Accounting for pensions in your financial statements: 20 questions

Many employers in the Local Government Pension Scheme ("LGPS") are familiar with their obligations under the UK Financial Reporting Standards, in particular FRS102 relating to pension scheme benefits. However, many more recent employers (such as academies) may be less familiar with these obligations, and this note answers some of the main initial questions which employers might have.

Whilst this is not really a "crash course" in FRS102, it will show the importance of this accounting standard. It also describes some of the standard Hymans Robertson processes which you need to be aware of, so we can work best with you for your own financial statements.

Please also see the section at the end of this briefing note entitled "Anything else?", for details about how you can learn more on this important subject.

"For many employers the impact of pensions on their financial statements is significant."

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1 The basics

Q 1.1 What is FRS102?

A 1.1 It is a UK Accounting Standard which affects employers who have employees (or ex-employees) in a defined benefit pension scheme[1]. This standard dictates how pensions are treated in the employer's Profit or Loss account and Balance Sheet.

The numbers are usually prepared by an actuary, who will also assist in setting some of the main assumptions (see Q 3.1 and Q 3.2).

[1] A defined benefit pension scheme is a pension arrangement where the amount of retirement benefit is calculated by a formula (usually directly proportional to the length of an employee's service and the level of earnings). The amount of pension is not linked to stock market conditions, and the employer is responsible for the scheme's funding in the long run.

Q 1.2 We do not have our own pension scheme, although some of our employees are members of the local authority pension fund. Does FRS102 still apply to us?

A 1.2 Yes. The LGPS is a defined benefit pension scheme and each county council, metropolitan borough, etc, will typically run its own LGPS Fund. As an employer of LGPS members, you are responsible for the eventual funding of your employees' pension benefits in the LGPS, and therefore you must disclose the relevant figures in your annual financial statements[2], as per FRS102.

Q 1.3 How important is FRS102?

A 1.3 For many employers the impact of defined benefit pensions on their financial statements is significant. For instance, it is not unusual for the pension expense on the account to be 20% or 30% of LGPS employees' pay rolls and for a large provision to be included on the Balance Sheet relating to the past service pensions deficit. For instance, for many new academies, the Balance Sheet provision relating to the LGPS is typically several hundred thousand pounds.

Q 1.4 Why isn't the Profit or Loss account figure the same as the contributions we pay to the LGPS Fund?

A 1.4 Accounting Standards in general, and FRS102 in particular, require the Profit or Loss account figure to be calculated using actuarial assumptions which will vary from year to year (see Q 3.1). In particular, it does not permit the Profit or Loss account figure to simply be set equal to the employer contributions paid. Allowing this would permit distortions of the employer's disclosed results e.g. taking a temporary pension contribution holiday would appear to improve profitability.

Q 1.5 Why must we include a pension provision on our Balance Sheet?

A 1.5 Again, FRS102 (in common with other accounting standards) requires the pension liability relating to your LGPS members to be valued using actuarial assumptions which will vary from year to year in line with market indicators (see Q 3.1). If the amount of pension scheme assets being held for your members is less than this liability value, the implication is that you will eventually need to make good this deficit. It is therefore treated as a provision in your financial statements, although this does not need to be paid immediately, nor does it affect the cash contributions paid by you as an employer to the LGPS (see Q. 1.6).

Q 1.6 How do the FRS102 figures affect the cash contributions we must pay to the LGPS?

A 1.6 They don't. The contributions are set by the Administering Authority (typically the main local authority in the area) for each LGPS fund, and this is done every 3 years. The next formal contribution-setting valuations are due to be carried out as at 31 March 2016 (in Scotland, 31 March 2017), with contributions being changed 12 months later.

Q 1.7 Can I take employees out of the LGPS, reduce the benefits which the LGPS pays them, or increase the contributions which my employees pay to the LGPS?

A 1.7 In general, no. The LGPS is open to most local government employees, and many of those working in similar roles. For instance, all non-teaching staff in academies must be allowed to join and remain in the LGPS. In some cases the employer may have the option to cease employees' membership of the LGPS, or to refuse LGPS membership to new employees; however, this is rare.

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2 Although, under certain types of admission agreement this may not be required. e.g. if your admission to the LGPS is on a 'pass-through' arrangement.

The benefits paid by the LGPS, and the rates of contributions paid by employees, are set in statutory regulations and cannot be altered by individual employers or even the local authorities themselves.

2 Process issues

Q 2.1 How much will my FRS102 calculations and disclosures cost?

A 2.1 At Hymans Robertson we have spent many years making our pension accounting systems as efficient and cost effective as possible.

The cost of preparing your FRS102 disclosure is typically much lower from the second year onwards. Please speak to the usual contact at your LGPS fund if you require details.

However, our costs are much less than typical private sector FRS102 report costs, due to our efficient systems and processes.

Q 2.2 When will our FRS102 figures be available?

A 2.2 Please speak to your normal local authority pension contact regarding any deadlines by which you require pension accounting information. However, note that FRS102 requires that calculations are carried out using market conditions at the accounting date, and therefore the FRS102 figures will not be available until some time later.

As far as data provision is concerned, there is in essence a choice for you between:

- using partial year data (where, for instance, we would estimate 12 months' data from the first 10 months experience) with a quicker turnaround time for production of your FRS102 report, or
- waiting until full 12 months data is available but with a later delivery time for the report.

Q 2.3 What data do I need to provide to the local authority pensions team?

A 2.3 Please liaise with your normal local authority pension contact regarding the provision of data, as different LGPS funds operate in different ways. However, one particular point to note is regarding early retirements during the year, particularly if these are due to take place in the few weeks before your accounting date (see Q 2.4).

Q 2.4 What information do you require regarding early retirements, and why do you need this?

A 2.4 If an employer makes a LGPS member redundant, or agrees to their early retirement, the member will receive their full pension unreduced from this earlier age. This will incur an added cost for the LGPS because the pension is paid for longer than expected. As the employer making this decision you are responsible for this added cost, and this will be included in your Profit or Loss account for the year, as well as having an impact on your Balance Sheet (see also Q 3.3).

Hymans Robertson's standard approach is to seek individual details for each early retirement (except ill-health cases), so that the appropriate early retirement strain can be calculated and included in the employer's FRS102 disclosures. You should note that the FRS102 strain is not necessarily the same as any early retirement cash contribution which you may be required to pay to the Fund.

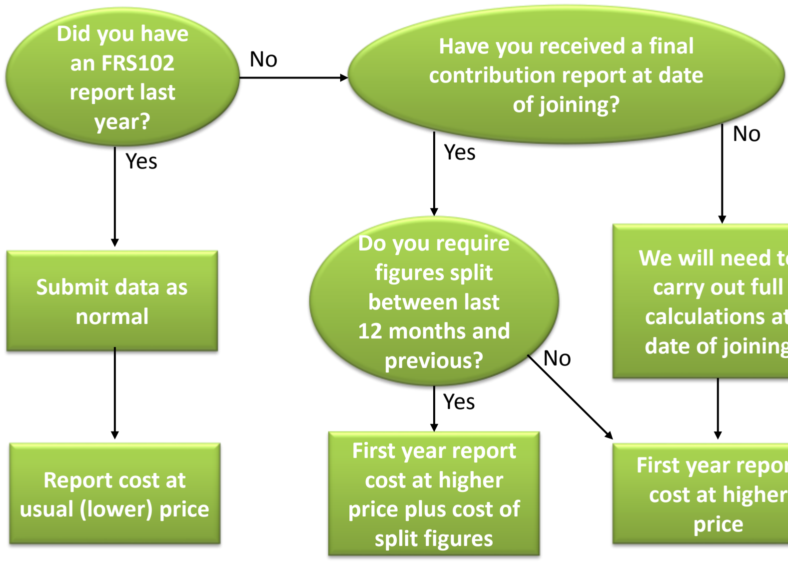
This means that, if you expect a number of such retirements in the few weeks before your financial year end, then you should consider whether it would be more appropriate to ask us to prepare figures based on full 12 months data, as the estimate based on the first 10 months will not reflect these retirements that occur close to the year end.

Q 2.5 We only joined the LGPS during the year: What is the process for this first FRS102 report?

A 2.5 Please see the process flow chart below. Unless your opening position figures were calculated on a finalised basis at the time, your FRS102 report is likely to require more data at this accounting date, and will cost more (see Q 2.1), than will be the case in future years.

Q 2.6 Our first set of financial statements this year will cover a period of more than 12 months: What is the process this year for FRS102?

A 2.6 Please see the process flow chart below. Our standard approach would be to prepare figures covering the whole term as a single accounting period, without preparing an interim figure 12 months prior to the current accounting date. If you wish this interim figure as well, this can be done, for an additional charge.



3 Technical issues

Q 3.1 How does the actuary calculate the liability value (for the Profit or Loss account and Balance Sheet)?

A 3.1 The actuary calculates the discounted (or capital) value of the LGPS benefits which are expected to be paid to your employees, ex-employees and their dependants.

- For the Profit or Loss account, the benefits valued are those built up in the accounting period (usually the last 12 months);
- For the Balance Sheet, the benefits valued are all those built up in all previous years to the financial year end.

The actuary estimates the discounted value of benefits by making various assumptions about the future regarding investment returns, pay growth, pension increases, life expectancy and so on. The financial assumptions must be based on market conditions at the accounting date, as per FRS102.

Q 3.2 Who decides the assumptions to be used?

A 3.2 FRS102 says that these must be decided by the employer on the basis of actuarial advice. In practice, most employers are happy to use the assumptions which we put forward, although some will ask us to prepare figures using slightly different assumptions. In any event, the principal assumptions must be disclosed in the pensions note that appears in the accounts, and the employer's auditor must be comfortable with these also.

In the unusual situation where we are asked to prepare figures using a set of assumptions which we are not comfortable with, we will still carry out the necessary calculations but will state in our report that the assumptions used fall outside our normal range of assumptions.

Q 3.3 How do different forms of retirement affect my Profit or Loss account and Balance Sheet at the end of the year?

A 3.3 Please see the table below. These all relate to situations where a member starts to receive an LGPS pension.

Type of retirement	Impact on Profit or Loss account	Impact on Balance Sheet
Retirement on or over age 65 (or "assumed pension age")	None	None
Redundancy below age 65 (or "assumed pension age")	Cost of earlier payment reflected as a "curtailment"	Cost increases Balance Sheet provision/deficit (offset by strain cash payments)
Early retirement below age 65, for efficiency or other reasons (not redundancy) where pension is not reduced	Cost of earlier payment reflected as a "past service cost"	Cost increases Balance Sheet provision/deficit (offset by strain cash payments)
Retirement due to ill-health	None	None

Q 3.4 What happens when markets change?

A 3.4 Changes during the accounting period are generally reflected in the Balance Sheet via the Other Comprehensive Income statement (OCI), but not the Profit or Loss account.

Changes that occur after the financial year end are normally reflected in next year's accounts.

Q 3.5 What if there is a significant change in our LGPS membership during the year?

A 3.5 This will depend on the size and nature of the change.

If it is a few joiners or leavers then we would not normally carry out any special additional calculations.

If it is a large influx or transfer out of members, it may be appropriate to specially allow for this. Please raise this with your usual LGPS pensions contact before the year end if possible.

Q 3.6 The UK Financial Reporting Standards recently changed; will this affect my disclosures this year?

A 3.6 FRS102 first came into effect for accounting years starting on or after 1 January 2015, (e.g. the first year of adoption for employers with a 31 August year-end will be 1 September 2015 to 31 August 2016). The changes to the FRS102 standard are broadly in line with the International Standard IAS19, i.e. the most significant change is to reduce the Expected Return on Assets assumption, which should lead to a higher charge to the Profit or Loss account.

The FRS102 changes require employers who report on a defined contribution basis[3] to recognise their share of committed deficit recovery contributions on the balance sheet.

[3] Which may apply to employers participating in a multi-employer scheme where the benefit obligation and asset share cannot be identified, such as the Universities Superannuation Scheme.

4 Anything else?

Q 4.1 Where can I find out more?

A 4.1 We understand that pensions can be a complex and murky area for those who do not have to deal with it very often. We also understand that pensions accounting can be even more so. Therefore, we are happy to provide whatever assistance you think you might need:

- to enhance your understanding of your pension obligations,
- to appreciate the factors which influence the numbers appearing in your accounts, and
- to make you aware of the likely impact of different choices which you may make as an employer.

In the first place, and for LGPS-specific comments, please speak to your usual pensions contact at your LGPS fund's pension team. They will normally be able to either answer your queries, or suggest ways in which you can learn more about your obligations and FRS102.

Hymans Robertson and the LGPS funds also run various training sessions, and you can ask your pensions contact about these. These sessions will typically include training on the FRS102 disclosures, and will also provide an opportunity for you to ask questions during and after the session.