

**ACCOUNTING ISSUE - EMPLOYER JULY & AUGUST 2017 FRS102 REPORTS**

Report of the Director of Resources

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**1. Purpose of the Report**

- 1.1 To provide the Pensions Committee with an overview of the misstatement in investment returns which led to the re-issue of FRS102 reports to a number of employers in December 2017, and additional cost incurred by the Pension Fund.

**2. Recommendations**

- 2.1 That the Pension Committee notes the content of this report.

**3. Background**

- 3.1 Academies and colleges are required to report under Financial Reporting Standard (FRS) 102, which dictates the information and disclosures required within their Statement of Accounts in relation to defined benefit pension schemes.
- 3.2 Academies within the Fund prepare their accounts in line with FRS guidance with a year-end date of 31st August. Higher Education and Further Education employers also prepare their accounts in line with FRS guidance, but instead have a year-end date of 31st July.
- 3.3 The fund's Actuary (Hymans Robertson) produce FRS102 reports for all employers within the fund who request a report. The Fund pays for these reports to be produced, and recharges the costs onto each employer.
- 3.4 Hymans Robertson calculates the figures required for each report using actuarial assumptions, the employer's payroll and membership data, and the return on investments experienced for 12 months prior to the reporting date.
- 3.5 Officers in Herts Finance provide Hymans Robertson with asset valuations and the percentage (%) return for the Fund's investments, on a quarterly basis. This information is extracted from reports from the fund's Custodian (BNY Mellon) and the fund's external investment consultant (Mercer)

- 3.6 Due to the time-lag in availability of full asset valuation data from Fund Managers/the Custodian, Hymans will routinely have to calculate valuations on a 'roll-forward' approach. For example, Hymans will receive quarterly returns data up to 30 June, but for those bodies with a 31 July year end, the returns for the subsequent month will be estimated.

#### 4. Issue

- 4.1 As part of the July and August 2017 FRS102 reporting exercise, Hymans Robertson requested the actual returns on fund investments up to 30<sup>th</sup> June 2017. This data is provided by the Fund's custodian (BNY Mellon) and investment consultant (Mercer) and analysed into the appropriate format by officers.
- 4.2 Data on fund returns for Q4 2016/17 and Q1 2017/18 (01.01.2017- 31.03.2017 & 01.04.2017 – 30.06.2017) was mistakenly extracted from the wrong Mercer performance period reports into the Hymans data capture spreadsheet. This was a result of human error on the part of the Officer compiling the submission. This resulted in the returns for these quarters being overstated, as the data used related to previous quarters, when asset returns were higher. The originally submitted and corrected asset returns are shown in the table below:

Period	Original Submission	Corrected Submission
01.04.16 – 30.06.16	3.60%	3.60%
01.07.16 – 30.09.16	7.10%	7.10%
01.10.16 – 31.12.16	2.30%	2.30%
01.01.17 – 31.03.17	6.10%	3.70%
01.04.17 – 30.06.17	3.70%	1.50%

- 4.3 Internal controls within the team responsible for the Fund in Herts Finance were not sufficient to identify the incorrectly entered data, and the misstated returns were sent to Hymans Robertson.
- 4.4 Hymans Robertson used the figures provided when producing employers' FRS102 reports, which yielded the following returns for employers reporting to each of the two financial periods affected:

*Returns from 1 August 2016 to 31 July 2017 – 15.7%*

*Returns from 1 September 2016 to 31 August 2017 - 16.6%*

Whereas these should have been:

*Returns from 1 August 2016 to 31 July 2017 – 10.7%*

*Returns from 1 September 2016 to 31 August 2017 - 11.6%*

- 4.5 The FRS102 reports were sent to 6 employers with a 31 July 2017 year-end, and 96 employers with a 31 August 2017 year-end. The affected employers are listed in Appendix A.

- 4.6 Initial Asset Allocation (IAA) reports were also sent to 11 employers seeking admission to the Fund, outlining the liabilities at the point of transfer, and an indication of the value of assets to be allocated to the employers to cover this.
- 4.7 The misstatement was noticed by Fund Officers after querying with Hymans that the overall explanation around the increase in the funding level included in the latest Hymans 'Navigator' report did not tally with knowledge of recent asset performance. The root cause of this misstatement was then identified in the last week of November 2017.

## **5. Impact**

- 5.1 As a result of the misstated investment returns, there were various figures within the FRS102 Reports which were also misstated:
- Actual Returns and Total Returns were overstated by c. 5%.
  - A number of Balance Sheet, Profit & Loss and 'Other Comprehensive Income' Disclosures were affected:
    - 'Return on assets excluding amounts included in net interest' was overstated, which impacted upon 'Total remeasurements recognised in Other Comprehensive Income (OCI)'.
    - 'Fair value of plan assets' was overstated, resulting in an overstatement in the closing position of c.5%.
  - Projected defined benefit cost - 'Interest income on plan assets' was overstated, resulting in the 'Total Net Interest Cost' (included in profit and loss) being overstated. The difference here was likely immaterial to most employers at around 0.125%.
- 5.2 The Initial Asset Allocation (IAA) reports had overstated initial funding levels.
- 5.3 The Education Schools Funding Account require all academies to submit their financial statements by 31<sup>st</sup> December to the Department for Education. Fines are imposed on Academies who fail to meet this deadline.

## **6. Action Taken**

- 6.1 Once the issue was identified Hymans Robertson were urgently requested to re-calculate three reports to assess the impact of the misstatement on affected employers' accounts, in order to dictate the appropriate rectification actions.
- 6.2 This analysis concluded that the c.5% overstatement of the 'Fair Value of Plan Assets' would likely lead to a material effect on employers' balance sheets and profit & loss statements. The IAA reports do not feed directly into employers' financial accounts, but instead would need to reconcile to the first FRS102 report the employer would receive, so officers felt it was necessary to reissue these as well.

- 6.3 A number of cessation reports had been produced, but not issued to employers – these also required revisions, as funding positions would have been overstated by the incorrect level of asset returns. Hymans Robertson offered to revise these reports free of charge.
- 6.4 The charges for the usual FRS102 report exercise for all employers is recharged onto the employer requiring the report. As the misstatement was not due to an error by any employers, the fund stated that no employer would be recharged for the cost of revising the reports.
- 6.5 Hertfordshire Pension Fund officers requested a full list of employers who received a FRS102 report in July or August, and those who received an IAA report between March 2017 and September 2017.
- 6.6 All employers affected by the FRS102 report misstatement were emailed a letter on 4<sup>th</sup> December 2017 to inform them of the issue and the scale of the impact. Employers were informed that the reports would be re-issued during that week, and invited to indicate if they had a urgent requirement for their report to be prioritised e.g. imminent Governor’s meeting to sign off their accounts.
- 6.7 Employers affected by the IAA misstatement were emailed on 5<sup>th</sup> December 2017.
- 6.8 Prioritised FRS102 reports were issued on 5<sup>th</sup> December – where Academies had indicated an urgent need. Remaining revised FRS102 reports were re-issued by 6<sup>th</sup> December 2017. IAA reports were distributed by 14<sup>th</sup> December 2017.
- 6.9 A quote for all of the FRS102 and IAA reports to be re-issued was requested. Hymans Robertson offered to carry this work out for the following discounted costs;

<b>Report</b>	<b>Total cost to re-issue</b>	<b>No. of reports</b>	<b>Cost per report</b>	<b>Average cost on original issue</b>
FRS102 July Reports	£2,100	6	£350	£608*
FRS102 August Reports	£24,000	96	£250	£429*
IAA reports	£4,400	11	£400	£750

\*Some employers requested and required bespoke assumptions, which Hymans Robertson will quote for accordingly.

- 6.10 This issue was initially raised at the Pension Committee meeting on 29 November 2017, when this full report was commissioned. The issue was also discussed in greater detail at the Pension Board meeting of 8 December 2017,

as more information was available, and where representatives of affected employer groups were present.

## 7. Outcome & Financial Cost

7.1 Following the initial contact (4 December 2017), a number of academies stated that they were due to sign off their accounts in the following days. These employers' reports were prioritised to be re-issued first on 5<sup>th</sup> December.

7.2 A number of employers responded to the re-issued report to state that additional work had to be undertaken by their auditors and/or their (externally sourced) accountants. The fund outlined that employers would be reimbursed for any reasonable additional costs incurred as a result of the misstatement. Employers were asked to invoice the fund for the reimbursement. To date, ten employers have invoiced the fund for additional fees incurred.

7.3 At the time of writing (7<sup>th</sup> February 2018), the financial impact of the misstatement is as follows;

Cost of all reports (detailed in 6.3) =	£30,500
Reimbursement of auditor/accountant fees =	£2,823
<b>Total financial impact to the fund =</b>	<b>£33,323</b>

7.4 Hertfordshire County Council, as Administering Authority of the Fund, have agreed that the above administrative cost outlined in 7.3 be allocated to the Council and included as part of its liabilities in the Fund, so as to not impact other employers in the Fund.

## 8. Enhanced Controls

8.1 All officers responsible for the fund have been informed on the issue, understand how this occurred, and understand the scale of the impact caused by this.

8.2 Officers consider that current controls systems in place are robust, however given this occurrence a review is underway of all external data submissions from the Hertfordshire Pension Team, to ensure that appropriate controls are in place for all processes, which are proportionate to the level of impact should an issue arise.

8.3 The process involved in providing the quarterly asset returns data required to Hymans Robertson has been reformatted. This now includes a reconciliation between performance data from BNY Mellon and Mercer to ensure consistency prior to submission.

8.4 Hymans Robertson will be sent the supporting evidence for investment returns from both BNY Mellon and Mercer in order to cross reference this.

- 8.5 The data produced by HCC Finance is to be reviewed by the Senior Accountant or Finance Manager for the fund before forwarding to Hymans Robertson.
- 8.6 Hymans Robertson has been instructed to not accept any data which does not meet the requirements in 8.2-8.4.
- 8.7 Hymans Robertson have been instructed to inform officers of any discrepancy they identify before reports are issued to employers.