CIPFA The Chartered Institute of Public Finance & Accountancy

report

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Committee	CIPFA/LASAAC
Venue	CIPFA Mansell Street
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Subject	2016/17 Code of Practice on Local Authority Accounting in the United Kingdom (the Code) – Accounting and Reporting by Pension Funds Review

The purpose of this report is to inform the Board about the review of the Accounting and Reporting by Pension Funds section of the Code

1 Introduction

1.1 During the consultation on the Code in 2015/16 CIPFA/LASAAC referred to the need to review section 6.5 of the Code Accounting and Reporting by Pension Funds. This report sets out the conclusions of the review.

2 Accounting and Reporting by Pension Funds Section of the Code

2.1 The accounting for pensions funds in Section 6.5 of the Code is based on EU adopted IFRS; this specifically includes IAS 26 *Accounting for Retirement Benefit Plans*. The adoption of IAS 26 is supported by specific requirements in IFRS by other standards to the extent that this is not superseded by IAS 26. The two most relevant are likely to be IAS 19 *Employee Benefits* and the financial instruments standards.

2.2 IAS 26 does not provide specifically for the format of the pension fund account or the net asset statement. The Code (as did the preceding UK GAAP based SORP) relies on the format of the accounts in the Financial Reports of Pension Schemes – a Statement of Recommended Practice 2015 (the Pensions SORP). The Pensions SORP was subject to consultation when the 2015/16 Code was subject to consultation and therefore CIPFA/LASAAC considered that it would review the requirements of the Code for pension fund reporting in the 2016/17 Code.

3 Pension Fund Account

3.1 The Secretariat has compared the format and line analysis of the Pensions Fund Account in the Code with those of the Pensions SORP. The analysis is available in Appendix 1 to this report. There are no fundamental omissions in the Code. There are a number of changes proposed to improve the presentation of the account for the users of the pension fund and the understandability of the Code's provisions for pension fund accounts preparers.

3.2 Paragraph 6.5.2.5 of the 2015/16 Code sets out that to ensure comparability between different local authority pension fund disclosures in this key area the investment income analysis should be based on that of the Pensions SORP. Therefore, to maintain this comparability the Secretariat recommends updating the analysis of investment income in line with the Pensions SORP analysis. This is not too different from the current requirements; where local authorities have any different forms of investment income this would be included in the other category and disclosed as relevant under IAS 1 *Presentation of Financial Statements*.

3.2 There are also two classes "transfers in from other pension funds" and "payments to and on account of leavers" where the Code does not suggest sub classifications and the Pension SORP does. Local authority accounts preparers might find it useful if this detail were specified in the Code rather than reliance being placed on IAS 1 requirements to analyse any material items. These sub-classifications are not intended to increase the reporting requirements but to assist local authorities in identifying them.

3.3 The CIPFA *Local Government Pension Scheme Fund Accounts 2014/15, Example Accounts and Disclosure Checklist* (Example Accounts) provides separate sections for income and expenditure from dealings with members. This separation is supported in the Pensions SORP by use of sub totals. The Secretariat considers that again accounts preparers might find it useful to add appropriate subtotals to improve the understandability of the statement. A similar argument can be made for total return on investments and therefore the Secretariat has added the two relevant subtotals to the format of the Exposure Draft of section 6.5 of the 2016/17 Code.

CIPFA/LASAAC is invited to agree to the proposals for a change of format for the Pensions Fund Account.

4 Net Assets Statement

4.1 The Secretariat has undertaken a similar analysis for the net assets statement and has concluded that there are no omissions (see the analysis in Appendix 2). However, again paragraph 6.5.2.5 of the 2015/16 Code sets out that to ensure comparability between different local authority pension fund disclosures in this key area that the investment assets and therefore the Secretariat has made some minor amendments to the sub classifications. This also accords with the approach to investment income in the Fund Account. The Secretariat has also retained the income from associates and joint ventures from the 2015/16 Code due to the theoretical possibility that the Fund may receive such income.

CIPFA/LASAAC is invited to agree to the proposals for a change of format for the Net Assets Statement.

5 Accounting Policies and Disclosures

General Application of other Sections of the Code to Pension Fund Financial Statements

5.1 As highlighted for the Board in previous papers and the Secretariat would note that as the Pension Fund financial statements for local authorities are supported by the full reporting and disclosure requirements of EU adopted IFRS (as adopted by the Code) this represents a robust reporting framework equal to that of the Pensions SORP. This was supported previously by the Board considering the *Local Government Pension Scheme Fund Accounts 2012/13 example accounts and disclosure checklist* and when considering whether this should be included in the development programme for the 2014/15 Code. Following a review of the Pension SORP the Secretariat would not change this conclusion with the possible exception of the two items highlighted below.

5.2 The structure of section 6.5 has been commented on a number of times by accounts preparers or other interested parties as it requires cross reference to other sections of the Code as they apply to pension funds and subject to the requirements of paragraph 6.5.1.3. It is sometimes difficult for accounts preparers to see the interaction between the two sections as it is feasible that almost all sections might apply (albeit this is very unlikely for some sections). In order to assist with demonstration of the robustness of the accounting requirements to external stakeholders and to assist accounts preparers with an understanding of how the other sections of the Code interact with the pension fund financial statements the Secretariat has produced a table[i] which it recommends is included as an Annex to Section 6.5. The table summarises in overview the application of each section or chapter of the Code to local authority financial statements.

CIPFA/LASAAC is invited to agree to the proposals for a change of format for the Net Assets Statement.

IFRS 13 Fair Value Measurement

5.3 CIPFA/LASAAC members have debated the impact of IFRS 13 *Fair Value Measurement* on IAS 26 *Retirement Benefit Plans* (ie there is a scope exclusion for fair value disclosures for IAS 26 and therefore for section 6.5). CIPFA/LASAAC considered that if it overrode this by means of an adaptation that this would mean that the Code would be more onerous than IFRS and this was very important under the streamlining agenda, particularly as this issue had not been consulted on. However, the Pensions SORP has adopted a form of fair value disclosures very similar to IFRS 13. Perhaps more importantly in discussing the users of the Pension Fund financial statements (the Pensions SORP uses the term interested parties), the Pensions SORP makes it clear that the fund's members and prospective members are concerned about investment risk, the fair value disclosures are an important element of IFRS in addressing this.

5.4 The Secretariat is of the view that for 2015/16 the lack of fair value disclosures would be addressed by other elements of IFRS[1] adopted by the Code. Firstly, the pension funds would have to report under paragraphs 3.4.2.83 on future and other sources of estimation uncertainty at the end of the reporting period that have a significant risk of resulting in a material adjustment for assets and liabilities in the next financial year. The IFRS 13 fair value disclosure structure would be the best means available of reporting such risks.

5.5 Secondly, paragraph 3.4.2.40 c)[2] of the Code requires administering authorities to provide sufficient additional disclosures when compliance with the specific requirements in the Code is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the authority's financial position and financial performance. Again the fair value disclosures are likely to mitigate against the risk of the administering authority providing insufficient

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[1] Under the Code's adoption of IAS 1
[2] Of the 2015/16 Code

information in the pension fund financial statements. This is the approach CIPFA will take in its guidance on the 2015/16 pension fund financial statements. However, the Secretariat consider that it would provide more certainty and be clearer for accounts preparers if the Code clearly stipulated these requirements and therefore such proposals should be included in the 2016/17 Code. It would recommend to CIPFA/LASAAC that the Board proposes adapting the reporting requirements of IFRS 13 to include fair value disclosure requirements in the 2016/17 Code.

CIPFA/LASAAC is invited to consider whether it agrees that it should adapt IFRS 13 and require fair value disclosures for pension fund financial statements.

The Accounting Treatment of Entities Established to Provide Services to the Pension Fund

5.6 A CIPFA/LASAAC member raised the issue of the impact of entities established to provide services to Pension Funds and whether or not group accounts would apply.

5.7 Section 6.5 itself does not provide direct reference to the provision of group accounts. However, the Secretariat is of the view that this is covered by paragraph 6.5.1.3 of the Code which sets out that other relevant provisions of the Code apply to the extent that they are not superseded by section 6.5 of the Code. Therefore technically this would mean that Chapter Nine's (Group Accounts) adoption of IFRS 10 *Consolidated Financial Statements* would apply to such arrangements. FRS 102 *Financial Reporting Standard applicable in the UK and Republic of Ireland* and thus the Pension SORP permits Pension Schemes to prepare consolidated financial statements (but do not require them to do so). However, the Secretariat considers that the nature of the pension fund arrangements ie that it is not a legal entity and as such it would be very difficult for the fund itself to exert control under IFRS 10. The Secretariat has confirmed this position in the Code in the new Annex to Section 6.5

CIPFA/LASAAC is invited to consider whether it agrees with the Secretariat's view on the impact of IFRS 10 on entities established to provide services to the pension fund.

Actuarial Present Value of Promised Retirement Benefits

5.8 One of the audit bodies that responded to the question of the Code's approach to the actuarial present value of promised retirement benefits noted that:

"The Code's guidance on the disclosure of the actuarial present value of promised retirement benefits could be improved. Currently it allows each of the three options available under IAS 26 but recommends one (which few authorities actually follow). It may be better to simply remove the other two options and require the one considered to be best practice. "

5.9 CIPFA/LASAAC's preferred option is for option A. The Board considered this issue in detail for the 2013/14 financial statements. The Secretariat would contend that this is the better financial reporting option. The Secretariat would argue for this on a number of fronts:

- **Transparency** - A frequent comment from scheme stakeholders, politicians and commentators is that LGPS data are difficult to access and compare. The three options permitted for the measurement of the actuarial present value of promised retirement benefits means that this is particularly true of the valuation of liabilities. The inability of the LGPS as a whole to present a figure for the liabilities of the scheme, prepared on the same basis on which funding and contributions-setting decisions are made, allows for inaccurate claims to be made as to the state of the scheme and lends weight to those that argue that the sector lacks transparency. Prescribing Option A will assist in building up a definitive, annual snapshot of the liabilities of the Local Government Pension Scheme on a funding basis – a figure that is usually only available once every 3 years, some 6 to 12 months after the valuation date.

- Best practice in financial reporting – CIPFA/LASAAC's terms of reference require that the Board seeks excellence in financial reporting. The Secretariat has already referred to the robustness of the financial reporting provided in the Code as the pension fund requirements adopt full IFRS to produce the financial statements. CIPFA also provides best practice by issuing guidance on adopting enhanced reporting of management costs. Thus the Local Government Pension Scheme's financial reporting has strived to be at the forefront of best accounting practice in the UK for pension funds. Following this option would ensure the robustness of financial reporting for all elements of the statements.

- The cost of moving to option A – CIPFA/LASAAC has previously been concerned about the cost of the reporting burden for local authorities if the Board restricted the reporting requirements to option A. The Secretariat understands that all of the actuarial firms operating in the LGPS sector offer inter-valuation monitoring services (powerful software tools that can track liabilities virtually in real-time), and most funds use these tools for their own monitoring.

5.10 The Secretariat therefore recommends that option A is included in the 2016/17 Code as this provides better financial information for the users of pension fund financial statements. It has therefore made the appropriate amendments to Section 6.5 of the Exposure Draft of the Code.

CIPFA/LASAAC is invited to consider whether it agrees with the Secretariat's recommendation on the reporting of the actuarial present value of promised retirement benefits.

Scottish Reporting Requirements

5.11 The same audit body commented that "*The LGPS accounts for Scottish authorities are published in a separate document rather than with the authority's annual accounts. The review of section 6.5 should ensure that this scenario is properly reflected.*"

5.12 CIPFA/LASAAC has made the reporting requirements for LGPS Schemes in Scotland explicit in the Code. The Secretariat has reviewed the structure of section 6.5 and included additional commentary in the section for Scottish local authorities. In addition the table at Annex A itemises specific Scottish requirements (including the need to publish the pension fund accounts as a separate document).

Administrative/Management Expenses

5.13 CIPFA/LASAAC members might be aware that there is a great deal of public scrutiny of investment management expenses for pension funds across sectors. In addition, the cost of administering the LGPS has also come under increasingly intense scrutiny in recent years, culminating in the DCLG Call for Evidence on the future structure of the LGPS[3], launched in June 2013. CIPFA, along with many other respondents to the Call for Evidence, stressed the need for a comprehensive, reliable and robust data set to underpin the type of decision-making necessary to inform structural reform of the LGPS. This includes the capture of LGPS scheme administration costs, prepared on a comparable basis. CIPFA/LASAAC members are aware that CIPFA has issued its Guidance *Accounting for Local Government Pension Scheme Management Costs* to assist with this issue and the guidance has been referred to in the 2015/16 Code.

5.14 The Pensions SORP also prioritises the reporting of transaction costs within pension fund financial statements and it recommends direct transaction costs should be analysed for each significant asset class disclosed in the investment reconciliation table. The Secretariat considers that it would be beneficial if the Code also included this recommendation, enabling local authorities to transparently report transaction costs. This would also allow greater scrutiny and comparison with other pension funds as the disclosure is a recommendation in the Pensions SORP. The Secretariat proposes including this disclosure as a recommendation, thus allowing authorities that might not have the information available to develop the systems to enable them to capture that data.

CIPFA/LASAAC is invited to consider the inclusion of the transaction costs disclosure in section 6.5 of the Code.

6 Minor Amendments

6.1 The Secretariat has made a number of minor amendments to the drafting of Section 6.5, eg adding appropriate preamble and to the financial statements, to improve the structure and readability of the section.

recommendation

CIPFA/LASAAC is asked to provide its initial views on the:

1) **Exposure Draft of the 2016/17 Code for Section 6.5; and**
2) **Invitation to Comment on 2016/17 Code in its references to the pensions review and the Exposure Draft of Section 6.5.**

[3] The Call for Evidence consultation paper can be found at www.gov.uk/government/uploads/system/uploads/attachment_data/file/208114/LGPS_Call_for_evidence.pdf . An analysis of responses to the Call for Evidence can be found at www.lgpsboard.org/index.php/structure-reform/board-analysismenu.

Appendix 1

Fund Account Comparison

Pensions SORP	Code	Secretariat Comments
Opening commentary …this SORP recommends the following disclosures with the bold items on the face of the Fund Account and items in italics disclosed separately in the notes to the financial statements where material.	**Opening Commentary** Note: the major categories are indicated in bold. The unbolded items may be analysed in the notes to the accounts, if not shown on the face of the Fund Account or Net Assets Statement. (Code paragraph 6.5.3.4).	
Employer contribution • *Normal* • *Augmentation* • *Deficit Funding* • *S75 Debts* • *Other* **Employee Contribution** • *Normal* • *Additional voluntary*	**Contributions** – Employer contributions – Member contributions	The additional information for employer/ employee contributions is covered by the disclosure requirements in paragraph 6.5.5.1 m) and u).
Transfers in • *Group transfers in from other schemes and scheme mergers* • *Individual transfers in from other schemes*	**Transfers in from other pension funds** – *Group Transfers from other schemes or funds* – *Individual Transfers from other schemes or funds*	*The example financial statements include an analysis of transfers in. The Secretariat recommends that the Code should include this as a reporting/ disclosure requirement.*
Other income • *Claims on term insurance policies* • *Any other category of income which does not naturally fall into the above classification suitably described and analysed where material*	**Other income**	Administering authorities will be able to provide an analysis of any material items of income under IAS 1.
Benefits paid or payable • *Pensions* • *Commutation of pensions and lump sum retirement benefits* • *Purchase of annuities* • *Lumps sum death*	**Benefits** – Pensions – Commutation of pensions and lump sum retirement benefits – Purchased annuities – Lump sum death benefits	This analysis should provide appropriate analysis for the LGPS.

benefits • *Other benefits* • *Taxation where lifetime or annual allowances are exceeded*		
Payments to and on account of leavers • *Refunds of contributions in respect of non-vested leavers* • *Refunds of contributions in respect of opt-outs* • *Purchase of annuities* • *Group transfers out to other schemes* • *Individual transfers out to other schemes*	**Payments to and on account of leavers** – *Refunds to members leaving service* – *Payments for members joining state scheme* – *Group transfers* – *Individual transfers*	*The example financial statements include an analysis of payments on account of leavers. The Secretariat recommends that the Code should include this as a reporting or a disclosure requirement.*
Other payments • *Premiums on term insurance policies* • *Any other category of expenditure which does not naturally fall into the above classification suitably described and analysed where material*	**Other payments**	Administering authorities should provide an analysis of any material payments under IAS 1.
Administrative expenses borne by the scheme *With suitable analysis where material*	**Administrative expenses**[4]	The 2015/16 Code includes additional guidance on administrative expenses per the footnote.
Net additions/(withdrawals) from dealings with members *Net amount of*	**Net additions/(withdrawals) from dealings with members** *Net amount of*	*The example financial statements divides the fund account using a similar description – it may be useful for*

[4] The Code refers to 'administrative expenses' in accordance with the requirements of IAS 26. CIPFA has issued guidance, *Accounting for Local Government Pension Scheme Management Costs*. This guidance does not change the accounting requirements for administrative expenses but describes them instead as 'management costs'. It does, however, suggest additional disclosure requirements. CIPFA/LASAAC recommends that local authorities have due regard to this guidance.

income or expenditure represented by the items above	*income or expenditure represented by the items above*	*account preparers if the Code specifies this subtotal.*
Investment Income • *Dividends from equities* • *Income from bonds* • *Net rents from properties (any material netting off should be disclosed)* • *Income from pooled investment vehicles* • *Income from Derivatives* • *Annuity income* • *Interest on cash deposits* • *Other(for example stock lending or underwriting)*	**Investment income** – Interest from fixed interest securities – **Dividends from equities** – Income from index-linked securities – **Income from pooled investment vehicles** – **Net rents from properties** – **Interest on cash deposits** – Share of profit/losses from associates and joint ventures – **Income from derivatives** – **Other** (for example stock lending or underwriting)	*Paragraph 6.5.2.5 sets out that investment income is based on the Pension SORP to assist with comparability. The Secretariat recommends that largely this approach is continued and therefore has suggested changes in accordance with the Pensions SORP classification but has retained the share of profits and losses from associates and joint ventures. The Secretariat has also removed the annuity income sub classification as this is not a particularly frequent transaction for local authorities. The text in bold highlights the matching sub classifications.*
Change in the market value of investments *(Comprising profits and losses on the disposal of investments)*	Profit and losses on disposal of investments and changes in value of investments	No comments
Taxation	**Taxes on income**	NA
Investment Management Expenses		The example financial statements include an analysis of investment management expenses in the note on management expenses ie administrative expenses per the 2015/16 Code.
Net returns on investments *Representing the net sum of the above items resulting in a net total of:*		*The example financial statements use a similar subtotal. The Secretariat recommends that it would be useful for account preparers if the Code specifies this subtotal.*

The net amount of increase or decrease in the fund *To which is added the:*	**Net increase (decrease) in the net assets available for benefits during the year**	NA
Opening net assets of the scheme *To give:*		The opening net assets information will be available from the comparative information in the net assets statement.
Closing net assets of the Scheme		The closing net assets information is available in the net assets statement

Appendix 2

Statement of Net Assets

Pensions SORP	**Code**
Investment Assets – Equities – Bonds – Property – Pooled investment vehicles – Derivatives – Insurance policies – Other investments – AVC investments – Cash – Other investment balances	**Investment assets** – Fixed interest securities (analysed between public sector and other) – **Equities (including convertible shares)** – Index-linked securities (analysed between public sector and other) – **Pooled investment vehicles (analysed between unit trusts, unitised insurance policies and other managed funds (including open-ended investment trusts, OEICSs, and assets held in limited liability – partnerships), showing separately those funds invested in property)** – **Derivative contracts (including futures, options, forward foreign exchange contracts and swaps)** – **Property** – **Insurance policies (with profit contracts, unitised with-profits contracts and annuity and deferred annuity contracts)** – Loans – **Other investments (such as works of art)** – **Cash deposits (including fixed term deposits, certificates of deposit, floating rate notes and other cash instruments)** – **Other investment balances (such as debtors in respect of investment transactions where these form part of the net assets available for investment within the investment portfolio; and other assets and liabilities directly connected with investment transactions, accrued dividend entitlements and recoverable withholding tax, suitably analysed where material)**
Investment Liabilities – Derivatives – Other investment balances	**Investment liabilities** – Derivative contracts (including futures, options, forward foreign exchange contracts and swaps) – Other investment balances (such as creditors in respect of

	investment transactions and other liabilities directly connected with investment transactions)
	Borrowings – Sterling – Foreign currency
Current Assets	**Current assets** – Contributions due from employers – Other current assets – Cash balances (not forming part of the investment assets)
Current Liabilities	**Current liabilities** – Unpaid benefits – Other current liabilities (such as accrued expenses, other than liabilities to pay pensions and other benefits in the future)
Total net assets	**Net assets of the scheme available to fund benefits at the period end**

Secretariat comment: there appears to be sufficient detail for local authority (LGPS) circumstances in the Net Asset's statement. The Secretariat only recommends minor amendments to the sub classification of investment assets to match the reporting requirements in the Pension Fund Account Statement.