



Higher Education

LGPS accounting

Bulletin 2
The big issues for pensions
accounting in 2020



LGPS accounting

This second bulletin on LGPS accounting for Universities considers some of the bigger issues we expect through this year's audit process.

Key points

- Your LGPS asset share is estimated – Universities should be satisfied that the level of approximation is sufficient for disclosure purposes
- Your McCloud recognition may attract future scrutiny – carefully documenting what has been recognised could be astute
- Measuring inflation is now more difficult with, arguably, a more volatile outlook. Inflation warrants extra attention



How Isio can help

As well as advising on the specific points raised in the bulletin, Isio can support Universities in the following areas:

- Provide detailed projections for 31 July 2020 year ends and 2020/21 fiscal periods
- Test standard assumptions to see what flex may be available and how this impacts outcomes
- Provide management teams with the knowledge to liaise and challenge both LGPS actuaries and auditors with confidence
- Comment on the wider implications for LGPS pension risk within the organisation to include within audit committee reports



Estimated asset share

It will depend on specific circumstances, but a 5% change in LGPS asset valuation might lead to a 5% to 15% change in a typical University's net balance sheet position.

Case Study

An LGPS employer identified a 9% difference between the asset used for funding and accounting purposes. The difference was due to the approximate approach used through the accounting process with disclosures requiring to be recalculated.

In general, it is not possible for LGPS funds to produce audited asset statements at 31 July and so your share of assets is approximated.

Asset reporting dates

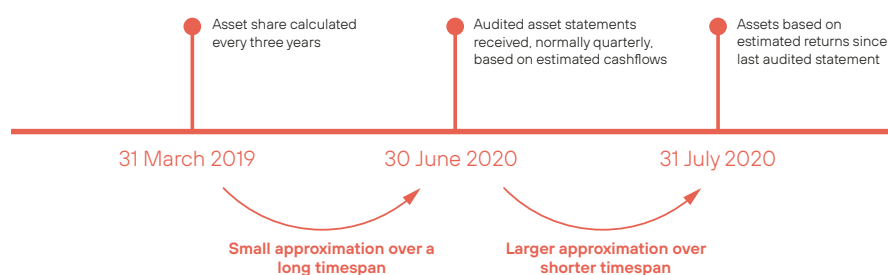
31 July is not a standard reporting date for LGPS funds. In general, funds adjust 30 June reports to approximate asset shares at 31 July. Some funds use estimated returns based on market index data, while others use actual return data provided by the LGPS fund. Auditors are often uncomfortable with estimated asset values for listed assets, where a market value is obtainable. The approach relies on modelling the evolution of assets, which introduces model error risk.

Correctly identifying your share of LGPS assets

LGPS assets are formally allocated at each triennial valuation with more informal allocation between valuations. The 'informal' aspect to allocation introduces an element of subjectivity with different approaches necessarily generating different answers.

Valuing less marketable assets

Listed equities and bonds are actively traded and have readily available prices on a day-to-day basis. Other investments such as property funds, infrastructure, private equity and other alternative investments need to be valued and audited. Typically, these valuations take place on a quarterly basis and so the value at 31 July is necessarily estimated. Recent market volatility has increased the uncertainty in this approach.



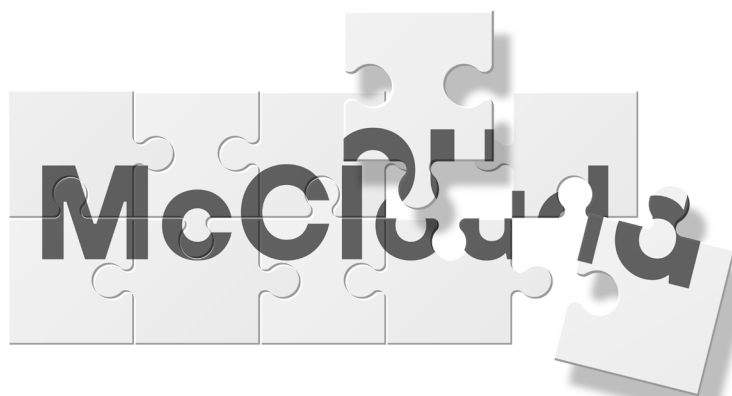
What you can do

Having a clear understanding of the approach used to identify your asset share and considering any limitations (and impact on materiality) of this will give greater comfort to your audit committees and auditors.



McCloud judgement

As pieces of the puzzle fall into place more recognition may be required



Whilst most Universities made an estimated allowance for the McCloud judgement at July 2019, there still remains significant uncertainty around how McCloud will be resolved. Further constructive obligations may develop as more pieces of the puzzle fall into place. Implementation of McCloud may take many years – unfortunately, this is an area that might need to be revisited this year and in future periods.

Due to the approach used last year very little recognition would have been made for younger members on the grounds that they would leave the scheme before retirement. Given statements by the Scheme Advisory Board it would seem that more recognition may be required for younger members. This is a complex issue but the additional recognition could be significant and in some cases higher than the amounts recognised last year. In our view, this recognition is likely to flow through Income & Expenditure, but this will depend on the approach used to calculate McCloud last year and it may be possible to put a case forward that would enable an OCI / SORIE treatment.

What you can do

We recommend Universities clearly document their approach to recognising McCloud (specifically during 2018/19) so that judgements around future accounting can be clearly evidenced and quickly resolved.

Understanding the approach adopted for your fund last year would also allow a view to be taken on the likelihood of future recognition. Some LGPS funds took a broad-brush approach to recognition based on analysis published by GAD, while others prepared estimates specific to their fund's circumstances.

The same could be said of your funds allowance for GMP equalisation, as further clarity and implementation follow in the coming years.

In a limited number of cases no recognition was made for either McCloud or GMP equalisation last year. In these cases, auditors may require further recognition or even restatement this year.



Inflation

University directors are responsible for deciding the appropriate assumptions and many Universities adopt standard assumptions proposed by their actuary, but this is not a requirement. If you would like to explore the process for using bespoke assumptions (and receiving appropriate independent advice around this) then please let us know. There may be a particular focus on inflation this year.

Inflation – a paradigm shift

A lot has changed over the last 12-months to say the least. From an inflationary perspective the following points were widely held as true last year:

- There was a market indicator for long-term RPI inflation (from which CPI is measured) and the relationship between RPI and CPI was largely statistical
- The outlook for future inflation, whilst uncertain, was relatively benign

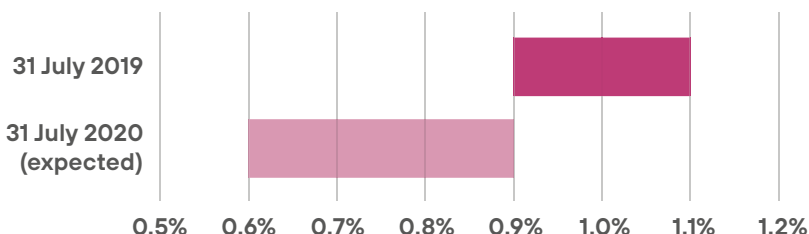
Recent discussions between Treasury and UK Statistics Authority around the suitability of RPI (and its convergence to CPIH) introduces a political dimension to the market views of RPI (and therefore CPI) and the outlook for future inflation now has greater uncertainty than it did, perhaps, 12-months ago.

We believe that both these points need to be factored into the way inflation is set and, depending on the approach taken, the liability disclosed could vary significantly. For example, we believe the difference in range of credible assumptions for CPI may be twice as wide as last year and there may be greater scrutiny from auditors over the approach used.

What you can do

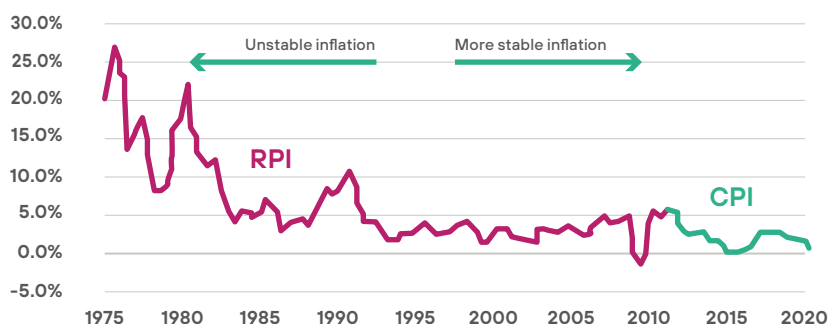
Taking advice on your pensions accounting assumptions, including inflation, will allow you to set assumptions appropriate for your University.

Gap between RPI and CPI



On a wider point, LGPS liabilities are CPI-linked defined benefit liabilities. A moderate increase in inflation without a corresponding increase in long-term interest rates could lead to a very painful financial outcome. We would encourage Universities to consider this risk and how it can engage with their LGPS funds to manage it. There has been a trend in non-LGPS funds to increase their hedging of inflation and interest rates to combat these risks – an approach not widely adopted within LGPS.

LGPS inflation increase



The chart to the right illustrates how we have enjoyed a period of relatively benign inflation, but also demonstrates that it has not always been that way.



Contact

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