

Local Government Pension Funds: 2017 Audit and Accounting update

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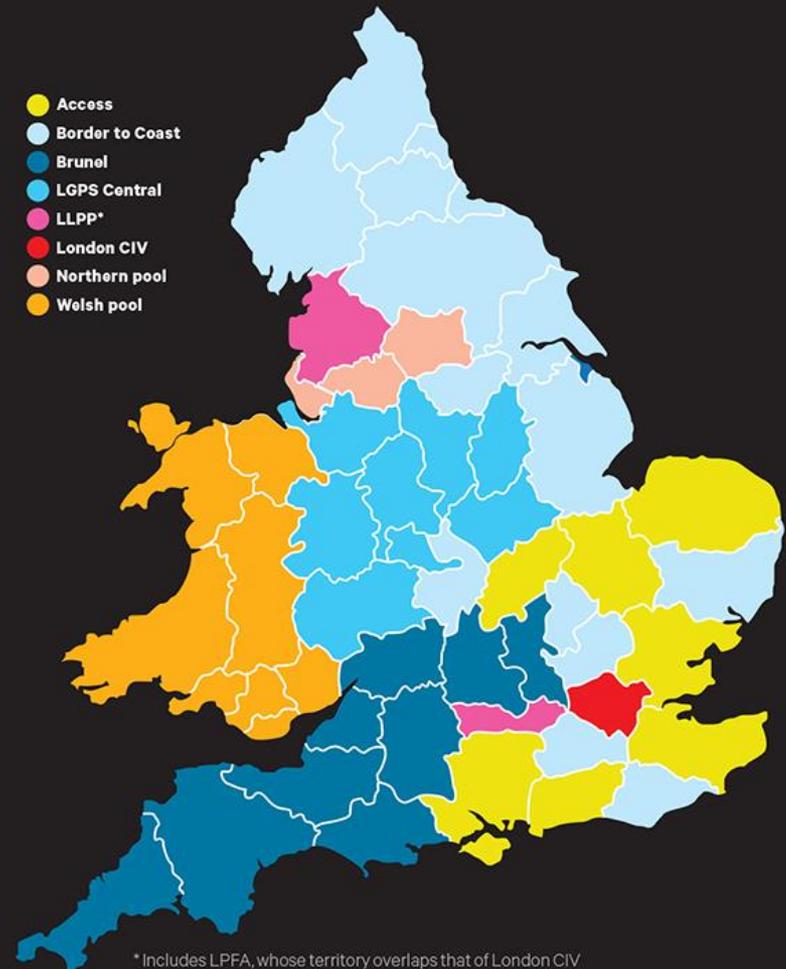


This session will
cover:

- Accounting for
asset pools

And Then There Were Eight

The 89 local authority pension plans in England and Wales have proposed to coalesce into eight large combines to comply with the government's consolidation edict.



DCLG guidance

Summer Budget 2015



- 6-8 asset pools to be established in England and Wales
- Average fund value at least £25bn
- Potential savings £190m - £240m from reduced investment management costs

Objective - “to deliver significantly reduced costs while maintaining overall investment performance”.

BUT no legislative change so no specific legal requirements

Asset pool proposals July 2016

Potential value of asset pools = 70% of total LGPS

London	32 London boroughs, City of London LGPS	£25bn
ACCESS	Northamptonshire, Cambridgeshire, East Sussex, Essex, Norfolk, Isle of Wight, Hampshire, Kent, Hertfordshire, West Sussex, Suffolk.	£23bn
Wales	Carmarthenshire, Cardiff, Flintshire, Gwynedd, Powys, Rhondda Cynon Taff, Swansea, Torfaen.	£13bn
Northern Pool	West Yorkshire, Greater Manchester, Merseyside	£35bn
Central	Cheshire, Leicestershire, Shropshire, Staffordshire, Derbyshire, Nottinghamshire, Worcestershire, WMIT	£34bn
Brunel	Avon, Cornwall, Devon, Dorset, Gloucester, Somerset and Wiltshire, Oxfordshire, Buckinghamshire, EAPF	£34bn
Border to Coast	Cumbria, East Riding, Surrey, Warwickshire, Lincolnshire, North Yorkshire, South Yorkshire, SYPTE, Tyne & Wear, Durham, Bedfordshire, Northumberland, Teesside.	£36bn
LLP	Lancashire, Berkshire and the LPFA	£13bn
Total		£179bn

PwC report November 2015

Report considered structure and governance of LGPS asset pools
Recommends “Authorised Contractual Scheme” (ACS) co-ownership model, with:

- ✓ Scheme operator authorised and regulated by FCA
- ✓ Separation of operational and oversight functions

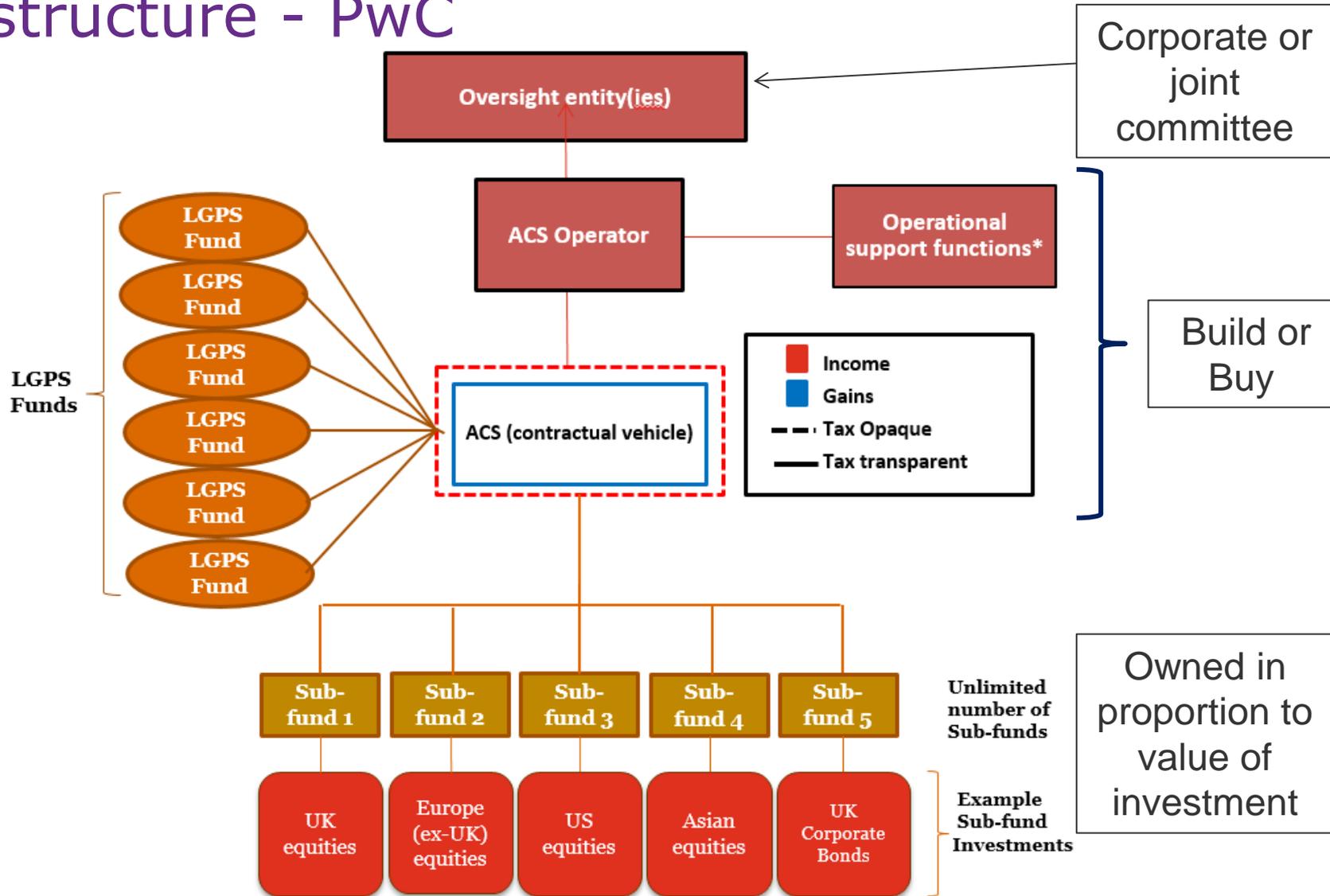
Benefits of this model:

- ✓ tax efficient - should avoid UK corporation tax, income tax or capital gains tax
- ✓ Creates umbrella structure for different sub-funds and fund managers

BUT other structures, such as limited companies or partnerships, are permitted and may be preferred



CIV structure - PwC



London CIV (Common Investment Vehicle)

- Set up December 2015
- £150k “subscription fee” from each LGPS covered set up costs
- Uses external fund managers
- Current investment value £850m
- All 33 London LGPS schemes have invested
- Aiming to grow to £25bn by 2020



- **BUT** this is not necessarily how the other 7 pools will operate as local discretion can be applied
- Other pools are still in the process of being established

Accounting for pooled asset vehicles

Key step is distinguishing between 3 types of expenditure:

1. Setting up the asset pool vehicle
2. Investing in pooled funds once the trading vehicle becomes active
3. Ongoing support and oversight

These transactions **must** be kept separate as they are accounted for in different ways



Step 1 – setting up the pooled asset vehicle

- This will be a separate legal entity responsible for meeting its own costs – but may need upfront investment before it can start to trade
- Initial investment may be made by the pension fund, administering authority or both depending on local agreements
- Investment may take the form of share capital, recharges for set up costs, providing services free of charge or a “subscription”

BUT whatever form it takes -

The value of the investment should be carried forward in the Net Asset Statement or Balance Sheet as a Long Term Investment

Net Assets Statement

2015/16		Notes	2016/17
£000			£000
-	Long term investments	14	150
4,211,994	Investment Assets	14	4,415,804
(35,360)	Investment Liabilities	14	(11,051)
4,176,634	Total net investments		4,404,873
(609)	Borrowings		(436)
36,482	Current Assets	21	104,178
(15,057)	Current liabilities	22	(11,506)
4,197,810	Net assets of the Fund available to fund benefits at the period end		4,497,109

Some practical considerations

- “Investor” = whoever made the investment ie who paid the money, **unless** it is clear that the payment is being made on another party’s behalf
- Investment may be a flat rate amount, or linked to the size of the LGPS or authority
- Local agreements may give each investor the same voting rights or votes *pro rata* to the size of fund or value of investments placed
- If a fund has dominant or significant control, group accounting might need to be considered

All of these issues (and more) will need to be decided locally as these details have not been nationally prescribed

Group accounting – assessment of control



Option 1 - Funding agreement states that each LGPS makes a flat rate contribution of £200k and nominates 1 director, all have equal voting rights



Joint venture

Option 2 – Set up costs are pro rata'd according to net asset value but each LGPS has equal voting rights



Joint venture

Option 3 - Set up costs and voting rights will both be pro rata'd according to net asset value



Subsidiary –
LGPS A has
control

Step 2 - Investing in pooled asset vehicles once they become active

This should be accounted for as a pooled investment - usual rules apply:

- ✓ Include in net asset statement at fair value – published price or fund manager’s valuation
- ✓ Analyse as a “pooled investment” in Note 14 or equivalent
- ✓ Include in level 1,2,3 fair value hierarchy as appropriate
- ✓ Include in Financial Instrument disclosures
- ✓ Include change in market value OR profit/loss on disposal as part of Net Return on Investments
- ✓ Separately identify investment management costs with appropriate “grossing up” if required

2014/15		Notes	2015/16
	Long term investments		
-	London CIV		150
	Investment Assets		
330,390	Bonds		416,672
1,080,286	Equities		183,056
1,947,004	Pooled investments		3,022,516
343,132	Private Equity		420,480
364,001	Property	15d	340,239
108,959	Cash deposits		12,700
16,541	Investment income due		7,608
21,681	Amounts receivable for sales		12,503
4,211,994	Total investment assets		4,415,924
	Investment liabilities		
(160)	Derivative contracts: Futures		(1,348)
(32,606)	Forward currency contracts		(6,883)
(469)	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

Step 3 – Ongoing support and oversight

Type of cost	Account for as	LGPS Accounting
Set up costs eg provision of working capital	Long term Investment	Carry forward on investing entity's balance sheet
Ongoing provision of support services, accommodation, IT infrastructure, senior management time etc	Administrative expenditure in pooled vehicle's own accounts	LGPS should recharge any costs incurred Agency accounting applies
Oversight costs eg setting up/attending a joint committee	Should be mostly accounted for as governance costs in pooled vehicle's own accounts	Any costs not recharged should be included in LGPS's own oversight and governance expenses in the Fund Account

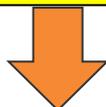
- All of the above costs could be incurred by the pension fund, the administering authority or a combination of both
- Model not specified so likely to be different at each pool

Remember that...

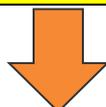
The pooled investment vehicle is a separate legal entity



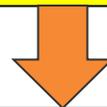
Must prepare its own set of accounts



These accounts should include administration, management and governance costs



If these costs have been incurred by another body on their behalf, agency accounting applies



An SLA or memorandum agreement should set out the basis for providing and recharging services

Pooled asset vehicles – Key messages

- ✓ Separate different cost components
- ✓ Set up costs should be carried forward as a long term investment in the balance sheet/net assets statement
- ✓ Recharge ongoing support services, accommodation and management time provided (agency accounting applies)
- ✓ Treat investments in funds or equities as pooled investments
- ✓ Any LGPS with overall control of an ACS should consider the need for group accounts

Arrangements are likely to vary between pools so use written agreements to set out the basis for the initial investment, voting rights and for providing and recharging services

Any questions?



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