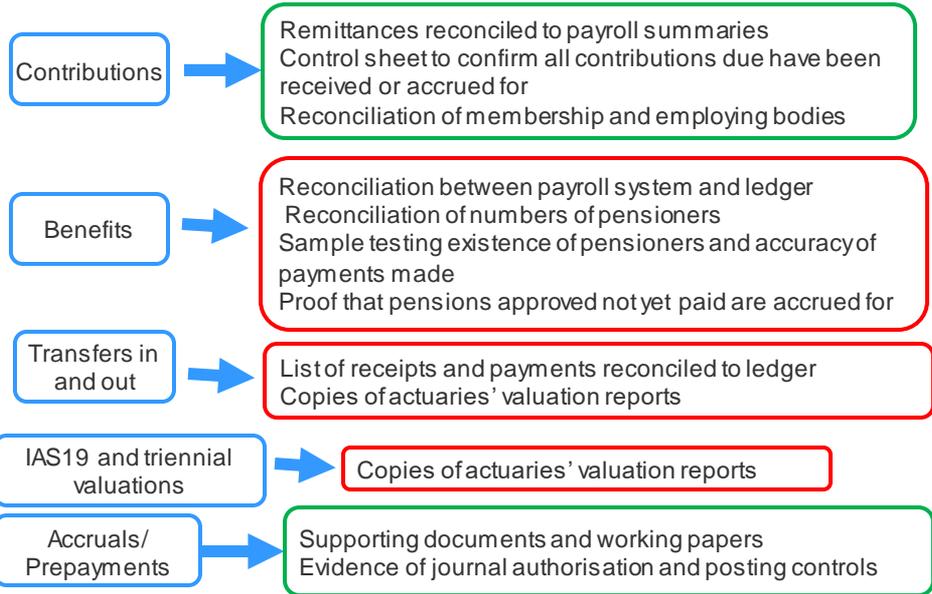
As well as transfers in and out

NOTE 10: PAYMENTS TO AND ON ACCOUNT OF LEAVERS²⁸

At the year-end there are further potential liabilities of £15.3m relating to transfers out of the pension fund where the Fund is awaiting final decisions. (see Note 26).

2017/18		2018/19
£000		£000
51	Refunds to members leaving service	21
9,182	Group transfers	3,612
14,303	Individual transfers	45,263
23,536		48,896

Apply IAS37 - accrue for payments approved or due but not yet paid at year end



The Fund Account - Costs and Investments

- Investment income
- Change in market value of investments
- Management costs



The Fund Account

2017/18 £000	Notes	2018/19 £000
Dealings with members, employers and others directly involved in the fund		
(193,229)	7	(215,976)
(34,464)	8	(25,238)
(227,693)		(241,214)
226,858	9	232,580
23,536	10	48,896
250,394		281,476
22,701	Net (additions)/withdrawals from dealings with members	40,262
14,008	11	13,270
36,709	Net additions/withdrawals including fund management expenses	53,532
Returns on investments		
(39,167)	12	(52,660)
604		773
(820,896)	14A	(300,444)
(859,459)	Net return on investments	(852,331)
(822,720)	Net (increase)/decrease in the net assets available for benefits during the year	(298,799)
(3,375,060)		(4,197,810)
(4,197,810)	Closing net assets of the scheme	(4,496,609)

Investment income

NOTE 12: INVESTMENT INCOME³¹

2017/18 £000		2018/19 £000
23,361	Income from equities	24,504
2,010	Income from bonds	12,821
1,613	Private equity income	5,070
7,891	Rents from property (Note 12A)	6,815
2,315	Pooled property investments	2,211
105	Pooled investments – unit trusts and other managed funds	318
978	Interest on cash deposits	298
700	Income from derivatives	500
194	Other	123
39,167	Total before taxes	52,660

Source:
Custodian
(Fund Managers)
CREST or
Euroclear
(in-house)

NOTE 12A: PROPERTY INCOME³²

2017/18 £000		2018/19 £000
8,632	Rental income	7,323
(741)	Direct operating expenses	(508)
7,891	Net income	6,815

Change in market value of investments

Period 2018/19	Market value 1 April 2017	Purchases during the year and derivative payments	Sales during the year and derivative receipts	Change in value during the year	Market Value 31 March 2018
	£000	£000	£000	£000	£000
Bonds	330,390	1,734,605	(1,656,820)	8,497	416,672
Equities	1,080,286	615,647	(1,175,741)	73,426	593,618
Pooled investments	1,794,391	1,532,272	(1,026,759)	157,860	2,457,764
Pooled property investments	152,613	153,661	(152,853)	769	154,190
Private equity	343,132	226,335	(185,628)	36,641	420,480
Property	364,001	18,548	(42,397)	87	340,239
	4,064,813	4,281,068	(4,240,198)	277,280	4,382,963
Derivative contracts:					
▪ Futures	1,495	5,160	(3,939)	(1,567)	1,149
▪ Options	(117)	3,517	(4,565)	1,735	570
▪ Forward foreign exchange	(18,072)	97,518	(90,426)	10,628	(352)
	4,048,119	4,387,263	(4,339,128)	288,076	4,384,330
Other investment balances:					
▪ Cash deposits	108,959			6,368	6,850
▪ FX contracts				6,000	6,000
▪ Amount receivable for sales of investments	21,681				2,741
▪ Investment income due	-				7,608
▪ Payable for purchases of investments	(2,125)				(2,656)
Net investment assets	4,176,634			300,444	4,404,873

Custodian provides this information

Ensure consistent with Notes 14 and 14b

Gross up for any fees deducted at source

Ensure closing balances agree to Net Asset Statement

Management costs

CIPFA guidance re-published 2016 - now incorporated into example accounts

Builds on the general principles established in 2014 ie:

- No netting off costs and investment returns
- Separate admin, governance and investment costs in disclosure note
- Analyse investment management costs

Also provides:

- more detailed accounting guidance
- worked examples for practitioners

Not mandated by Code BUT most LGPS now follow this guidance



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

Note 11 a: Investment management expenses

2015/16		2016/17
£000		£000
9,615	Management fees	8,935
1,815	Performance related fees	1,820
150	Custody fees	145
35	Transaction costs	25
11,615		10,925

Investment costs - recognition

Cost is defined in accounting standards 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 so the Fund Account discloses investment costs and 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
- Report **all** costs affecting investment yields in the Annual Report

Working paper requirements

Investments

- Reconciliation of custodians report to fund manager statements
- Reconciliation of draft accounts and ledger balances
- Valuation reports for other assets eg investment property

1. Relevant agresso reports
2. Correspondence with fund managers to identify
 - split of management and performance fees
 - fees netted off capital values or income
 - transaction costs
3. Calculations supporting year end accruals for unpaid fees

Admin and management costs

The Net Asset Statement

- Investment valuations and IFRS 13
- Investments analysis
- Other assets and liabilities



Net Assets Statement – 2018/19 changes

2017/18		2018/19	
0	Long-term investments	14	500
4,211,994	Investment assets	14	4,415,424
(35,360)	Investment liabilities	14	(11,051)
4,176,634	Total net investments		4,404,873
0	Long-term debtors	21A	30
36,842	Current assets	21	103,648
4,213,476			4,508,551
(609)	Long-term borrowing		(436)
(15,057)	Current liabilities	22	(11,506)
4,197,810	Net assets of the fund available to fund benefits at the end of the reporting period		4,496,609

IFRS 13 Fair value measurement

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

IFRS 13 aims to provide a consistent definition based on:

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

with additional disclosures to explain the valuation techniques applied

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

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 LGPS assets and liabilities



Most LGPS assets should already be valued at "highest and best" price



Specific valuation issues should only arise if the LGPS has directly held property, artefacts or shares in unquoted companies AND these are not revalued each year



How to value unquoted investments



Insurance policies
Antiques
Works of Art

Valuation by auction house or loss adjuster



Share capital in unquoted companies

Value at net assets /% shareholding or expected share of future profits

Cash

Separate bank a/c?
Risk of co-mingling?
Investment Strategy ?



Loans and overdrafts

Limited to:
• Change of fund manager
• Cashflow shortfalls
• 90 days maximum

Fair Value disclosures

All assets

- ✓ Valuation method for each asset type, including directly held property
- ✓ Analysis by level 1-3 hierarchy
- ✓ Disclose transfers between levels
- ✓ Include description of significant inputs for levels 2 and 3

New for Level 3 investments only:

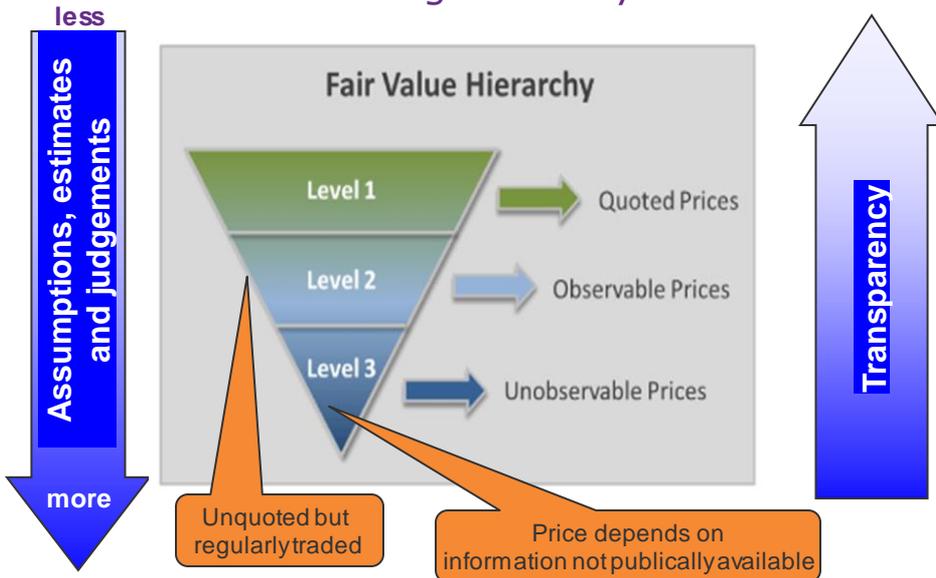
- ✓ Description of key sensitivities
- ✓ Sensitivity analysis for investment valuations
- ✓ Reconciliation of opening to closing balances
- ✓ Analysis of realised and unrealised gains or losses in year

PRAG guidance on level 1-3 hierarchies

Suggested categorisation for investments:

Quoted equities Exchange traded pooled funds and derivatives (active markets only) Cash	1 – published price
Corporate/Government Bonds	2 – regularly traded
OTC derivatives Unquoted pooled funds Hedge funds	2/3 depending on frequency of trading
Unquoted equities Special purpose vehicles Property	3 – depend on “expert” valuation

Pricing hierarchy



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. 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 by John Smith FRICS in accordance with RICS guidelines	Existing lease terms & rentals 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

Fair Value disclosures (2) – Level 3 assets

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

Fair Value disclosures (3)

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	(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

The Net Asset Statement

- Investment analysis



Investment disclosures - Note 14

	Note ref in example accounts
Analysis of investments	14
Reconciliation of movements on investments	14a
Detailed analysis of investments	14b
Fund Manager analysis	14c
Stock lending	14d
Property holdings	14e

Information comes from Custodian – ensure it:

- reconciles to Fund Managers’ reports **and**
- reconciles to the Net Asset Statement

Note 14: Investments analysis (Summary)

Should = net investment assets in NAS

Market value 31 March 2018 £000		Market value 31 March 2019 £000
0	Long term investments	500
	Equities	
	Investment assets	
330,390	Bonds	416,672
1,080,286	Equities	593,118
1,794,391	Pooled investments	2,457,764
152,613	Pooled property investments	154,190
343,132	Private equity	420,480
364,001	Property (see Note 14E)	340,239
	Derivative contracts:	
1,655	Futures	2,497
14,534	Forward currency contracts	6,531
352	Purchased/written options	734
108,959	Cash deposits	12,850
-	Investment income due	7,608
21,681	Amounts receivable for sales	2,741
4,211,994	Total investment assets	4,415,424
	Investment liabilities	
	Derivative contracts:	
(160)	Futures	(1,348)
(32,606)	Forward currency contracts	(6,883)
(469)	Purchased/written options	(164)
(2,125)	Amounts payable for purchases	(2,656)
(35,360)	Total investment liabilities	(11,051)
4,176,634	Net investment assets	4,404,873

Note 14c: Investments analysis (Detailed)

31 March 2018 £000		31 March 2019 £000
	Bonds	
	UK	
65	Public sector quoted	618
6,810	Corporate quoted	3,972
-	Corporate unquoted	106
	Overseas	
2,565	Public sector quoted	6,474
320,771	Corporate quoted	405,316
179	Corporate unquoted	186
330,390		416,672
	Equities	
	UK	
176,748	Quoted	246,394
	Unquoted	500
	Overseas	
900,073	Quoted	343,129
3,465	Unquoted	3,595
1,080,286		593,618
	Pooled funds – additional analysis	
	UK	
805,230	Fixed income unit trust - quoted	936,960
61,621	Other unit trusts - unquoted	79,420
27,871	Hedge funds	26,145
	Overseas	
272,805	Fixed income unit trusts - quoted	162,377
613,284	Other unit trusts - unquoted	639,671
	Quoted equity	601,438
19,711	Hedge funds	11,753
1,794,391		2,457,764
	Pooled property investments - unquoted	
152,613		154,190
343,132	Private equity - unquoted	420,480
364,001	Property	340,239
16,541	Derivatives	9,762
876,287		924,671

31 March 2018 £000		31 March 2019 £000
108,959	Cash deposits	12,850
-	Investment income due	7,608
21,681	Amounts receivable from sales	2,741
130,640		23,199
4,211,994	Total investment assets	4,415,924
	Investment liabilities	
(33,235)	Derivatives	(8,395)
(2,125)	Amounts payable for purchases	(2,656)
(35,360)	Total investment liabilities	(11,051)
4,176,634	Net investment assets	4,404,873

Note 14c: Fund Manager analysis

Split between pooled and non-pooled investments

NOTE 14C: INVESTMENTS ANALYSED BY FUND MANAGER⁴⁰

Market value 31 March 2018			Market value 31 March 2019	
£000	%		£000	%
Investments managed by XYZ regional asset pool:				
0	0	N and G Investment Management	589,438	13.4
0	0	XYZ Regional Asset Pool	500	0
0	0		589,938	13.4
Investments managed outside of XYZ regional asset pool:				
4,511	0.1	ABC Currency Management	1,088	0.0
553,783	13.2	N & G Investment Management	0	0
755,917	18.1	Alternative Assets	941,774	21.4
245,867	5.9	XYZ Credit Management Ltd	248,905	5.6
804,457	19.3	Offside IM (Global) Ltd	872,569	19.8
551,486	13.2	SFM International (UK) Ltd	544,237	12.4
481,161	11.5	White Stone Investment Managers	389,104	8.8
434,137	10.4	Faraday Investment Management Ltd	425,655	9.7
345,315	8.3	Ellebeau in-house investment team ⁴¹	391,603	8.9
4,176,634	100.0		3,814,935	86.6
4,176,634	100.0	Total	4,404,873	100.0

Also disclose individual shareholdings or investments representing 5% or more of Fund assets

Note 14e - Investment property

- Separate disclosure requirements only apply to directly held property **not** pooled investments
- Carry at fair value (RICS valuation required)
- Disclose any disposal restrictions, obligations or covenants
- Disclose future rental income

NOTE 14E: PROPERTY HOLDINGS⁴⁴

The Fund's investment in property portfolio comprises investments in pooled property funds and a number of directly owned properties which are leased commercially to various tenants. Details of these directly owned properties are as follows.

2017/18		2018/19
£000		£000
386,091	Opening balance	364,001
	Additions:	
1,801	Purchases	12,299
-	New construction	4,211
438	Subsequent expenditure	2,038
(24,683)	Disposals	(42,397)
327	Net increase in market value	87
27	Other changes in fair value	-
364,001	Closing balance	340,239

The future minimum lease payments receivable are as follows:⁴⁵

31 March 2018		31 March 2019
£000		£000
6,823	Within one year	7,793
33,254	Between one and five years	31,566
5,698	Later than five years	4,125
46,675	Total future lease payments due under existing contracts	43,484

The above disclosures have been reduced by a credit loss allowance of 5% per annum reflecting the Fund's expected loss from late or non-recovery of rents from tenants. This has been based on the Fund's own historic experience but also information on similar properties received from the Fund's property letting agents. In accordance with paragraphs 7.2.9.1 and 7.2.9.2 of the Code the loss allowance has been calculated based on the estimated lifetime loss allowance for all current tenancies.

Investments – what can go wrong

- Custodian's statement not agreed to Fund Manager reports
- Draft accounts do not agree to ledger
- Inconsistencies between investments analysis notes or between notes and Net Asset Statement
- Fees deducted at source not identified and grossed up
- Incorrect fair Value hierarchy
- Inconsistencies with change in market value of investments

The Net Asset Statement

- Other assets and liabilities



NOTE 21: CURRENT ASSETS⁶⁶

31 March 2018		31 March 2019
£000		£000
	Short term debtors	
2,976	Contributions due – employees	2,413
17,667	Contributions due – employers	7,032
<u>20,643</u>		<u>9,475</u>
3,809	Transfer values receivable (joiners)	1,463
7,786	Sundry debtors	4,554
156	Prepayments	159
<u>32,394</u>	Total	<u>15,621</u>
4,448	Cash balances	88,027
<u>36,842</u>		<u>103,648</u>

NOTE 21A: LONG TERM DEBTORS⁶⁷

31 March 2018		31 March 2019
£000		£000
	Long term debtors	
0	Reimbursement of lifetime tax allowances	30
<u>0</u>	Total	<u>30</u>

NOTE 22: CURRENT LIABILITIES⁶⁸

31 March 2018		31 March 2019
£000		£000
(6,220)	Sundry creditors	(8,043)
(7,195)	Transfer values payable (leavers)	(2,030)
(1,642)	Benefits payable	(1,433)
<u>(15,057)</u>		<u>(11,506)</u>

- Introduced in 2016 - limits the amount of pension that can be paid without an extra tax charge
- Responsibility for payment rests with the pensioner
- **BUT** some funds offer to pay the tax upfront and are reimbursed from pension deductions over time
- This creates a long term debtor in the accounts.

Note 21:
Current
Assets

31 March 2018		31 March 2019
£000		£000
	Long term debtors	
0	Reimbursement of lifetime tax allowances	30
<u>0</u>	Total	<u>30</u>
	Short term debtors	
2,976	Contributions due – employees	2,413
17,667	Contributions due – employers	7,032
<u>20,643</u>		<u>9,475</u>
3,809	Transfer values receivable (joiners)	1,463
7,786	Sundry debtors	4,554
156	Prepayments	159
<u>32,394</u>	Total	<u>15,621</u>

Common problems

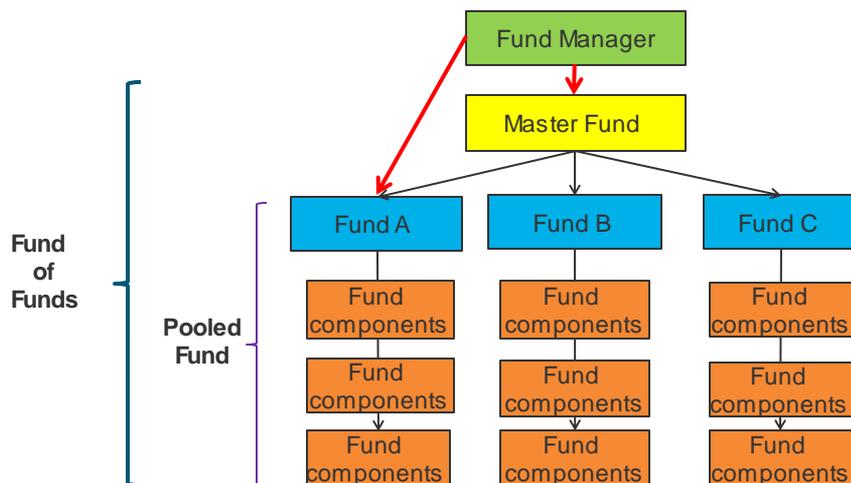
- Accruals/prepayments missed or double counted
- Fund Manager/investment balances left out
- No accruals for Fund Manager fees due not yet paid for
- Previous year end adjustments not reversed out
- Poor audit trail between ledger and draft accounts
- Debit balances not transferred out of creditors and vice versa
- Year end adjustments incorrectly posted to cash accounts

The Net Asset Statement

- Pooled investments and asset pools



Pooled Funds/Fund of Funds



Venture capital

- Money provided to finance new and growing companies
- Enables pension funds to invest in their local area, creating and safeguarding jobs
- Investment usually represents purchase of share capital
- Profit is generated when the shares are sold as part of management buyout, flotation or sale of the company
- Venture capitalists may be involved in running the company as directors or shareholders with voting rights
- Most venture capital funds use a pool format, investing in a range of companies to spread risk and create a more regular income stream

How to value pooled investments

Pooled investments are relatively easy to value if they:

- have published bid prices eg unit trusts or
- are regularly traded

BUT some will be neither - possible valuation methods include:

- ✓ Drilling down to value each separate component
- ✓ Estimate a value based on
 - traded instruments with a similar mix of investments **OR**
 - sale prices achieved by similar funds
- ✓ Obtain independent experts' valuation

All permissible **BUT** method of valuation needs to be disclosed in the accounts

National asset pools - 1

- 8 pools now established across England and Wales
- DCLG objective is "to deliver significantly reduced costs while maintaining overall investment performance"
- Outside London, pools will start to trade on 1 April 2018.

London	£25bn
ACCESS	£23bn
Wales	£13bn
Northern Pool	£35bn
Central	£34bn
Brunel	£34bn
Border to Coast	£36bn
LLP	£13bn
Total	£179bn

DCLG
target
value =
75% of all
LGPS
investments

Different transactions are involved which need to be separately identified and accounted for:

Type of cost	Accounting
Set up costs – may be: <ul style="list-style-type: none"> • share capital • loans • Staff or services provided free of charge Investor may be LGPS, Council or both	Include as: <ul style="list-style-type: none"> • Long term investment (NAS) • Short or long term loan (NAS) • Admin costs in Fund Account if not being recharged to pool Accounted for by whoever pays unless specified otherwise
Scrutiny and oversight	Include in oversight and governance costs in Fund Account
<ul style="list-style-type: none"> • Transitioned investments • Investment management costs 	<ul style="list-style-type: none"> • Pooled investments in NAS • IME costs in Fund Account

Shares in or loans to national asset pools will need to be accounted for as follows:

Type of investment in asset pool	Accounting
Loan	<ul style="list-style-type: none"> • Analyse in NAS as short or long term • Carry at amortised cost • Remember soft loan disclosures if loan terms are not commercial rates
Share capital	Carry at Fair Value in NAS based on: <ul style="list-style-type: none"> • Balance Sheet value • Future profit forecasts • Future cash flow forecast OR • Cost (in year 1) if fair value cannot yet be ascertained

CIPFA Investing in asset pools - disclosure

NOTE 14C: INVESTMENTS ANALYSED BY FUND MANAGER⁴⁰

Market value 31 March 2018		Market value 31 March 2019	
£000	%	£000	%
Investments managed by XYZ regional asset pool:			
0	0	589,438	13.4
0	0	500	
0	0	589,938	13.4
Investments managed outside of XYZ regional asset pool:			
4,511	0.1	1,088	0.0
553,783	13.2	0	0
755,917	18.1	941,774	21.4
245,867	5.9	248,905	5.6
804,457	19.3	872,569	19.8
551,486	13.2	544,237	12.4
481,161	11.5	389,104	8.8
434,137	10.4	425,655	9.7
345,315	8.3	391,603	8.9
4,176,634	100.0	3,814,935	86.6
4,176,634	100.0	4,404,873	100.0

Note 14c Investment Manager Analysis

Market value 31 March 2018	Market value 31 March 2019
£000	£000
0	500
Long term investments:	
Equities	
Investment assets	
330,390	416,672
1,080,286	593,118
1,794,391	2,457,764
132,813	154,190
343,132	420,480
364,001	340,239
Derivative contracts:	
1,655	2,497
14,534	6,531
352	734
108,959	12,850
-	7,608
21,681	2,761
4,211,994	4,415,424
Investment liabilities	
Derivative contracts:	
(160)	(1,348)
(32,606)	(6,883)
(469)	(164)
(2,125)	(2,506)
(35,360)	(11,051)
4,176,634	4,404,873
Net investment assets	

Note 14a: Investments Analysis

The Net Asset Statement

Derivatives



- Should be reported gross and stated at fair value
- No offsetting of assets and liabilities
- May be quoted (ETD) or unquoted (OTC) investments
- Separate category in investments analysis disclosure notes
- Separate disclosure note (note 15 in example accounts)
- Include in investment risk disclosures and IFRS13 levels 1-3

Underlying	Exchange traded derivative (ETD)	Over the counter (OTC)
Exchange rate		Forward foreign exchange
Interest rate		Swaps
Equity price	Futures	
Security price	Options	Options

Increasingly difficult to measure

Types of Derivative - Forward Foreign Exchange

Two parties agree to **exchange currencies** on a **specific future date** at an **agreed rate of exchange**

Characteristics:

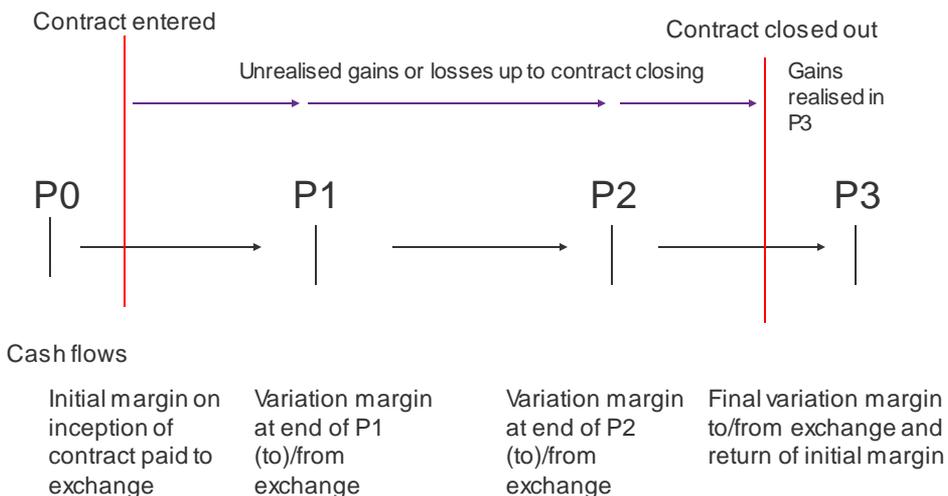
- Over the counter contract – each is potentially unique
- No published value/price
- No commission payable (normally)
- Settled on a gross basis on settlement date
- No collateral
- Value calculated using published market information on exchange rates

Types of Derivative - Futures

A contract which **derives** its value from the underlying change in value of a commodity over time

- Commodity may be shares or price of metal/wheat/oil etc
- No initial consideration
- Initial and variation margin cash movements are transfers between cash/amounts due to/from brokers
- Unrealised gains/losses = typically variation margin cash movements over life of contract
- Gains/losses are unrealised until the contract is closed
- Economic exposure is disclosed in notes to accounts

Futures accounting



What can go wrong?

	Opening market value £000	Purchases / derivative payments £000	Sales / derivative receipts £000	Change in market value £000	Closing market value £000
Fixed interest	620,234	451,466	(495,134)	30,536	607,102
Equities	267,345	45,234	(34,245)	104,256	382,590
Derivatives:					
Foreign exchange forwards	3,049	1,751,345	(1,752,312)	2,100	4,182
Interest rate swaps	-	350,000	(350,000)	-	60,139
Futures	51,234	341,000	(332,095)	-	60,139
	941,862	2,939,045	(2,963,786)	152,126	1,069,247
Cash	(52,347)			2,434	(58,299)
Total	889,515			154,560	1,010,948

- Forward FX – Purchases and payments in-year dwarf everything else
- Futures - Two problems here which are very much linked – a large market value for the futures and a large negative cash balance or investment creditor.
- Another issue you may also see is futures with a £Zero market value

IFRS 9 - hedging

Description of financial instrument	How this has been applied to manage risk	Possible impact on future cash flows
Fair value hedges		
Interest rates	Hedges are entered into to mitigate the risk presented by variable rate unit trust in pooled investments. Their underlying values are linked to the relative movement over time on specified interest rates eg between a named unit trust bond and LIBOR. Settlement occurs at fixed points throughout the contract term based on the difference between the two rates on the specified date	A reduction of 10% in current carrying value could reduce the year end Fund Account balance by £3.4m
Forward foreign exchange contracts	Mitigate the risk that adverse movements on foreign exchange rates will affect the carrying value and investment income relating to pooled funds including quoted overseas equities. Settlement is calculated at the contract end date based on the difference between spot rate and forward rate on a specified basket of currencies.	A reduction of 10% in current carrying value could reduce the year end Fund Account balance by £0.7m

	Nominal value £'000	Inception date	Carrying value at 31.3.2019 £000	Changes in fair value 2018/19 £000	Changes in fair value since inception £000	Hedge ineffectiveness 2018/19 %	Hedge ineffectiveness since inception %	Where ineffectiveness has been recognised
UK pooled investments – unit trusts (classified as FVTPL)								
Interest rate hedges	£40,000	1/7/2017	£26,145	(£1,726)	(13,855)	6.2%	34.6%	As part of change in market value of investments
Overseas pooled investments – unit trusts (classified as FVTPL)								
Forward foreign exchange contracts	£7,500	8/3/2018	£6,661	(£788)	(£839)	10.5%	11.2%	As above
Interest rate hedges	£5,500	1/1/2019	£5,092	(£408)	(£408)	7.4%	7.4%	As above

Financial Instruments



Identifying Financial Instruments

Financial Instruments are defined as ..."Any **contract** giving rise to a **financial asset** in one entity and a **financial liability** or **equity instrument** of another entity

Financial assets are cash or a contractual right to cash or other assets (eg trade debtors or derivatives)

Financial liabilities are contractual obligations to deliver cash or other assets, or to exchange financial assets under potentially unfavourable conditions - e.g. derivatives

Equity instruments are an interest or residual interest in the net assets of another entity (eg share capital) even if there is no contractual obligation to make payments -e.g. non-transferable shares or debentures

Financial instruments - examples

IAS 32

IFRS 9

Financial Assets	Not Financial Assets
Cash Equity/debt instruments Forward transactions Property fund	Property (not a contract) Subsidiaries, associates & JVs (scoped out as covered by IAS 27) Leases (scoped out as covered by IAS17)
Financial Liabilities	Not Financial Liabilities
Overdrafts Trade creditors Guarantees	Tax owed Promised future retirement benefits (both statutory obligations not contracts)

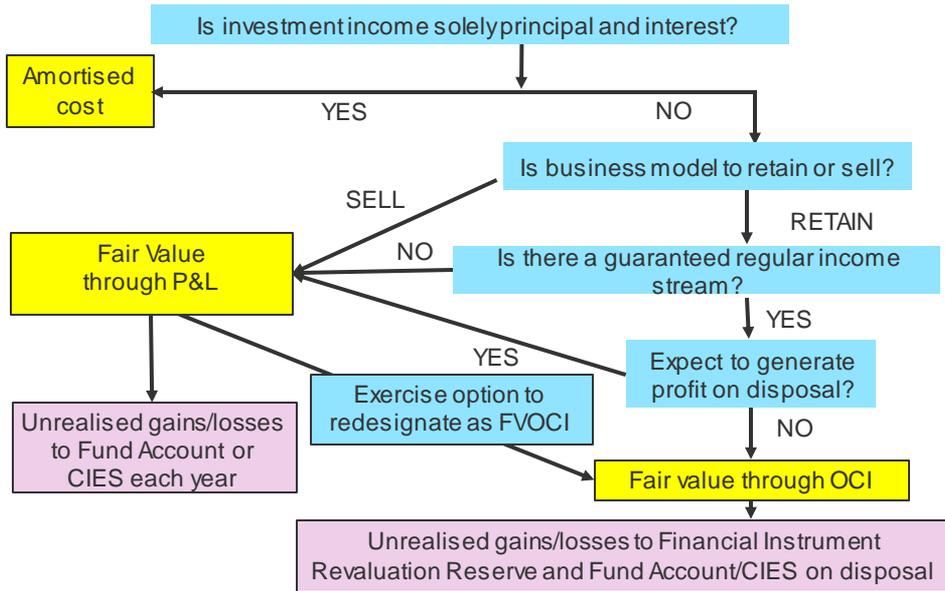
IFRS 9 – Financial Instruments

2018/19 Code introduces:

- new financial instrument classification, with new category of Fair Value Through Other Comprehensive Income (paragraphs 7.1.5.1 to 7.1.5.5 of the Code)
- new requirement for expected loss allowances (paragraph 7.2.9.1 of the Code)
- the option of additional disclosures for hedging (under section 7.1.8 of the Code).

NO requirement to restate comparative data for 2017/18 (Code para 7.4.3.3)

CIPFA performance in public services **FI classification – IFRS 9** cipfa.org.uk



CIPFA performance in public services **FI classification – pension funds** cipfa.org.uk

FI classification – pension funds

	1 Business model?			2 Contractual cashflows?	Conclusion
	Hold solely to collect contractual cashflows?	Hold to collect cashflows AND sell	Neither	Solely payments of principal & interest on principal o/s on specific dates?	Classification and valuation
Bonds	Yes	Yes	N/a	No	FVTPL – Fair Value
Equities	No	Yes	N/a	No	FVTPL - FV
Pooled Vehicles	No	Yes	N/a	No	FVTPL - FV
Private Equity	No	Yes	N/a	No	FVTPL - FV
Cash	Yes	No	N/a	Yes	Amortised cost
Debtors & Creditors	Yes	No	N/a	Yes	Amortised cost

FI classification - asset pools

	1 Business model?			2 Contractual cashflows?	Conclusion
	Hold solely to collect contractual cashflows?	Hold to collect cashflows AND sell	Neither	Solely payments of principal & interest on principal o/s on specific dates?	Classification and valuation
Scenario 1 – profit share or dividend	Yes	No	N/A	No	FVTPL – Fair Value
Scenario 2 – share option or disposal premium	No	Yes	N/A	No	FVTPL – Fair value
Scenario 3 – loan	No	No	Yes	Yes	Amortised cost
Scenario 4 – no cash flow benefit	No	No	Yes	No	FVOCI – Fair value

CIPFA FI disclosures – net asset statement

2017/18			2018/19		
Fair value through profit and loss	Assets at amortised cost	Liabilities at amortised cost	Fair Value through Profit and Loss	Assets at amortised cost	Liabilities at amortised cost
£000	£000	£000	£000	£000	£000
Financial Assets					
330,390			416,672		
1,080,286			593,618		
1,794,391			2,457,764		
152,613			154,190		
343,132			420,480		
16,541			9,762		
	113,407			94,877	
	0			6,000	
	21,681			10,349	
	7,942			4,713	
3,717,353	143,030		4,052,486	115,939	
Financial Liabilities					
(33,235)			(8,395)		
		(2,125)			(2,656)
		(6,220)			(8,043)
		(603)			(436)
3,684,118	143,030	(8,954)	4,044,091	115,939	(11,135)

+ separate heading for FVOCI (if any)

FI totals + directly held property + non-contract debtors and creditors = Net Asset Statement

FI disclosures - Fund account

Income, expense, gains or losses

- Net gains and losses by instrument category
- Impairment losses by class of financial asset
- Interest on impaired financial assets

Should reconcile to
Change in
Market Value
of Investments (excluding
directly held property)

NOTE 17B: NET GAINS AND LOSSES ON FINANCIAL INSTRUMENTS⁵⁸

2017/18		2018/19
£000		£000
	Financial assets	
845,434	Fair value through profit and loss	289,556
	Amortised cost – realised gains on derecognition of assets	
	Amortised cost – unrealised gains	12,368
	Financial liabilities	
(12,446)	Fair value through profit and loss	(1,567)
	Amortised cost – realised losses on derecognition of assets	
	Amortised cost - unrealised losses	
832,998	Total	300,357

IFRS 9 – credit losses

- **NOT** investment assets
- **NOT** government or local authority counterparties
- **MAY** apply to income from directly held property **OR** transactions with admitted bodies
- Calculate and account for lifetime loss allowance **ONLY**

Note 14 – Direct Property Holdings

The future minimum lease payments receivable by the fund are as follows:

31 March 2018		31 March 2019
£000		£000
8,623	Within one year	7,793
32,354	Between one and five years	31,566
5,698	Later than five years	4,125
46,675	Total future lease payments due under existing contracts	43,484

The above disclosures have been reduced by a credit loss allowance of 5% per annum reflecting the fund's expected loss from late or non-recovery of rents from tenants. This has been based on the fund's own historic experience but also information on similar properties received from fund's property letting agents. In accordance with paragraphs 7.2.9.1 and 7.2.9.2 of the Code the loss allowance has been calculated based on the estimated lifetime loss allowance for all current tenancies.

Financial instrument disclosures

Also remember to disclose:

- Any reclassification between categories (Code defines and restricts reclassification)
- Any derecognition or transfer of assets
- Any offsetting arrangements
- All collateral held, and any defaults and breaches that have occurred

FI risk disclosures (1)

Credit risk	Maximum exposure and collateral held Age analysis and credit quality of past due/impaired assets
Collateral	Nature and carrying amount If not convertible, policy for disposal
Liquidity risk	Maturity analysis and arrangements for Arrangements for managing liquidity risk
Market risk	Sensitivity analysis for each market risk

Qualitative

Extent of risk exposures and how they arise
How the risks are managed – policies and processes
Any changes from previous period

Links to:
Risk register
Funding &
Investment
Strategies

Quantitative

Quantify exposure to risk
Based on information provide to key management
Highlight any concentrations of risk
Include sensitivity analysis

Consistency?

Source?

Arithmetic?

	Value at 31/3/15	Effect on asset values	
		+100 BPS	-100 BPS
	£000	£000	£000
Cash & equivalents	12,850	-	-
Cash balances	88,027	-	-
Fixed interest securities (10 year)	416,672	(41,670)	41,670
Total change in assets available	517,549	(41,670)	41,670

Financial Instruments – common problems

Scope - Financial Instruments not correctly identified
(ie directly held property or non-contractual items not excluded)

Valuation

- Valuations incorrect or out of date
- Impairments not identified or not properly accounted for

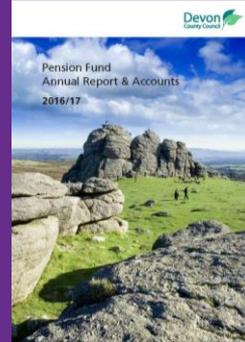
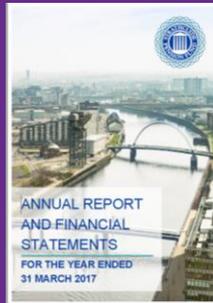
Inconsistency – FI disclosures don't agree to the rest of the accounts

Non-tailored risk disclosures

- Copied from somewhere else
- Not focused on key risks

Annual Reports

- Updated guidance
- Scheme administration
- Post Pool reporting
- Transparency Code



Annual Report Guidance

- Updated for 2018/19
- Includes disclosure checklist
- Consultation period ended 10 December 2018
- Due for publication January 2019

Main changes are:

- asset pooling
- transparency code
- CIPFA working group on pensions administration



<p>Scheme management</p> <ul style="list-style-type: none"> • Manager/advisor details • Risk management • Scheme administration summary <p>Scheme Administration</p> <ul style="list-style-type: none"> • Caseload statistics • Unit costs • Performance against key targets • Complaints • Outsourcing arrangements • Pensions admin strategy (optional) 	<p>Investment management</p> <ul style="list-style-type: none"> • Funding Strategy Statement • Investment Strategy Statement (Statement of Investment Principles in Scotland) • Asset allocations • Investment performance • Investment costs • Transition to national asset pools
<p>Actuarial report</p> <p>Statement of Accounts</p> <ul style="list-style-type: none"> • Employing body details • Contribution rates • Policies & Guidance for employers • Communication Strategy (England) 	<p>Management commentary</p> <p>Annual Governance Statement</p> <p>Financial performance</p> <ul style="list-style-type: none"> • 1 year & 3 year financial forecasts • Cash flows and asset values • Current year outturn vs budget • Analysis of administration and governance costs • Summary of financial position • Pension overpayments & recoveries • Outstanding borrowings (Scotland)
<p>Governance</p> <ul style="list-style-type: none"> • Governance compliance statement • Governance arrangements • Compliance with Myners principles & CIPFA/SOLACE framework 	

Process	No. of cases commenced in year	No. of cases completed in year	No. cases outstanding at year-end	% completed in year	Average cases per fee staff member
Deaths – initial letter acknowledging death of member					
Deaths – letter notifying amount of dependants pension					
Retirements – letter notifying estimate of retirement benefits					
Retirements – letter notifying actual retirement benefits					
Retirements – process and pay pension benefits on time					
Deferment – calculate and notify deferred benefits					
Transfers in/out – letter detailing transfer quote					
Refund – Process and pay a refund					
Divorce quote – letter detailing cash equivalent value and other benefits					
Divorce settlement – letter detailing implementation of pension sharing					

Process	KPI	%	Legal requirement	%
Deaths – initial letter acknowledging death of member	5 days		2 months	
Deaths – letter notifying amount of dependants pension	10 days		2 months	
Retirements – letter notifying estimate of retirement benefits	15 days			
Retirements – letter notifying actual retirement benefits	15 days			
Retirements – process and pay pension benefits on time	15 days			
Deferment – calculate and notify deferred benefits	30 days			
Transfers in/out – letter detailing transfer quote	10 days			
Refund – Process and pay a refund	10 days			
Divorce quote – letter detailing cash equivalent value and other benefits	45 days			
Divorce settlement – letter detailing implementation of pension sharing order	15 days			
Joiners – notification of date of enrolment	40 days			

Process	2013/14	2014/15	2015/16	2016/17	2017/18
Investment Management Expenses					
Total cost (£'000)					
Total membership (fem)					
Cost per member (£)					
Administration Costs					
Total cost (£'000)					
Total membership (fem)					
Cost per member (£)					
Oversight and Governance Costs					
Total cost (£'000)					
Total membership (fem)					
Cost per member (£)					
Total cost per member (£)					

Asset Pools (1)

	Direct £000s	Indirect £000s	Total £000s	Cumulative £000s
Set up costs:				
Recruitment				
Legal				
Procurement				
Other support costs eg IT, accommodation				
Share purchase/subsription costs*				
Other working capital provided eg loans				
Staff costs**				
Other costs				
TOTAL SET UP COSTS				
Transition costs:				
Transition fees				
Taxation (seeding relief)				
Other transition costs				
TOTAL TRANSITION COSTS				

	Asset Pool			Non-Asset Pool			Fund Total	
	Direct £000s	Indirect £000s	Total £000s	Direct bps	Indirect bps	Total bps	£000s	bps
Management fees								
ad valorem								
performance								
research								
PRIIPS compliance								
Asset pool shared costs								
Transaction costs								
commissions								
acquisition/ issue costs								
disposal costs								
registration/filing fees								
taxes and stamp duty								
Custody								
Other								
Total £000								

Asset category	Opening value		Closing value		Performance		Passive Index*	Local Target
	£000s	%	£000s	%	Gross %	Net %		
Asset Pool managed investments								
Pooled investment vehicles:								
Active listed equity								
Active fixed income								
Passive listed equity								
Passive listed income								
Private debt								
Property								
Unlisted equity								
Infrastructure								
Cash								
Multi-Asset Funds/ Diversified Growth Funds								
Other								
Total								
Non-Asset Pool managed investments								
Pooled investment vehicles:								
Active listed equity								
Active fixed income								
Passive listed equity								
Passive listed income								
Private debt								
Property								
Unlisted equity								
Infrastructure								
Cash								
Multi-Asset Funds/ Diversified Growth Funds								
Other								

Asset Pools (2)

Calculating price and quantity variances for an asset portfolio transferred to an asset pool at 1/10/16, as at 31/3/18

Value of assets at 1/10/16	£112m		
ad valorem fee rate	55bp per £1m		
Value of assets at 31/3/18	£156m		
ad valorem fee rate	50bp per £1m on first £100m		
	45bp per £1m on next £30m		
Fund	40bp per £1m on next £30m		
Price variance			
Current fund value at old rate	£156m x £0.0055 =		£858,000
Current value at new fee rate	£100m x £0.0050 =	£500,000	
	£30m x £0.0045 =	£135,000	
	£26m x £0.0040 =	£104,000	
			£739,000
PRICE VARIANCE			£119,000
Quantity variance			
Old rate x (old fund value - new fund value) =	£0.0055 x (£112m - £156m)		
QUANTITY VARIANCE			(£242,000)
Total variance			
TOTAL VARIANCE	Old fees - new fees = £616,000 - £739,000 =		(£123,000)

Calculating price and quantity variances for an asset portfolio transferred to an asset pool at 1/10/16, as at 31/3/18

Value of assets at 1/10/16	£112m		
ad valorem fee rate	55bp per £1m		
Value of assets at 31/3/18	£156m		
ad valorem fee rate	50bp per £1m on first £100m		
	45bp per £1m on next £30m		
Fund	40bp per £1m on next £30m		
Price variance			
Current fund value at old rate	£156m x £0.0055 =		£858,000
Current value at new fee rate	£100m x £0.0050 =	£500,000	
	£30m x £0.0045 =	£135,000	
	£26m x £0.0040 =	£104,000	
Performance fee			£641,143
			£1,380,143
PRICE VARIANCE			(£522,143)
Quantity variance			
Old rate x (old fund value - new fund value) =	£0.0055 x (£112m - £156m)		
QUANTITY VARIANCE			(£242,000)
Total variance			
TOTAL VARIANCE	Old fees - new fees = £616,000 - £1,380,143 =		(£764,143)

Asset Pools (3): Comparison of Costs and Savings

(a) Total expected costs and savings (as per Business Case submissions)

	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25
	£000	£000	£000	£000	£000	£000	£000	£000	£000
Set up costs	X	X							
Transition costs		X	X	X	X	X			
Fee savings			(X)						
Net savings realised	X	X	X	X	(X)	(X)	(X)	(X)	(X)

(b) Expected vs actual costs and savings to date (this table would be extended in future years as more actual data becomes available). NB [(actual and expected figures are significantly different an explanation should be provided).

	2016/17				2017/18			
	Actual		Budget		Actual		Budget	
	In-year	Cumulative to date						
	£000	£000	£000	£000	£000	£000	£000	£000
Set up costs (1)	X	X	X	X	X	X	X	X
Transition costs (1)			X	X	X	X	X	X
Fee savings (2)					(X)	(X)	(X)	(X)
Net savings realised	X	X	X	X	X	X	X	X

(1) – should agree to Pool Set up Costs table above (2) – should agree to savings variance analysis below
 NB. Example is based on a pool outside London in the early stages of transition where fee savings have yet to be realised.

Scheme Advisory Board – Code of Transparency

- ✓ In England and Wales a Voluntary Code of Transparency was launched in 2017
- ✓ Templates have been developed for Fund Managers to complete so that **ALL** cost data is consistently identified and collected and reported
- ✓ LGPS should report information received from fund managers in the Investments Section of their annual report



Annual Report contents – common problems

- ✘** Key information not included or out of date
 - No annual and/or 3 year financial forecasts or cash flow summaries
 - No data on quality of administration and whether targets have been met
 - No info on transparency agenda and hidden costs
 - No information on risk management
- ✘** No elected member input – no formal approval or sign off
- ✘** No explanation of how governance arrangements work in practice or the role of the local pensions board
- ✘** Long or complex documents copied in without summarising key points or explaining how issues are being addressed

Any Questions?



Preparing Local Government Pension Fund accounts and annual reports

2018/19

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