AUDIT & STANDARDS COMMITTEE	Agenda Item 27 Brighton & Hove City Council

Subject:		**Approval of the revised Audited Statement of Accounts 2018/19**	
Date of Meeting:		**17 September 2019**	
Report of:		**Executive Director for Finance & Resources**	
Contact Officer:	**Name:**	**Nigel Manvell**	**Tel: 01273 293104**
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Ward(s) affected:		**(All Wards);**	

FOR GENERAL RELEASE

1. PURPOSE OF REPORT AND POLICY CONTEXT

1.1 This report provides an update to the committee regarding the conclusion of outstanding audit queries relating to the valuation of pension fund assets and liabilities within the approved 2018/19 accounts.

1.2 Information was requested and obtained from the East Sussex Pension Fund actuary, Hymans Robertson, to satisfy a number of outstanding audit queries. The revised information indicated a material difference in the revaluation of the council's pension fund assets and liabilities. To ensure an unqualified audit opinion from the auditor on its accounts, this report therefore requests that the committee considers the amended accounts and re-approves them for publication together with a revised Letter of Representation.

2. RECOMMENDATIONS:

That the Audit & Standards Committee:

2.1 Notes the updated findings of the auditor (Grant Thornton) in their updated Audit Findings Report (AFR).

2.2 Approves the revised, audited Statement of Accounts for 2018/19.

2.3 Approves the revised Letter of Representation.

3. CONTEXT/ BACKGROUND INFORMATION

3.1 The main legislative requirements relating to the preparation, publication and audit of the council's accounts are contained in the Local Audit and Accountability Act 2014 and the Accounts and Audit Regulations 2015.

3.2 Under the Accounts and Audit Regulations 2015, the council's accounts for 2018/19 must be approved by Members of the authority and under the council's Constitution, the Audit & Standards Committee is charged with this responsibility. The Statement of Accounts must be approved and published by the 31 July 2019. The committee approved the audited accounts on 23 July and they were duly published on 31 July on the council's website.

3.3 However, at the meeting on 23 July, the authority's external auditor, Grant Thornton, advised the committee in their Audit Findings Report (Agenda Item 10) that there were a number of audit queries outstanding. In particular, in relation to the valuation of pension fund assets and liabilities, at page 8 of their report the auditor advised:

> *'Our work on this risk is not yet complete at the date of writing this report. We have raised a number of audit queries with the actuary around the level of pension fund assets/liabilities and interest income and the reasonableness of the application of the roll forward assumptions by the actuary.'*

3.4 In response to these queries a revised International Accounting Standard (IAS) 19 report was requested from the pension fund actuary, Hymans Robertson. The IAS 19 report set out revised valuations for the whole range of assets and liabilities held by the fund which indicated a significant increase in the Net Pension Deficit relating to Brighton & Hove City Council from £314.409m to £353.823m; an increased deficit of £39.414m compared to the previous actuarial valuation.

3.5 This difference is above the auditor's defined 'materiality level' of £11.653m for the authority and therefore not adjusting the accounts for the revised valuation would be likely to lead to 'qualification' of the accounts by the auditor, together with the potential negative reputational impacts this may bring.

3.6 The accounts have therefore been amended for the revised pension fund valuations and resubmitted to the auditor. The audit review of the revised accounts is now complete, and the accounts are available for the committee to re-approve alongside an accompanying, revised Letter of Representation.

3.7 If approved, the auditor is expected to be able to provide an audit completion certificate and issue an Unqualified Opinion for the 2018/19 accounts, which will be re-published on the council's website.

3.8 It should be noted that this issue appears to be a common problem across the sector. A recent article in Public Finance (the journal of the Chartered Institute of Public Finance & Accountancy, Cipfa) highlighted that Public Sector Audit Appointments (PSAA) ltd, the Local Government Association company that appoints 98% of local authority, police and fire authority auditors, has seen an increase in the number of audit opinions that missed the 31 July target from 13% last year to 40% this year. This is likely to have been caused by pension fund valuation issues, most notably, the impact of the McCloud judgement (see below). The PSAA is reported to be conducting an enquiry as to why an increased number of appointed auditors have missed the July target[1].

Impact of the Revised Pension Valuations

3.9 While the increase in the Net Pension Deficit would appear to be very substantial, it must be remembered that these are valuations of current and future assets and liabilities of all current pension scheme members (employees) and pensioners and the associated employer and employee contributions, investment assets and

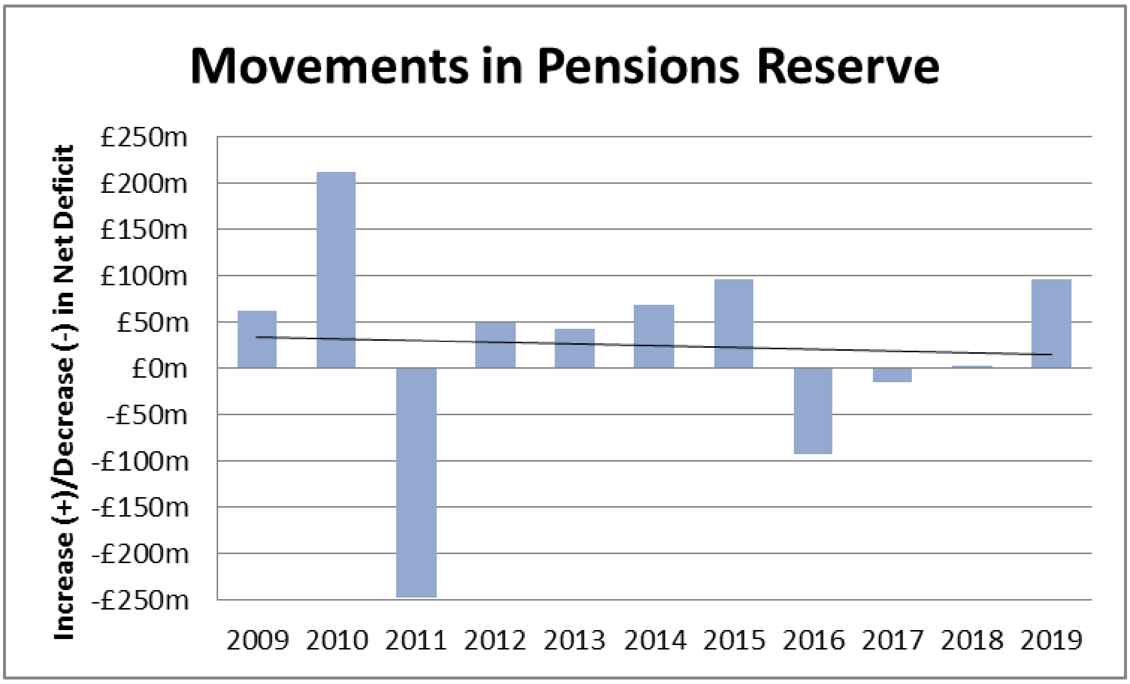
[1] It should be noted that while the 31 July is a statutory publication deadline for local authorities, it is not a statutory target for the completion of the audit or issuing of an audit certificate. However, it is an agreed target for auditors under their PSAA contract.

incomes. Such valuations are not only a 'snapshot' at a point in time but make very broad judgements and assumptions about a whole range of factors including:

- Projected wage growth;
- Projected inflation (i.e. future cost of pensions);
- Projected interest rates;
- Projected GILT yields;
- Investment performance;
- Life expectancy and morbidity rates.

3.10 At best therefore, these valuations can only give a sense of scale to potential future assets and liabilities. They cannot be regarded as a statement of fact and the only certainty in relation to these valuations is that the actual assets and liabilities generated by the fund over the next 3 to 40 years are likely to be very different to the current snapshot valuation.

3.11 To illustrate the volatility of valuations, the graph below shows how the IAS 19 snapshot valuation of the net pension deficit has moved over the past 10 years:



This clearly indicates very large movements year-on-year. It is therefore more advisable to look for long term trends rather than to be concerned by annual movements, for example, the straight black line shows the average movement over 10 years and this indicates a fairly flat trend over the period.

3.12 It is also important to understand the impact of movements in the valuation of the net pension deficit (pension reserve) on the council's finances. In practice, the impact is very low. The main reasons for this are that:

1) It is a valuation of current and future assets and liabilities. Conversely, the council's statutory funding basis is annual i.e. the council is only funded, through taxation and government grants, to meet the cost of current expenditure, not future years' liabilities – in the case of pensions, its statutory

funding basis only enables it to meet the cost of the annual employer's contribution to the scheme.

2) The annual employer's contribution rate is determined by the actuary and is designed to ensure that the council's contributions will, together with projected investment incomes, result in a balanced and fully funded pension fund. However large local authorities are subject to prescribed 'stabilisation mechanisms' and this council can currently only incur maximum increases in its annual employer contribution rate of 0.5% per annum.

   Therefore, regardless of the size of any movement in the net pension deficit, the effect on the council's finances will normally be the same i.e. a 0.5% annual increase in employer pension contribution. Since the council, like the majority of local authorities, has a significant projected net pension deficit, it is likely to see 0.5% annual increases for many years and therefore the council's current 4-Year Medium Term Financial Strategy has already planned for these increases.

3) Any change in the net pension deficit is simply matched by an increase (or decrease) in the Pension Reserve. This is an unusable reserve that links to point 1) above i.e. it matches the future net pension deficit because the local authority is not funded to recognise or meet these costs in the current year.

3.13 The valuation of pension fund assets and liabilities and the resulting net pension deficit (or, very unlikely, surplus) is something for members to note and observe over a longer time frame. For example, were the deficit to substantially increase (e.g. double in size) and remain at a higher level for a period of years, this may indicate that either the Pension Fund is performing poorly in terms of investment returns, or that there has been a sustained global downturn, or that the council is paying contributions well below the level it needs to. The actuary's triennial valuation report is likely to reflect this situation and will set out more detailed implications. However, even in this scenario, plans to address the situation would still need to be actioned over a long time frame (3 to 10 years for investment strategy adjustments and a longer time frame for contribution adjustments due to the application of the stabilisation mechanism to local authorities).

The McCloud Judgement

3.14 There is also another impact of the revised actuarial valuation. As reported to the committee on 23 July 2019, when the Local Government Pension Scheme (LGPS) was reformed in 2014, transitional protections were applied to certain older members within ten years of normal retirement age. The benefits accrued from 1 April 2014 by these members are subject to an 'underpin' which means that they cannot be lower than what they would have received under the previous benefit structure. The underpin ensures that these members do not lose out from the introduction of the new scheme by effectively giving them the better of the benefits from the old and new schemes.

3.15 In December 2018 the Court of Appeal upheld a ruling that similar transitional protections in the Judges' and Firefighters' Pension Schemes were unlawful on the grounds of age discrimination; this is known as the McCloud Judgement. The UK Government requested leave to appeal to the Supreme Court but this was denied by the Court of Appeal on 27 June 2019. The benefits accrued by LGPS members from 2014 will therefore need to be enhanced so that all members, regardless of age, will benefit from the underpin. This clearly has implications for the valuation of pension fund liabilities which will increase as a result.

3.16 Due to the timing of the Court of Appeal decision and subsequent delays in interpreting the full implications of the decision, at the time of publication of its 2018/19 Statement of Accounts the council recognised the potential impact of the McCloud judgement as a ‘Contingent Liability’ with a potential increase to the net pension deficit of £5.312m. However, now that the judgement has been upheld without leave to appeal and having instructed the actuary to provide a revised valuation in response to the auditor’s outstanding queries, the amended accounts now take full account of the McCloud Judgement which is incorporated in the Comprehensive Income & Expenditure Statement and the Balance Sheet. The Contingent Liability note has consequently been removed and the details of the revised pension fund valuations, including the impact of the McCloud judgement, are included in a revised Note 23 to the accounts (Defined Benefit Pension Schemes).

4. ANALYSIS & CONSIDERATION OF ANY ALTERNATIVE OPTIONS

4.1 Where there are outstanding audit queries and the conclusion of this work identifies a material difference or misstatement in the accounts, the authority has three main options open to it:

1) Challenge the audit findings and enter into dispute with the auditor. Since the information resulting in the identified differences was provided by a well-established, independent firm of professional actuaries, any challenge to the revised valuations would be hard for the authority to evidence or support.

2) Leave the accounts un-amended and accept a ‘qualification’ of its accounts by the auditor. Annual financial statements are a primary document for third parties to rely on when assessing the financial transparency, resilience and standing of an organisation. Qualification of the statements may therefore have potential reputational consequences and may, for example, impact on the authority’s ability to succeed in funding bids or to attract inward investment into the city.

3) Accept the audit findings, amend the accounts and submit them for audit review and subsequently for member re-approval leading to an ‘unqualified’ and unmodified audit opinion.

4.2 Option 3 is the recommended option as this not only ensures that the accounts are as accurate as possible but maintains the authority’s good financial reputation and standing.

5. COMMUNITY ENGAGEMENT & CONSULTATION

5.1 No further consultation has been undertaken in relation to the revised accounts.

6. CONCLUSION

6.1 Following the conclusion of outstanding audit queries relating to the valuation of pension fund assets, liabilities and investment incomes, a difference in the valuation of the net pension deficit of £39.414m has been identified. This difference exceeds the auditor’s defined ‘materiality level’ and therefore the accounts have been amended for this change and the committee are recommended to approve the revised accounts and revised Letter of Representation to ensure an unqualified audit opinion.

7. FINANCIAL & OTHER IMPLICATIONS:

Financial Implications:

7.1 The financial implications are included in the body of the report. The revised Letter of Representation does not include any fundamental change other than to reflect the fact that adjustments for the potential impact of the McCloud judgement are now incorporated in the revised accounts.
Finance Officer Consulted: James Hengeveld *Date: 16/08/19*

Legal Implications:

7.2 The legal framework for approving the council's statement of accounts is provided by regulation 9 of the Accounts and Audit Regulations 2015 (statutory instrument 2015/234), relevant details of which are set out in the body of the report.

7.3 The Regulations require either Full Council or a committee of the council to approve the statement of accounts. At Brighton & Hove Council, the Audit & Standards Committee is the designated committee for this purpose.

7.4
Lawyer Consulted: Elizabeth Culbert *Date: 02/09/19*

Equalities Implications:

7.5 There are no equalities implications arising directly from this report. The accounts are a statutory publication and were made available for public inspection at the council's main offices and on the council's website. Information on the accounts will, as far as possible, be provided in a manner that meets the needs of those requesting information.

Sustainability Implications:

7.6 There are no direct environmental implications arising from this report. However, it is believed that the reputation of the council's financial control framework and its ability to demonstrate sound financial management could have an impact on the willingness of other funding partners to invest in and with the council. This could affect the level of inward investment in respect of projects that contribute towards sustainability.

Any Other Significant Implications:

7.7 The quality of a public authority's accounts is of reputational importance and where the auditor gives an unqualified opinion, citizens, partners and other stakeholders can be assured that the accounts present fairly the financial position of the council.

SUPPORTING DOCUMENTATION

Appendices:

1. Statement of Accounts (copy circulated to Members and published to the council website alongside the agenda)
2. Revised Letter of Representation

Documents in Members' Rooms

None

Background Documents

1. Revised Audited Statement of Accounts 2018/19