LASAAC
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FRS 17 RETIREMENT BENEFITS: HRA ACCOUNTING ENTRIES - INTERIM GUIDANCE

LASAAC

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HRA ACCOUNTING ENTRIES

1 PURPOSE

1.1 The 2003 *Code of Practice on Local Authority Accounting in the United Kingdom A Statement of Recommended Practice* (the SORP) requires *Retirement Benefits* to be accounted for in accordance with FRS 17 from 1 April 2003. This document provides guidance to local authorities in Scotland on the application of *FRS 17 Retirement Benefits* to the Housing Revenue Account.

1.2 This guidance complements CIPFA's LAAP Bulletin 56 and should be read in conjunction with it. The journal entries exemplified in this guidance relate to the HRA only. Example journal entries for establishing opening balances are included in CIPFA's LAAP Bulletin 56 and are not reproduced here.

2 SCOPE

2.1 This paper applies to Scotland only. It is expected that CIPFA will produce a further LAAP Bulletin shortly which addresses the FRS 17 accounting entries for the HRA. This guidance has however been released by LASAAC at the earliest possible stage, and on an interim basis, to enable local authorities in Scotland to address the accounting entries for 2003/4.

3 INTRODUCTION AND BACKGROUND

3.1 CIPFA's LAAP Bulletin 56 expressed the objectives of FRS 17 as being to ensure that:

(a) financial statements reflect at fair value the assets and liabilities arising from an employer's retirement benefit obligations and any related funding;

(b) the operating costs of providing retirement benefits to employees are recognised in the accounting period(s) in which the benefits are earned by the employees, and the related finance costs and any other changes in value of the assets and liabilities are recognised in the accounting periods in which they arise; and

(c) the financial statements contain adequate disclosure of the cost of providing retirement benefits and the related gains, losses, assets and liabilities.

3.2 FRS 17 is a complex financial reporting standard, but it is based on a simple principle – that an organisation should account for retirement benefits when it becomes committed to give them, even if the actual payment will be many years into the future.

3.3 The fundamental accounting distinction for pensions schemes is whether they are "defined contribution" or "defined benefit". These terms are explained in the 2003 SORP. This guidance and CIPFA's LAAP Bulletin 56 are primarily concerned with defined benefit schemes. Local authorities will already have considered for the 2001/02 and 2002/03 accounts how they will classify their retirement benefits schemes.

3.4 The nature of the Housing Revenue Account as a separate statutory revenue account, but which is consolidated into the Consolidated Revenue Account, has led to debate within the profession and with government on how FRS 17 should be applied to the HRA. . It has been concluded that the principles of FRS 17 are equally applicable to the provision of housing as they are to other services of a local authority and therefore, FRS 17 applies in full to the HRA.

3.5 The Local Government Pension Reserve Fund (Scotland) Regulations (SSI 580), which was laid before Parliament in December 2003, provides the statutory accounting basis for FRS 17 for local authorities in Scotland. The Scottish Executive advised LASAAC in February 2004 that the reserve fund established under this power should also reflect the impact of FRS 17 on the HRA, even though there will be no separate pension reserve fund in respect of the HRA.

4 THE COMPONENTS OF FRS 17

4.1 From 2002/03, the movement on the pensions asset/liability was analysed into its components in the transitional disclosures by way of notes to the accounts required by the 2002 SORP. In 2003/04 the 2003 SORP required that the cost elements should be recognised and accounted for in the primary Statements of Account and supported by notes to the account. CIPFA's LAAP Bulletin 56 provides further information on the components of FRS 17.

4.2 This guidance considers the accounting treatment and disclosures for:

- Current service cost;
- Past service cost;
- Settlements and curtailments;
- Interest;
- Return on the asset; and
- Pension liability/asset and reserve.

4.3 A point to note, is that where pension contributions are due but unpaid to the pension fund scheme at the year-end, these do not affect the pension liability, which is calculated on an actuarial basis, but are accounted for separately as a current creditor and deducted from the local authority's share of the pension scheme assets. Similarly, in the case of an unfunded scheme, amounts due to but unpaid to pensioners at the year end do not affect the pension liability, which is calculated on an actuarial basis, but are accounted for separately as a current creditor.

4 FRS 17 JOURNALS

OPENING BALANCES

4.1 The SORP's provisions on FRS 3 *Reporting Financial Performance* require that a change in accounting policy should be accounted for by restating the comparative figures in the preceding period and adjusting the opening balances of reserves for the cumulative effect. The transitional disclosures required by FRS 17 in the 2002 SORP will assist local authorities with the recognition of the opening pension net asset or liability for 2003/04.

4.2 Local authorities should refer to CIPFA's LAAP Bulletin 56 for advice on the journals required.

MOVEMENTS ON THE PENSIONS ASSET/ LIABILITY

Current service (pensions) cost

4.3 The current service (pensions) cost is an estimate of the true economic cost of providing the pension benefits 'earned' by employees in the financial year. Broadly, it seeks to measure the discounted cost of the additional pension benefits earned by scheme members by virtue of the additional year of pensionable service achieved. FRS 17 measures pension liabilities and any pension scheme investment assets separately, so measurement of the liability is unaffected by whether the scheme is funded or unfunded or whether any fund established to meet liabilities is in surplus or deficit.

5.4 The SORP assumes that the current service (pensions) cost will be based on an actuarial valuation, even where there is no statutory requirement for one (i.e., for unfunded schemes). Where there is a valuation, the SORP requires it to be updated to reflect economic conditions at 1 April of the year of account, not 31 March.

5.5 Current service (pensions) cost is to be stated net of employees' contributions, to reflect the fact that part of the total pensions liabilities are funded by employees rather than the authority as employer. BVACOP recognises that local authorities will allocate current service costs to services on the basis of reasonable, justifiable and consistent estimates and should be referred to on this matter.

Example 1

For the year 2003/04 the HRA's share of the current service cost is assessed as being £3,700k

		£'000
DR	HRA - Current Service Cost	3,700
CR	Pensions Liability	3,700
	Charging FRS 17 Current Service Cost to the Housing Revenue Account	

Past Service Costs

5.6 Unlike 'current' service costs 'past' service costs are non-periodic costs – they arise from decisions taken in the current year, but whose financial effect is derived from years of service earned in earlier years. For instance, if scheme regulations were amended to increase the level of benefits receivable by scheme members', total liabilities would rise but most of the rise would not relate to employee activity in the current year. It is therefore presented and separately from the current service cost in the HRA.

5.7 ‘Vesting’ of past service costs refers to the process of an entitlement to benefits becoming unconditional, not to when the payment falls due. Usually vesting will be immediate, but sometimes the increase in benefits is phased in over more than one year, in which case a straight-line allocation of the cost across the years over the benefits are phased should be made.

5.8 It is important to note that any provisions created under FRS 12 for liabilities not funded by the pension scheme, such as added years, should be written back and provision established under FRS 17, as part of calculating the opening, 1 April 2003, pension liability.

Example 2

A reorganisation of the Housing Department has meant the authority has agreed that two members of staff who work entirely on HRA services can take early retirement. The Council’s actuary has assessed the added years liability to be £34k. This is recognised immediately in the HRA.

		£’000
DR	HRA - Past Service Cost	34
CR	Pensions Liability Charging FRS 17 Past Service Cost to the HRA	34

Gains and losses on Settlements and Curtailments

5.9 Settlements and curtailments are, like past service costs, non-periodic cost. They are likely to be comparatively rare events in public sector pension schemes. The SORP defines a ‘settlement’ as an

“irrevocable action that relieves the employer (or the defined benefit scheme) of the primary responsibility for a pension obligation and eliminates risks related to the obligation and the assets used to effect the settlement”.

5.10 An example would be where a pension scheme contracts with an insurance company to take over its death in service benefits liabilities. Such ‘settlements’ may involve recognising a matching pension asset (e.g. the insurance contract) exactly equal to the liability ‘settled’ rather than reducing the liability (on the principle of separately recognising the employer’s pension liabilities and the employer’s share of the pension scheme assets).

5.11 The SORP defines a curtailment as an

> "an event that reduces the expected future years of service of present employees or reduces for a number of employees the accrual of defined benefits for some or all of their service".

5.12 An example of this would be where, from a certain date the lump sum pension benefits accruing to members were reduced. For instance, if the lump sum for reckonable service after this date was based on two times the annual pension rather than three times the annual pension.

Example 3

A decision by the Pension Scheme Trustees to curtail pension benefits means that reckonable service earned after a certain date will earn a retirement lump sum of twice the associated annual pension rather than three times the associated annual pension. The calculation of the authority's pension liability had been made on the assumption that members would continue to accrue lump sum pension benefits of three times the associated annual pension. The actuary has assessed the reduction in the local authorities pension liability as £2.8m. The share of the payment attributable to the HRA has been assessed as £700,000.

		£'000
DR	Pension Liability	700
CR	HRA	700
	Gain arising on curtailment of lump sum pension benefits	

Interest Cost

5.13 Interest cost is the amount needed to unwind the discount applied in calculating the current service cost. As members of the scheme are one year older and one year closer to receiving their pension, the provisions made at present value in previous years for their retirement costs need to be uplifted by a year's discount to match current values.

5.14 The amount should be calculated using the specified rate applying at 1 April of the year of account. The 2003 SORP has specified that for 2003/04 this is 3.5 per cent before inflation (real). It will be based on the opening value of liabilities, but must reflect changes in scheme liabilities during the year (on a fair basis to be determined by the authority).

5.15 The fact that the HRA is a statutorily separate single service revenue account results in a different treatment for interest and for the return on assets than for General Fund services. In the Consolidated Revenue Account interest and return on assets is not included in the Net Service Cost but as part of Net Operating Cost as 'finance costs' are considered to be corporate rather than a cost to be allocated across services. However, because the HRA is a statutory single service revenue account, the HRA's share of such costs must be allocated to it. However, for consistency of presentation in the Consolidated Revenue Account (CRA) with other services, these items should be stripped out of the HRA service cost on consolidation and shown as part of net operating expenditure in the CRA.

Example 4

The HRA's share of pension 'interest' cost has been assessed to be £2,700k.

		£'000
DR	HRA– Interest Cost	2,700
CR	Pensions Liability	2,700
	Charging interest costs to the HRA – the unwinding of the discount	

Expected Return on Assets

5.16 The expected return on assets is a measure of the return (income from dividends, interest, etc, and gains on invested sums) on the investment assets held by the scheme for the year. It is not intended to reflect the actual realised return by the scheme, but a longer-term measure, based on the value of assets at the start of the year (taking into account movements in assets during the year) and an expected return factor.

The expected return should be based on:

- for quoted corporate or government bonds – application of the current redemption yield at the start of the year to the market value of bonds held; and
- for other assets (especially equities) – application of the rate of return expected for each significant class of assets over the long-term at the beginning of the year to the fair value of assets held.

The SORP makes it mandatory that authorities seek actuarial advice in setting rates of return.

Example 5

The actuary has assessed the Expected Return on Assets for the HRA's proportion of the pension scheme assets to be.

		£'000
CR	HRA - Expected Return on Assets	3,500
DR	Pensions Liability	3,500
	Charging the expected rate of return on HRA share of scheme assets to the HRA	

Actuarial Gains and Losses

5.17 Actuarial gains and losses are recognised as movements on reserves, there is no impact on the HRA. Further explanation of actuarial gains and losses is contained in CIPFA's LAAP Bulletin 56.

Payments to the Pension Fund

5.18 The payments to the pension fund are treated primarily as a cash flow item and a movement on the pensions asset/liability. There is no separate impact on the HRA. Refer to CIPFA's LAAP Bulletin 56 for further information.

Example 6

During the year the local authority pay £1,900k to the pension fund administrators.

		£'000
DR	Pensions Asset	1,900
CR	Cash Payment to pension fund	1,900

Appropriations to and From the Pensions Reserve

5.19 The 2003 SORP requires that the cost of providing pensions for employees is accounted for in accordance with generally accepted accounting practice subject to the interpretations set out in the SORP i.e. on an FRS 17 basis. However, the 2003 SORP (paragraph 3.75) also requires that:

"Where the payments made for the year in accordance with the scheme requirements do not match the change in the authority's recognised asset or liability for the same period, the recognised cost of pensions will not match the amount required to be raised in taxation. This is represented by an appropriation to or from the pensions reserve, which equals the net change in the pensions liability recognised in the Consolidated Revenue Account."

5.20 The impact of this requirement on the HRA is that its share of the appropriation to or from the pension reserve must be shown in the HRA. In practice this will mean two movements between the HRA and the pensions reserve. The reversal out of the total FRS 17 debits and credits and its replacement with an appropriation from the pensions reserve to charge the HRA with the pension payments payable for the year in accordance with the scheme requirements.

5.21 The HRA accounting statement does not have an appropriations section. Transfers to and from the pensions reserve therefore require to be shown as a service cost. However, for consistency of presentation with other services, these transfers should be stripped out of the HRA service cost on consolidation and shown in the appropriation section of the consolidated revenue account.

Examples 7 and 8

In the example provided, the sum of the movement on the net assets and liabilities recognised in the Housing Revenue Account in the year is £2,234k. The impact of these transactions (i.e. the net change in the pensions liability recognised in the Consolidated Revenue Account) is reversed out to the pensions reserve.

The movements in the net assets and liabilities recognised in the HRA in the comprised:	Dr	£3,700k	Current Service Cost
	Dr	£34k	Past Service Costs
	Cr	£700	Curtailment of members' pension benefits
	Cr	£3,500k	Expected Return on Assets
	Dr	£2,700k	Interest Cost
	Dr	**£2,234k**	

		£'000
CR	HRA (the sum of the movements on the net assets and liabilities recognised in the HRA)	2,234
DR	Pensions Reserve	2,234

Being the reversal out of the FRS 17 composite entries (net Debit of £ 2234k to the HRA) and appropriation to the pensions reserve

The pensions payment(s) payable to the pension fund in the year (in accordance with the pensions regulations) is appropriated from the pensions reserve to reconcile back to the statutory rent requirement.

		£'000
CR	Pensions Reserve	1,900
DR	HRA	1,900

Charging the pension cost payable to the pension fund in accordance with the pensions regulations to the Housing Revenue Account and making an appropriation from the pensions reserve.

Summary of differences between HRA and general fund services

5.22 In summary, the following differences can be identified in applying FRS 17 to the separate HRA accounting statement compared with other services

- the net of the HRA pensions interest cost and expected return on pension assets should be shown as service cost in the separate HRA statement (rather than operating expenditure as for other services); and

- the structure of the HRA does not include an appropriations section. Transfers to and from the pensions reserve should therefore be shown as service cost in the separate statement.

5.23 In both cases above, these items should be stripped out of service cost on consolidation and disclosed in a manner consistent with other services.

6. PRESENTATION IN THE STATEMENT OF ACCOUNTS

6.1 The 2003 SORP reflects the historic presentation of the Housing Revenue Account, but does not specifically provide for presentation of the accounting effects of FRS 17 or its interaction with the other statements of account.

6.2 It is expected that the CIPFA/LASAAC Joint Committee will formally alter the 2004 SORP. The following presentation is however recommended for 2003/04 and is based on proposed draft amendments to the SORP. The recommended presentation is incorporated in this guidance to assist practitioners in preparing the published statement of accounts and represents implementation guidance rather than an amendment to the 2003 SORP.

THE HOUSING REVENUE ACCOUNT: SCOTLAND

This account reflects the statutory requirement to account for local authority housing provision, as defined in the Housing (Scotland) Act 1987. It shows the major elements of housing revenue expenditure and capital financing costs, and how these are met by rents, housing support grant and other income.

Information to be included in the accounting statement

Income

- Dwelling rents (gross)
- Non-dwelling rents (gross)
- Housing Support Grant
- Contribution to/from General Fund
- Any other income

Expenditure

Repairs and maintenance (including the pension costs of the HRA employees charged to this head on a SORP-compliant (FRS 17) basis)

Supervision and management (including the pension costs of the HRA employees charged to this head on a SORP-compliant (FRS 17) basis)

Capital financing costs

Bad or doubtful debts

Any other expenditure (including the pension costs on a SORP-compliant (FRS 17) basis of the HRA employees charged to this head, if any)

Pensions interest cost and expected return on pensions assets

Transfer to/from the Pension Reserve

Transfers to/from working balance

Information to be disclosed in notes to the account

(a) The number and types of dwelling in the authority's housing stock.

(b) The amount of rent arrears (excluding amounts collectable on behalf of other agencies) and the provision considered to be necessary in respect of uncollectable debts.

(c) The nature and amount of any exceptional or prior year items not disclosed in the statement.