CIPFA The Chartered Institute of Public Finance & Accountancy

Pension Liabilities: Accounting for the McCloud Judgement in 2018/19

Briefing from the CIPFA Pension Network

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This note is intended to assist authorities and LGPS funds in determining an appropriate accounting treatment in their 2018/19 annual accounts. It does not amend the 2018/19 Code of Practice (the Code) requirements.

Background

As noted in CIPFA Bulletin 03 (paragraphs 75-78) a ruling has been made regarding age discrimination arising from public sector pension scheme transition arrangements. Court of Appeal judgements were made in cases affecting judges pensions (eg McCloud) and firefighter pensions (eg Sergeant) which had previously been considered by employment tribunals. The rulings have implications for the LGPS, Police and Fire schemes since similar reforms were implemented.

The final situation in terms of employer pension liabilities and financial impact is not clear, since the government may appeal and any remediation process, including cost cap considerations, may affect the resolution and financial impact for entities. Timescales for the resolution of this matter may be lengthy and outcomes may be challenging for entities to assess and quantify, especially at Fund or Authority level.

Scheme Level Estimation [England & Wales: LGPS, Fire, Police]

The Government Actuary's Department (GAD) is currently undertaking a scheme level review for England and Wales of LGPS. The Home Office are yet to make a decision on a similar exercise for the Police and Fire schemes.

An initial review to assess the scale of the overall impact on each Scheme of the McCloud judgement is proposed. This will be followed by a scheme level indication of the change in pension liabilities and service cost, as well as sensitivity analysis, to identify the impact that changes in key factors may have on these two elements.

This work may assist authorities in estimating and evidencing the materiality, or otherwise, of the impact on their 2018/19 accounts and to inform any disclosure within the accounts, for example disclosures regarding how and when entities will gain information on the potential impact. See further below regarding determination of appropriate disclosures.

Accounting Consideration: Assessing Materiality

Authorities should consider the materiality of the impact of the McCLoud judgement for their annual accounts (see Code references in the footnote[1]).

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[1] Code 2018/19 paragraphs on materiality include: 1.7.1; 2.1.1.6; 2.1.2.11; 3.4.2.27

If the matter is immaterial no reference in the accounts is required, although an authority may note that there is some uncertainty due to the factors identified but these are not considered to be material for the authority.

In the event that the matter is considered material an authority will need to consider whether:

- the liability, and current and past service costs, are amended; and/or
- what disclosures are appropriate under the Code requirements (see below).

Entities will need to assess, with appropriate advice as necessary, whether they have sufficient information to amend the pension liabilities for the McCloud judgement implications.

Accounting Consideration: Disclosures if Deemed Material

In considering relevant disclosures authorities should note Section 8.2 of the Code (provisions, contingent liabilities and contingent assets) does not address the treatment of post-employment benefit contingent liabilities. The effect of the pension benefit disclosure requirements [the Code 18/19 paragraphs 6.4.3.42 1) and 3)] is however that authorities are required to provide additional information as necessary to inform readers of the accounts about risks and cash flow uncertainties. It is regarded as reasonable to suggest that this may be appropriately undertaken through disclosure of information, consistent with the principles and approach to contingent liabilities expressed in Section 8.2 of the Code, as part of the 'post-employment benefit' disclosures. Any such disclosure may suitably reference:

- The background / reason for the uncertainty concerning the pension liability (i.e. the court cases and implications)
- An indication of the scale of the uncertainty and if quantification is not currently possible, an explanation of why this is not possible and an explanation of the process and timescale by which the impact will become identified. An indication of 'scheme level' estimates may be appropriate if available.
- An indication of any uncertainties affecting the cash flows (eg appeal by government)
- An explanation of the impact that this may have on funding arrangements – specifically the employers contributions in future years and any deficit recovery plan arrangements

Any disclosure under IAS 37 Provisions and Contingent Liabilities in the accounts would appropriately cross-reference to the above disclosures in the pensions benefit note.

Supporting Code 18/19 Extracts (bold emphasis added)

Section 6.4 (Post-Employment Benefits)

- "6.4.3.42 The following disclosures shall be made for defined benefit plans:

  1) An authority shall disclose information that:
  a) explains the characteristics of its defined benefit plans **and risks associated** with them (see 5) below)
  b) identifies and explains the amounts in its financial statements arising from its defined benefit plans (see 6)–10) below), and
  c) **describes how its defined benefit plans may affect the amount, timing and uncertainty of the authority's future cash flows** (see 11)–13) below).

- "6.4.3.42 3) If the disclosures provided in accordance with the requirements in this and other sections of the Code are insufficient to meet the objectives in 1) above, an authority **shall disclose additional information necessary to meet those objectives."**

Section 8.2 (Provisions, Contingent Liabilities and Contingent Assets)

- "8.2.1.3 **This section of the Code does not cover provisions, contingent liabilities and contingent assets in relation** to:

  ………where another section of the Code deals with a specific type of provision, contingent liability or contingent asset, instead an authority applies that section of the Code instead of this section; for example……**employee benefits (chapter six)"**

- 8.2.2.2 A **contingent liability** is:

  - a **possible obligation** that arises from past events and whose existence will be **confirmed only by the occurrence or non-occurrence of one or more uncertain future events** not wholly within the control of the authority, or

  - a **present obligation that arises from past events** but is not recognised because:
    a) it is not probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation, or
    b) the **amount of the obligation cannot be measured with sufficient reliability**.

- "8.2.2.20 In the extremely rare case **where no reliable estimate can be made**, a liability exists that cannot be recognised. That liability is disclosed as a contingent liability."

- "8.2.2.21 An authority shall not recognise a contingent liability in the financial statements but **disclose as a note to the accounts**,"

- "8.2.2.22 **A contingent liability shall be disclosed in the extremely rare case** where a liability exists but **a reliable estimate cannot be made**."
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The Code Guidance Notes 2018/19 include:

- Module 8 B20 regarding a contingent liability "The note to the Balance Sheet should describe the nature of the contingent liability and **(where practicable)** an estimate of its financial effect and an indication of the uncertainties relating to the amount or timing of any outflow."

(CIPFA CPN Network & CIPFA FAN, 2019)