

Local Government Pension Funds: 2016/17 Audit and Accounting update

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This session will cover:

- Changes to example pension fund accounts for 2016/17
- 2016 Management costs guidance

2016/17 example accounts

Main changes are:

- Management costs
- Fair Value
- Key personnel disclosures



Management costs guidance

2014 guidance was re-published in June 2016 following extensive consultation with practitioners and stakeholders

2016 publication builds on the general principles established in 2014 with:

- more detailed accounting guidance
- worked examples for practitioners

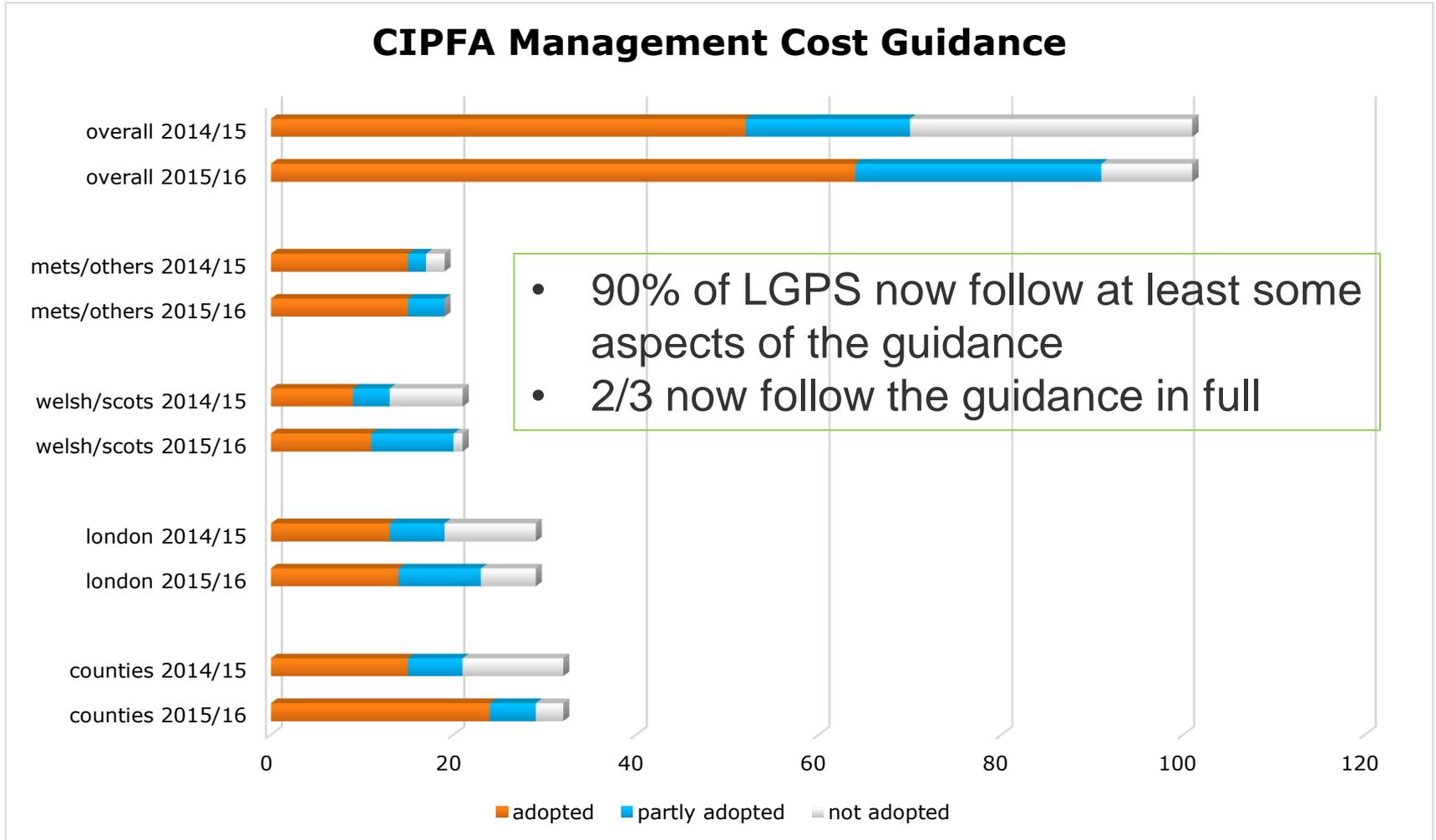
Now incorporated into example accounts for 2016/17

Guidance only:

Recommended, not mandated by the Code – but followed by most pension schemes in practice



Management costs guidance



Source: analysis of 2015/16 published accounts

Management expenses

Suggested disclosure note 1

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

Investment costs

Suggested disclosure note 2

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

No further analysis of administrative, oversight and governance or transaction costs is required if these are not significant

Investment costs – financial reporting

Cost is defined in the Code as “ an amount that has to be paid to buy or obtain something” ...and a **liability** as “ being legally responsible for something” ...

Soonly those costs which the pension fund has a legal responsibility to pay should be included in the Fund Account and Net Asset Statement**But**

Liaise with Fund Managers to identify any costs netted off against income at source, especially transaction costs and pooled budget fees

Back to basics – consider:

- Am I legally responsible for these costs?
- What is the corresponding entry in the fund manager’s accounts?
- Do I have control over whether or not these costs are incurred?

Investment costs – the transparency agenda

- Costs should not be netted off against income
- **All** costs and fees connected to investment income should be identified and reported across the whole “investment chain”

Best practice:

Include grossed up costs for which the LGPS is legally liable in the Fund Account

Disclose 3rd party investment costs in the investments section of the annual report

Also disclose in the annual report

- **Basis of fee setting agreements with Fund Managers**
- **Performance based fee element**
- **Targets/benchmarks set and achievement rates**

IFRS 13 Fair value measurement

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

IFRS 13 aims to provide a consistent definition with additional disclosures to explain the valuation techniques applied

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

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

IFRS 13 - Extra disclosures

Extended from 2015/16:

- ✓ Valuation method for each asset class
- ✓ Analysis by level 1-3 hierarchy now includes financial assets which are not financial instruments (eg directly held property or shares)
- ✓ Transfers between levels of fair value hierarchy

New for Level 3 investments only:

- ✓ Quantitative data on significant inputs
- ✓ Sensitivity analysis for investment valuations
- ✓ Reconciliation of opening to closing balances
- ✓ Analysis between realised and unrealised gains/losses in the Fund Account

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 using the investment method by John Smith FRICS in accordance with RICS guidelines	Existing lease terms & rentals Independent market research Tenant covenant strength 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
- Refer to PRAG guidance published May 2016 for suggested classification of investments into Level 1 to 3 hierarchies

Fair Value disclosures (2)

Level 3 assets	Valuation range +/-	Value at 31 March 2017 £000	Valuation increase £000	Valuation decrease £000
Freehold property	5%	3,565	3,775	3,415
Unquoted equity	10%	49,898	54,888	44,908
Hedge funds	15%	420,480	483,552	357,408

- **Similar to sensitivity disclosures in financial instrument risks**
- **Liase with Fund Managers to clarify basis of valuation, sensitivity range and any changes to the method of valuation during the year**

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	7,983	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

Other changes

- 2016/17 Code has aligned investment asset classification and descriptions with Pension SoRP – “Bonds” have replaced “fixed interest securities”
- Code requires separate disclosure of members allowances, audit fees and taxation where significant **AND** where LGPS costs can be separately identified
- Key management personnel disclosure now required by para 3.9.4.2 of Code

Key management personnel compensation

Who?

“chief officers, elected members....having authority and responsibility for planning, directing and controlling the activities...” [Code 3.9.2.2]

- **May be different people for Council and pension fund**
- **May also include pensions panel members if remunerated**

Compensation includes:

- a) Short-term employee benefits eg pay, NI, annual leave
- b) Post-employment benefits eg pension
- c) Other long-term post-employment benefits
- d) Termination benefits
- e) Performance related pay and bonuses

Disclose in total and for each category – no names required

Key management compensation –in practice

2015/16 £000		2016/17 £000
51	Short term benefits	43
43	Post employment benefits	51
2	Other long term benefits	3
20	Termination benefits	30
116	Total	127

Action:

- **Identify Key Personnel early**
- **Identify possible benefits**
- **Engage actuary to value post – employment benefits**

Any questions?



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