2018/19 Audit and Accounting Considerations for Pension Funds

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Objectives for the session

- Look back at 2017/18
- 2018/19 Financial Reporting
- Current issues for 2018/19

Look Back at 2017/18 and implications for 2018/19

Headline messages

- All opinions were unqualified
- No issues identified within fund which had an impact on the administering authority's VFM conclusion
- Do not tend to see queries from local electors in respect of pension funds but are seeing Fund's receive greater challenge on ESG and climate change policies – but not through the audit
- Majority of funds signed off before the end of July – seeing move to also bring Annual Report timescales forward in England

Themes

- No really significant issues reported
- Analysis of investment classes and categories
- Estimates of Level 3 investments being materially different from final March 2018 fund manager confirmations
- Financial instruments remains area where most amendments and narrative amendments were made
- Early close will continue to have an impact particularly on evidencing valuation of Level 3 investments

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Expectations on auditors

FRC – auditors' regulator –

- Expects us to test the extent to which Pension Funds have challenged valuations reported by investment managers for harder to price investments.
- Do you get any independent assessment of the figures?

Response

- As part of the audit most auditors will seek to independently verify a selection of investment asset prices to third party information (and adjust for cash flows) and obtain independent confirmation on asset existence.
- Potential increase in auditor queries on aspects of the accounting and valuation process and the data used.

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2018/19 Financial Reporting

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Pension Fund Financial Reporting 2018/19

In practice, IFRS 9 is anticipated to have limited impact for pension funds because:

- Most assets and liabilities held by pension funds are already classed as fair value through profit and loss (FVTPL) - statutory override does not apply to pension funds
- Local authority pension funds are likely to have a limited need to recognize expected credit losses.
    - Relatively few assets are expected to be classified as FVOCI and the majority of assets at amortised cost are likely to be debtors with other local authorities and central government which the Code exempts from the need for a loss allowance.
    - But – potentially lease rentals receivable from directly held investment property, contributions from admitted bodies not covered by 3rd party guarantees
- IFRS 15 – given nature of income streams – contributions, dividends, rental streams would not anticipate having significant impact in practice

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Pension Fund Financial Reporting 2018/19

- The 2018/19 Code has moved away from a prescribed or expected "list" of accounting policies, emphasizing instead that management should develop and disclose, within the overall Code framework, the accounting policies most significant to its own transactions, balances and circumstances.
- Changes to guidance have also been made to reflect the introduction of regional asset pools and recommendations in the CIPFA paper "Proposals for Post Pool Reporting", published May 2018.
- Where regional asset pools have established companies limited by share capital as the vehicle for the pool:
  - the value and classification of the shares in the company held by each participating pension fund will need to be considered for Fair Value and financial instrument accounting.
  - Each pension fund will need to develop its own accounting polices based upon the arrangements in place and whether or not the sums of money involved are material. This may well constitute a critical judgment to be disclosed in the Notes to the pension fund accounts.

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2018/19 Current Issues

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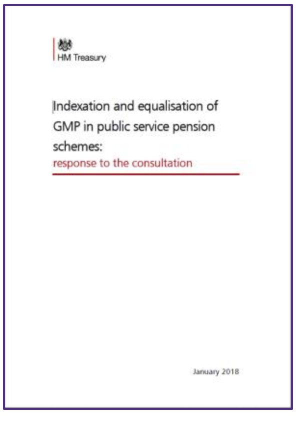
Pooling

- Funds beginning to move assets into pools
- Audit Firms in co-ordinated discussions with pools on evidence they will require for audits
  - Type 1 v Type 2 Report
  - Mainly Level 1 assets to date
  - Use of custodian
  - Looking through wrappers
- MHCLG private consultation on statutory pooling guidance
  - From 2020, when new investment strategies are in place, expectation that new investments outside the pool only in very limited circumstances

GMP indexation and equalisation

- Single State Pension in April 2016 and need for an ‘interim solution’
- ‘Interim solution’ extended to 5 April 2021 with preferred longer term option to be conversion of GMP to scheme benefit
- ‘Lloyds’ High court judgement October 2018 – GMP must be equalised and underpayments corrected
- Has a ‘trigger event’ occurred for LGPS?
- What would expected accounting be?


HM Treasury

Indexation and equalisation of GMP in public service pension schemes:
response to the consultation

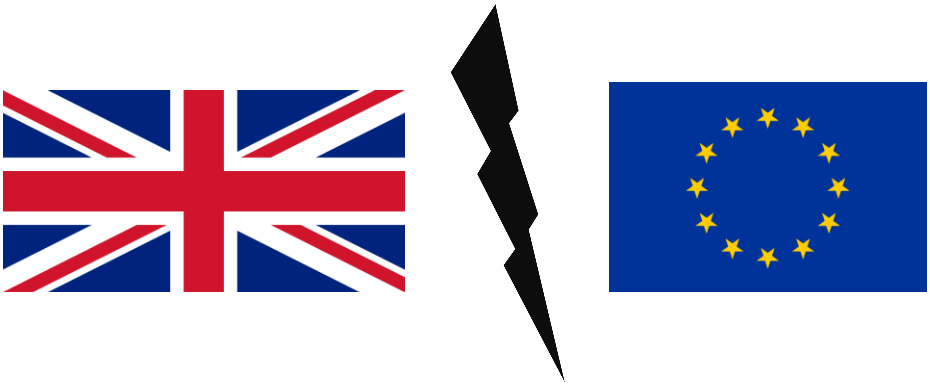
January 2018

New obligation - past service cost

OR

Remeasurement due to changed assumptions - other comprehensive income

Impact of Brexit



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General financial reporting aspects of Brexit

- Management should take ownership for assessing impacts / potential impacts for their organisations - considering direct and generic risks arising from Brexit
- This is likely to include considering the impact on:
  - (i) risk and uncertainty disclosures
  - (ii) impairment of financial and non-financial assets
  - (iii) fair values of assets and liabilities - level 2 & 3, and
  - (iv) what relevant information readers of the financial statements would require.
- Auditors will need to obtain sufficient, appropriate audit evidence over key areas of judgement and estimation uncertainty

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Audit and accounting implications

- For Funds - roll forward or projected asset valuations i.e. from 31 December 2018 – especially Level 3
- For employers – actuaries can produce accounting reports in April using an element of estimated Fund asset returns or later in May based on finalised Fund assets returns over the year
- Employers have choice however if there are differences which could have a material impact on an employer's accounts auditors may request employers to obtain an updated accounting report.
- Early discussion with auditors

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Administrative thoughts

- Do you have EU Citizens in the Fund or UK Citizens living in Europe?
- The Department for Work and Pensions (DWP) has published guidance for trust based funds in respect of the payment of occupational pension benefits to EU citizens in the UK and UK nationals in the EU in a 'no deal' scenario.
- The Pensions Administration Standards Association (PASA) is bringing together representatives from across the industry, including from the administration, legal, advisory, actuarial, data and trustee sectors.
- The group will help develop and promote best practice on issues arising from the ruling, from how to address missing data through to dealing with transfer requests and rectifying underpayments.
- LGPS potentially learn from this?

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Pension Liabilities

Nature and financial impact

Statutory override

Assessment of actuarial risk

Tripartite agreement

Legal advice – permissible?

Early payment of pension contributions

- From employer's perspective is there a legal view on spreading charge to GF and is it clear on actuary's certificate?
- Would anticipate pension funds recognising full income in the year early payment received.
- Correctly reflected in IAS 19 net defined benefit liability calculations?

Other observations on 2019

- Scheme Advisory Board picking up the 2015 KPMG report examining the issues and challenges of separating the pension's functions of LGPS administering authorities from their host authorities.
- Trust based funded schemes will be required with effect from 1st October 2019 to publish their policy on ESG considerations including specifically, climate change risk.
- LGPS administering authorities have long been required to publish their policy on ESG factors. Although it can reasonably be inferred from government policy that this should include specific consideration of climate change risk and the way that this might impact on the long term sustainability of investments, it is not mandated in the same way that it will be for trust based schemes.
- Continuing focus of the Pensions Regulator on scheme records.

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