HER MAJESTY'S TREASURY, UNITED KINGDOM

TREATMENT OF UNFUNDED PUBLIC SECTOR EMPLOYEE PENSION SCHEMES IN GOVERNMENT ACCOUNTS

By David Watkins — October 1, 2003

Accounting for central government in the United Kingdom

1. The Government Resources and Accounts Act 2000 requires departments to prepare accruals based accounts (known as resource accounts) in accordance with directions issued by the Treasury. The Act lays various duties on the Treasury in exercising the power to issue directions, including a requirement that resource accounts conform to generally accepted accounting practice subject to such adaptations as are necessary in the context of departmental accounts.

2. Generally accepted accounting practice in the United Kingdom (UK GAAP) is usually defined as including the disclosure requirements of companies legislation and pronouncements of the Accounting Standards Board (ASB) through accounting standards and other documents. The Treasury promulgates accounting advice to departments through the Resource Accounting Manual, one of the objectives of which is to provide a framework for resource accounting, applying accounting standards developed by the ASB where applicable). In developing and maintaining this framework, including determining the applicability of accounting standards, the Treasury is required by the Government Resources and Accounts Act 2000 to consult, and seek the advice of, a group of persons who appear to the Treasury to be appropriate to so advise. This group, appointed following consultation with the Comptroller and Auditor General, is the Financial Reporting Advisory Board (FRAB). The FRAB reports to Parliament each year on its activities, including commentary on its decisions and on the adherence of central government accounting to UK GAAP.

Financial Reporting Standard 17 Retirement Benefits

3. The ASB issued Financial Reporting Standard (FRS) 17 *Retirement Benefits* in December 2000. It applies to the account of a company providing its employees with retirement benefits – not to the accounts of the pension scheme. The main requirements of FRS17 include the need for a company operating a defined benefit scheme to:

- measure pension scheme assets at market value at the balance sheet date (rather than at an actuarial value)
- measure pension scheme liabilities using a projected unit method and discounted at the current rate of return on a long-term corporate bond; and
- include on its balance sheet the company's share of the surplus of the scheme to the extent it can be recovered or of the deficit to the extent that the company has an obligation to make good that deficit.

4. Employers who participate in a multi-employer pension scheme and who cannot identify their separate share of the surplus or deficit will account for their contributions to that scheme – which is the same accounting treatment used by employers who operate a defined contribution scheme.

5. The ASB originally proposed a phased introduction over three years, but increased this to five years in November 2002, when the International Accounting Standards Board (IASB) announced its review of International Accounting Standard (IAS) 19 *Employee benefits*. The delay in full implementation should allow the ASB to ensure that there is convergence between the two standards in due course. The transitional arrangements are:

- for accounting periods ending on or after 22 June 2001, closing balance sheet information (no comparatives required) is to be given in the notes only. This includes disclosure of the actuarial assumptions used to derive the value of pension scheme liabilities;
- for accounting periods ending on or after 22 June 2002, opening and closing balance sheet information and performance statement information for the period (no comparatives required), together with disclosure of the actuarial assumptions, are to be given in the notes only;
- for accounting periods ending on or after 1 January 2005, the standard is fully effective.

5. From the Treasury's viewpoint, the two key differences between FRS17 and IAS19 are that:

- IAS19 currently allows actuarial gains or losses to be smoothed over the remaining working lives of participating employees, although, at a minimum, a net gain or loss in excess of 10 per cent of the greater of defined benefit liabilities or fair value of the scheme assets at the beginning of the financial year should be recognised immediately in the statement of financial performance. Under FRS17, the actuarial gain or loss should be recognised immediately in full in the Statement of Total Recognised Gains and Losses; and
- IAS19 allows the employer to limit the level of the asset or liability shown on the balance sheet by reference to a calculation based on actuarial losses, past service costs and available funds. FRS17 provides for no such limit.

Accounting for employee benefits in resource accounts

6. The main central government employee pension schemes in the United Kingdom are unfunded, defined benefit schemes. The schemes are subject to routine Parliamentary funding procedures and, under the terms of the Government Resources and Accounts Act 2000, the scheme administrators have to publish separate scheme resource accounts. The Treasury, having consulted the FRAB, determined that the central government sector will implement FRS17 in line with the ASB's original timetable: that is, that the standard becomes fully effective for the accounts for the year ending 31 March 2004.

7. FRS17 will apply to the unfunded, defined benefit schemes in the following way:

- employers contributing to a multi-employer defined benefit scheme in which the employer's share of the underlying assets and liabilities is not identified will account as if it were a defined contribution scheme (that is, following the multi-employer provisions as set out in FRS17); and
- employers contributing to a defined benefit scheme that has a separate parliamentary Supply Estimate, and for which the liability for any deficit is therefore recognised and provided for by Parliament separately from the employing department's operational funding, will also account for it under FRS17 as if it were a defined contribution scheme.

8. The main public sector pension schemes that fall into these categories are the Armed Forces Pension Scheme, the Principal Civil Service Pension Scheme, the National Health Service Pension Scheme, the Teachers' Pension Scheme, the United Kingdom Atomic Energy Authority Superannuation Scheme, the Research Council's Pension Scheme and the Judicial Pension Scheme. Employers' contributions into these schemes are generally set at rates intended to meet, over time, the costs recognised in the financial statements prepared for each of the schemes.

9. The FRAB accepted the Treasury's proposals that these schemes' liabilities (and any assets) will be recognised in the scheme balance sheet to reflect the fact that the liability is subject to separate Supply. Thus, from 2003-04, the accounts for the above pension schemes will look significantly different from private sector pension scheme accounts. The liabilities of each of the unfunded public sector employee pension schemes will be consolidated into Central Government Accounts, which will be prepared, audited and published for the first time for 2003-04.

10. FRS17 will apply without elaboration to public sector bodies that either have funded schemes or operate small, unfunded single employer schemes. However, recognising that the implementation of FRS17 could represent a significant administrative burden to what might be relatively small organisations, the Government Actuary's Department, working with the Treasury, has produced a spreadsheet solution that provides these smaller schemes (those with fewer than 1,000 members) with an easy-to-use method of obtaining a figure for their pension scheme liabilities.

Budgeting for pension schemes

11. Following the introduction of resource accounts, the United Kingdom has introduced a system of resource budgeting under which departments have to budget on an accruals basis. The introduction of FRS17 from 2003-04 means that, from 2003-04, the pension schemes have had to prepare their budgets on using the requirements of FRS17.