12 Pensions Accounting

Chapter 12 Contents

12.1 Introduction

12.1.1 This first section of this chapter deals with pensions accounting by employers, whether they are reporting entities or preparing the financial statements of reportable activities covered by this Manual. The second section deals with pensions accounting by the following public sector pension schemes:

Principal Civil Service Pension Scheme (PCSPS)

Armed Forces Pension Scheme (AFPS)

NHS Superannuation Scheme

Teachers' Superannuation Scheme

United Kingdom Atomic Energy Authority Superannuation Schemes

Judicial Pension Scheme

Department for International Development – Overseas Superannuation Scheme

Research Councils' Pension Scheme

DFP Northern Ireland Superannuation and Other Allowances

HPSS Northern Ireland Superannuation Scheme

Police Service Northern Ireland Pension Scheme

Northern Ireland Teachers' Superannuation Scheme

Scottish NHS Superannuation Scheme

Scottish Teachers' Superannuation Scheme

12.1.2 This chapter also considers the accounting treatment of termination benefits (also known as early departure costs or compensation payments) by the above public sector pension schemes for which there is no applicable financial reporting standard.

12.1.3 Short-term employee benefits are covered in chapter 10.

12.2 Pensions accounting by reporting entities

12.2.1 The following accounting standard deals with accounting for employee benefits:

IAS 19 *Employee benefits*.

IAS 19 Employee Benefits

Applicability

12.2.2 IAS 19 applies, as adapted in paragraph 12.2.4 below, to all reporting entities and reportable activities covered by the requirements of this Manual.

Objective of IAS 19

12.2.3 The objective of IAS 19 is to prescribe the accounting and disclosure for employee benefits – i.e., short-term benefits such as salaries and wages; post-employment benefits that result from employment; other long-term benefits such as long service awards, and termination benefits. It requires an entity to recognise the cost of providing employee benefits in the period in which the benefit is earned by the employee, rather than when it is paid or payable:

(a) a liability when an employee has provided service in exchange for employee benefits to be paid in the future; and

(b) an expense when the entity consumes the economic benefit arising from service provided by an employee in exchange for employee benefits.

Adaptations of IAS 19 for the public sector context

12.2.4 The following adaptations of IAS 19 apply in respect of post-employment benefits:

Recognition and measurement

a) the requirements of IAS 19 are to apply to the accounts of the pension schemes themselves as well as to reporting entities and reportable activities covered by the requirements of this Manual; and

b) in the financial statements of the pensions schemes only (see section 12.3), contributions from employer and employees are to be shown as income in the statement of comprehensive net expenditure rather than as, respectively, a credit to the pension provision or a deduction from the current service cost. As a consequence, the pension provision will not reflect contributions.

Interpretations of IAS 19 for the public sector context

12.2.5 The following interpretations of IAS 19 for the public sector context apply:

Recognition and measurement

a) employers whose employees are members of the pension schemes listed in paragraph 12.1.1 shall account for the scheme as a defined contribution plan;

b) IAS 19 permits alternative approaches to the recognition of actuarial gains and losses. The first is that only those actuarial gains and losses falling outside an agreed corridor are recognised in the performance statement; the second is that all actuarial gains and losses are recognised. Only the second of these alternatives is permitted; that is, the use of the corridor approach is not available;

c) IAS 19 requires the present value of defined benefit obligations (and, if applicable) the fair value of the plan's assets to be determined with sufficient regularity that the amounts recognised in the financial statements do not differ materially from those determined at the reporting period date. This shall be interpreted to mean that the period between formal actuarial valuations shall be four years, with approximate assessments in intervening years. Acceptable approximations shall include adjusting full valuation results using the latest available membership data;

d) the application of a discount rate advised annually by HM Treasury will not apply to funded schemes within central government. Reporting entities with funded schemes should use a discount rate in accordance with IAS 19 as advised by the scheme's actuary;

e) where a central government entity has a share of a local government (or other) pension scheme liability on its statement of financial position, then that entity will use a discount rate determined by the appropriate authority (for example, CIPFA or a qualified independent actuary) in valuing its share and not the rate advised annually by HM Treasury; and

f) voluntary early retirements under scheme rules will be discounted at the pensions rate and not at the provisions rate.

12.3 Pensions accounting by the public sector pension schemes

12.3.1 The following accounting standard deals with accounting by pension schemes:

IAS 26 *Accounting and Reporting by Retirement Benefit Plans.*

IAS 26 Accounting and Reporting by Retirement Benefit Plans

Applicability

12.3.2 IAS 26 applies, as adapted and interpreted, to the financial statements prepared by the unfunded pension schemes listed in paragraph 12.1.1.

Objectives of IAS 26

12.3.3 The objective of IAS 26 is to provide guidance on the form and content of the financial statements prepared by retirement benefit plans. It complements IAS 19, which deals with the determination of the cost of retirement benefits in the financial statements of employers.

Adaptation of IAS 26 for the public sector context

12.3.4 The following adaptation applies to the pension schemes noted in paragraph 12.1.1:

a) IAS 26 does not apply to forms of employment benefit other than retirement benefits. However, where schemes currently report separately transactions relating to termination benefits (also known as early departure costs or compensation payments) they should continue to do so. The treatment of such costs will depend on whether the scheme acts as a principal or an agent, and whether or not the early departure costs (however described) are regarded as retirement benefits and included within the pension provision. Guidance on the accounting arrangements for termination benefits is given below.

Interpretations of IAS 26 for the public sector context

12.3.5 In applying IAS 26, entities should be aware of the following interpretations for the public sector context:

Disclosures

a) paragraph 18 of IAS 26 allows the present value of the expected payments by a retirement benefit plan to be calculated and reported using either current salary levels or projected salary levels. The pension schemes listed in paragraph 12.1.1 are to calculate and report the present value of the expected payments using projected salary levels; that is, the option of using current salary levels is not available.

b) paragraph 17 of IAS 26 allows information concerning the actuarially determined present value of promised retirement benefits to be disclosed (a) as part of the statement of net assets, (b) by way of note, or (c) in a separate actuarial report which is attached to the accounts. The pension schemes listed in paragraph 12.1.1 are to disclose the actuarially determined present value of promised retirement benefits within the statement of financial position; that is, options (b) and (c) are not available.

Other requirements

Content of the financial statements

12.3.6 Although not addressed specifically in IAS 26, the financial statements prepared by pension schemes shall include (and see also the proforma *Magenta*):

a Report of the Scheme's Managers;

a Report of the Scheme's Actuary;

a Statement of the Accounting Officer's responsibilities;

a Governance Statement;

a Report of the Auditor;

a Statement of Parliamentary Supply;

a [Combined[1]]Statement of Comprehensive Net Expenditure;

a [Combined] Statement of Financial Position;

a [Combined] Statement of Changes in Taxpayers' Equity;

a [Combined] Statement of Cash Flows;

supporting notes.

Additional voluntary contributions (AVCs)

12.3.7 AVCs are amounts deducted from employees' salaries and paid over directly by employers to approved AVC providers. They do not include employees' normal contributions in respect of the purchase of added years.

12.3.8 AVC transactions should be included in the financial statements of the pension schemes by way of note showing:

the value of the AVC investments at the beginning of the year;

amounts paid to the AVC providers during the year;

the investments purchased by the AVC providers;

the value of sales of investments to provide pension benefits;

the changes in the market value of investments;

the value of the AVC investments at the end of the year;

the existence (if any) of any guarantee given by the scheme.

[1] These statements are described as "Combined" if the statement reflects transactions relating to both pensions and early departure costs.

12.3.9 If the AVC arrangements include life assurance cover, the note should also show the contributions received to provide life cover, and the benefits paid on death.

Termination benefits (also known as early departure costs or compensation payments)

Introduction

12.3.10 The accounting treatment of termination benefits by **employers** is dealt with in IAS 19 (see section 12.2). For convenience, termination benefits are paid to the individuals concerned using the arrangements for paying pensions, with the amounts being recharged to employers. Ideally, separate statements for these transactions should be prepared, but, for historical reasons, it is appropriate to prepare statements showing both pension transactions and those relating to termination benefits. The following paragraphs describe the treatment of termination benefits in the accounts of the pension schemes, notwithstanding that IAS 26 does not address this issue. As the arrangements for paying termination benefits and their recovery from employers may differ from scheme to scheme, the following guidance is of a general nature and may need to be interpreted to reflect individual circumstances.

Agent or principal?

12.3.11 In some cases, the scheme acts purely as an agent, with individuals having recourse to their former employers in the case of default; in others, the scheme acts as principal. It is important for schemes to establish their status by reference to their governing statutes and regulations.

Schemes acting as an agent

12.3.12 The statement of financial position should recognise and measure only a current asset or liability being timing differences between amounts due to former employees and their recovery from employers. It will not recognise either the total liability to former employees or the total amount recoverable from employers.

12.3.13 The Statement of Comprehensive Net Expenditure will show only any costs falling to the scheme such as differences between any amounts pre-funded and the offsetting liability.

Schemes acting as a principal

12.3.14 The statement of financial position should recognise and measure:

a) a provision representing the total future liability to former employees. Depending on the terms of the regulations relating to compensation payments, this provision may be incorporated into that for pensions but where it is not, the provision should be discounted at the general provision discount rate (not the pension discount rate); and

b) a sum representing the total amounts due from employers where those amounts are recharged to employers on a regular basis.

Pre-funding the liability

12.3.15 Some schemes permit employers to pre-fund their liabilities either by means of a lump sum, or paying instalments over a short number of years.

Schemes which act as an agent

12.3.16 The instalments or lump sums should be shown separately in the statement of financial position as a long-term liability which is reduced as the amounts are paid to the employees. Where the instalments or lump sums received offset a greater value of liabilities, there will be a cost to the scheme that should be recognised in the Statement of Comprehensive Net Expenditure. Ideally, the cost should be allocated to individual years on an actuarially determined basis, but, in most cases, it will be sufficient to take the actual loss in the year – that is, the difference between the amounts pre-funded in respect of a given year and the payments made in respect of the respective individuals during the year.

12.3.17 Conversely, schemes will benefit if payments to individuals are lower than amounts pre-funded by employers, and will record this as a gain (on an actual basis) if the amounts are not refundable to employers or capable of being offset against other individuals.

Schemes which act as a principal

12.3.18 Amounts receivable from employers by way of a capitalised payment to discharge their liability are to be regarded as special pension scheme contributions in the Statement of Comprehensive Net Expenditure.

12.3.19 Amounts receivable from employers on an on-going basis are to be regarded as “other income” in the Statement of Comprehensive Net Expenditure.