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CIPFA Bulletin 15 – Reporting of pensions surpluses and IFRIC 14

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CIPFA issues Bulletins to assist practitioners with the application of the requirements of the Code of Practice on Local Authority Accounting in the United Kingdom (the Code), the Service Reporting Code of Practice (SeRCOP) and the Prudential Code, and to provide advice on emerging or urgent accounting issues. Bulletins provide influential guidance that is intended to be best practice, but they are not prescriptive and do not have the formal status of the Code, SeRCOP or the Prudential Code.

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CIPFA Bulletin 15 – Reporting of pensions surpluses and IFRIC 14

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Introduction

1. CIPFA has been requested by auditors to provide guidance on the application of IFRIC 14 *IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* in accordance with the prescriptions in the *Code of Practice on Local Authority Accounting in the United Kingdom* (the Code). This is because a significant number of authorities have moved from a net defined benefit liability to a net defined benefit asset position in 2022/23 and need to consider whether there is an asset ceiling that would limit the authority's ability to recognise the asset.

2. This Bulletin relates only to scheduled bodies under the pension fund regulations in England, Scotland and Wales[1]. It considers the key elements, but CIPFA would note that the whole of the IFRIC and relevant parts of the Code should be referred to directly. IFRIC 14 is freely available on the IFRS Foundation website (this requires registration). Discussion with scheme actuaries should also be held (this may require facilitation of the administering authority).

3. Local authority Local Government Pension Scheme (LGPS) plans are statutorily prescribed and have a specified routine process for the determination of employer contributions. This process is carried out for the pension fund as a whole, but separate contribution rates are set for each employer. Rates are set for a three-year period, based on actuarial advice having regard to the most recent triennial valuation. The rates for each employer are formally separated into:

   - primary rates, which meet the cost of ongoing accrual for current active members, and
   - secondary rates, which mainly reduce deficit or reduce surplus over a given period.

4. Local authority LGPS plans do not have all the features on which IAS 19 and IFRIC 14 provide guidance. In particular:

   - No element of surplus fund assets belongs to pension fund members.
   - Local authority employers cannot normally obtain refunds of surplus during the normal life of the plan.
   - Local authority employers are not normally in a position to wind up a plan and thereby obtain refunds. In the event of the discontinuation of a local authority the pension fund assets and liabilities would be transferred to a successor authority.

5. When an authority has a surplus in a defined benefit plan, under paragraph 6.4.3.27 of the Code and IAS 19, it is required to measure the net defined benefit asset at the lower of:

   - the surplus in the defined benefit plan, and
   - the asset ceiling, determined using the discount rate specified in paragraph 6.4.3.8 of the Code.

[1] The Local Government Pension Scheme Regulations 2013 (Part 1) and the Local Government Pension Scheme (Scotland) Regulations 2018 (Part 1).

Availability of economic benefits through refunds or reductions in contributions

6. The IAS 19 asset ceiling is a specified estimate of the present value of the economic benefit which the employer organisation can realise, either through refunds or by gaining economic benefit through reductions in future contributions. Such an economic benefit may be available even if it is not realisable immediately at the end of the reporting period.

7. Under IAS 19, employer organisations should recognise the maximum economic benefit that is available from refunds, reductions in future contributions or a combination of both. However, they must not recognise economic benefits from a combination of refunds and reductions in future contributions based on assumptions that are mutually exclusive.

Refunds

8. IFRIC 14 explains that refunds may be available under a variety of circumstances ie where:

    - the refund is available immediately without a requirement to settle plan liabilities
    - it is assumed that liabilities are settled gradually over the life of the plan until all members have left the plan, and
    - liabilities are settled in a single event such as wind up of the plan.

9. IFRIC 14 specifies that the economic benefit available as a refund must be measured as the amount of the surplus at the end of the reporting period that the employer has a right to receive as a refund, less any associated costs.

10. In measuring the amount of a refund available if the plan is wound up, the IFRIC specifies that this must include the costs to the plan of settling the plan liabilities and making the refund.

11. None of these options will normally be available to local authorities that are scheduled bodies.

Reductions in future contributions (where there is no minimum funding requirement)

12. If there is no minimum funding requirement the economic benefit available as a reduction in future contributions is the present value of future service costs over the shorter of the expected life of the plan and the expected life of the employer organisation. The future service costs exclude amounts that will be borne by employees.

13. The IFRIC requires that an employer organisation must determine the future service costs using assumptions consistent with those used to determine the defined benefit obligation and with the situation that exists at the end of the reporting period as determined by IAS 19. That is assuming:

    - no change to the benefits to be provided by a plan in the future until the plan is amended, and
    - a stable workforce in the future unless there is a reduction in the number of employees covered by the plan.

    In the latter case, the assumption about the future workforce must include the reduction.

Reductions in future contributions (where there is a minimum funding requirement)

14. If there is a minimum funding requirement, then the component of the asset ceiling available through reductions in contributions will need to be adjusted if part of the minimum funding requirement relates to future service.

15. If there is a minimum funding requirement relating to future service, then the economic benefit available as a reduction in future contributions is the present value of future service costs, less the present value of minimum funding requirement contributions for future service. This calculation is carried out under the same assumptions outlined in paragraphs 12 and 13. If the employer makes prepayments in relation to the minimum funding requirement, this is reflected in the calculation of present value.

Application to local authorities in LGPS schemes

16. In all cases, the net defined benefit asset will be measured at the lower of:

    - the surplus in the defined benefit plan, and
    - the asset ceiling.

17. As noted at paragraph 4, local authority LGPS plans will not in general have any access to refunds. The asset ceiling will in such cases reflect only the economic benefit that may be achieved through reductions in future contributions. However, each employer organisation should review the position having regard to the specific terms and conditions of the LGPS scheme. If appropriate, the asset ceiling should be calculated as the maximum economic benefit that is available from refunds, reductions in future contributions or a combination of both as detailed at paragraph 6.

Minimum funding requirement in local authority LGPS plans

18. CIPFA has received representations from audit firms setting out their view that the requirements of Regulation 67 of the Local Government Pension Scheme Regulations 2013 and Regulation 62 of the Scottish equivalent represent a minimum funding requirement for the purposes of IFRIC 14. CIPFA notes that the description of minimum funding requirements in IFRIC 14 goes wider than the requirement previously embedded in general UK statutory provisions and might be subject to such an interpretation.

19. CIPFA considers that the IFRIC agenda decision in 2015 is likely to support a view that there is a minimum funding requirement. That decision sets out that when the entity estimates the future minimum funding requirement contributions, it should:

    - include the amounts in the schedule of contributions for the fixed period specified by the schedule, and
    - beyond that period, make an estimate that assumes a continuation of those factors establishing the minimum funding basis as determined by the pension trustees.

    Note that although LGPS schemes do not specifically have trustees administering authorities act in such a way that is analogous to these activities.

20. Having said this, each employer organisation should review their position having regard to the terms and conditions under which they are enrolled in the LGPS scheme and other facts and

circumstances. Although this could be outside of the scope of the bulletin, authorities will also need to consider the impact on their group accounts.

21. In order to carry out the calculation of any adjustment to the asset ceiling under IFRIC 14, it is necessary to identify the amount of employer contribution in each period that relates to future service.

22. The starting point for this calculation will be the portion of the employer contribution calculated using the primary rate, which relates to future accruals based on factors common to all members of the fund. Consideration then needs to be given as to whether all of part of the contribution calculated using the secondary rate should be included in the calculation of contributions for future service.

23. The secondary rate increases or reduces the employer contribution based on factors specific to that employer. The secondary rate mainly serves to:

- reduce deficits in the employer's pension provision by providing additional contributions to the fund, or
- reduce surpluses in the employer's pension provision by reducing the level of contributions to the fund.

Additional contributions that reduce deficits are achieved through positive secondary rates and relate only to past service. These are not included in the calculation of contributions for future service. Reduced contributions that reduce surpluses are achieved through negative secondary rates. These negative amounts are applied to reduce contributions for future service.

24. It should be noted that while the main purpose of the secondary rate is to reduce deficits or surpluses as described above, it can encompass other factors specific to the employer, and these may sometimes relate to future service. Where this is the case, the relevant component of contribution at the secondary rate needs to be applied to increase or reduce the contribution for future service. Detailed information on the calculation of the secondary rate will normally only be held by the scheme actuary, who will need to be consulted in order to determine the amount of contributions that relate to future service. It should not be assumed that all projected contributions relate to future service.

Reporting of any limitation on the net defined benefit asset

25. Implementation of paragraph 10 of IFRIC 14 for local authorities requires reference to paragraph 3.4.2.91 of the Code, which states that:

"A local authority shall disclose information about the assumptions it makes about the future, and other major sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year."

26. For the net defined benefit asset this is likely to include disclosure of any restrictions on the current realisability of the surplus or disclosure of the basis used to determine the amount of the economic benefit available.

27. Where an asset ceiling is applied, the Code requires the effect of the asset ceiling to be disclosed (see Code paragraph 6.4.3.45 6) a) iii) and 7) c) iv)). CIPFA is of the view that the reporting of any limitation on the net defined benefit asset should clearly explain why the pension surplus

reported under IAS 19 is not fully realisable by the authority in the form of either refunds or reduction in employer's contributions so that the users of the accounts and other stakeholders can understand why the net defined pension benefit asset (if any) is limited to the economic benefits realisable by the authority and what 'realisable' might mean in this context.