

## Retirement benefits and early departure costs

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## 8.1 Introduction

8.1.1 This chapter applies only to the following pension schemes in the public sector:

Principal Civil Service Pension Scheme (PCSPS)  
Armed Forces Pension Scheme (AFPS)  
NHS Superannuation Scheme  
Teachers' Superannuation Scheme  
United Kingdom Atomic Energy Authorities Superannuation Schemes  
Judicial Pension Scheme  
Department for International Development – Overseas Superannuation Scheme  
Research Councils' Pension Scheme.

8.1.2 It identifies the accounting standard (FRS 17) and UITF Abstract 35 that apply to the financial statements prepared by these schemes, and how FRS 17 should be adapted for the public sector context.

8.1.3 This chapter also considers the accounting treatment of **early departure costs** (also known as compensation payments) for which there is no applicable accounting standard.

## 8.2 Retirement benefits

8.2.1 The following accounting standard deals with accounting for retirement benefits:

FRS17 *Retirement benefits* (paragraphs 8.2.2 to 8.2.13).

### FRS 17 Retirement Benefits

#### *Applicability*

8.2.2 FRS17 applies, as adapted in paragraph 8.2.4 below, to the schemes listed in paragraph 8.1.1.

#### *Objectives of FRS 17*

8.2.3 The objectives of FRS 17 are to ensure that:

- (a) financial statements reflect at fair values 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 period 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.

#### *Adaptation of FRS 17 for the public sector context*

8.2.4 The following adaptations of FRS 17 apply to the pension schemes listed in paragraph 8.1.1 above:

- a) the requirements of FRS17 are to apply to the accounts of the pension schemes themselves rather than to the accounts of the employers;
- b) the period between formal actuarial valuations is to be four years and not three;
- c) although the rate to be used when discounting the scheme liabilities is, as required by FRS 17, the AA corporate bond rate, it will be applied for each Spending Review period and not annually. HM Treasury will advise the appropriate rate;
- d) the employees contributions are to be shown as income in the Revenue account rather than as a deduction from current service costs;
- e) the contributions from employers are to be shown as income in the Revenue account rather than as a credit to the pension provision; and
- f) in consequence, the pension provision does not reflect contributions.

## **UITF Abstract 35 Death-in-service and incapacity benefits**

### ***Applicability***

8.2.5 UITF35 applies in full to the entities covered by this Manual.

### ***UITF consensus***

8.2.6 The consensus in the UITF is that the cost of providing death-in-service and incapacity benefits should be recognised in accordance with paragraphs 73 and 74 of FRS 17 except where the benefits are provided through a defined benefit pension scheme and are not wholly insured, in which case the uninsured scheme liability and the cost for the accounting period should be measured by applying the principles in paragraphs 20 and 22 of FRS 17.

### ***Other requirements***

8.2.7 Pension schemes listed in paragraph 8.1.1 above should observe the requirements set out in paragraphs 8.2.6 to 8.2.13 below.

### ***Format of the accounts***

8.2.8 A model pension scheme account is shown at Appendix 00 [to follow].

8.2.9 The account shall consist of:

- A Report of the Scheme's Managers;
- A Report of the Scheme's Actuary;
- A Statement of the Accounting Officer's responsibilities;
- A Statement of Internal Control;
- A Report of the Auditor;
- A Statement of Parliamentary Supply;
- A [Combined] Revenue Account<sup>1</sup>;
- A [Combined] Balance Sheet;

<sup>1</sup> These statements are described as "Combined" if the statement reflects transactions relating to both pensions and early departure costs (see 8.3.2 below).

A [Combined] Cash Flow Statement;  
Notes

*Additional voluntary contributions (AVCs)*

8.2.10 AVCs are amounts deducted from employees' salaries and paid over directly by employers to approved AVC providers. They do not include employees' normal contributions in respect of the purchase of added years.

8.2.11 AVC transactions should be included in the financial statements of the pension schemes by way of note showing:

- The value of the AVC investments at the beginning of the year;
- Amounts paid to the AVC providers during the year;
- The investments purchased by the AVC providers;
- The value of sales of investments to provide pension benefits;
- The changes in the market value of investments;
- The value of the AVC investments at the end of the year;
- The existence (if any) of any guarantee given by the scheme.

8.2.12 If the AVC arrangements include life assurance cover, the note should also show the contributions received to provide life cover, and the benefits paid on death.

*Administration costs*

8.2.13 Where the arrangements so provide, the costs of administering the scheme should be borne by the scheme. However, the more normal arrangement is for the costs to fall on the principal operating department or agency and hence will not be included in the scheme statements.

**8.3 Early departure costs (also known as early retirement costs or compensation payments)**

**Introduction**

8.3.1 Employees whose employment is terminated through redundancy, severance or early retirement may be entitled to compensation payments determined in accordance with a Compensation Scheme (but see 8.3.2 below). NB not all of the schemes noted in 8.1.1 have compensation arrangements. Employers meet the costs although, for convenience, payments to individuals are commonly made using the arrangements for paying pensions with the amounts being recharged to employers.

8.3.2 Until relatively recently, there were no separate Compensation Schemes, and early departure costs were not distinguished from pension payments. Following the introduction of Compensation Schemes, it should be possible to make the distinction and, in time, it should be possible to prepare separate financial statements for pension schemes and compensation schemes. But, so long as it remains impossible to identify separately all compensation payments, combined pension scheme and compensation scheme accounts should be prepared, disclosing early departure costs as described below.

8.3.3 Although FRS 12 applies to the compensation payments in the accounts of employers, there are no accounting standards relating to the accounting treatment of early departure costs by compensation schemes.

8.3.4 In some cases, the pension/compensation schemes act purely as an agent with individuals having recourse to their former employers in the case of default; in others, the schemes act as a principal. It is important, therefore, for schemes to establish their status by reference to their governing statutes and regulations.

### ***Schemes which act as a principal***

8.3.5 The pension scheme/compensation scheme *balance sheet* should recognise and measure:

- a) a provision representing the total future liability to former employees; and
- b) a debtor, being amounts due from employers (see also paragraph 8.3.10 which considers the situation where employers pre-fund their liability).

NB in the notes, the gross amounts for debtors and pre-funded amounts should be shown.

8.3.6 The *revenue account* should recognise:

- a) The cost of setting up the initial provision
- b) Any increases or decreases in the provision.

### ***Schemes which act as an agent***

8.3.7 The pension scheme/compensation scheme *balance sheet* should recognise and measure only a current asset or liability being timing differences between amounts due to former employees and their recovery from employers (see also paragraph 8.3.13 which considers the situation where employers pre-fund their liability)

8.3.8 The scheme balance sheet will not recognise the total liability to former employees or the total amount recoverable from employers.

8.3.9 As amounts due to and from individuals and employers are accounted for as balance sheet items, the *revenue account* will show only any costs falling to the scheme such as differences between the pre-funded amounts and the offsetting liability (see 8.3.13 below).

### **Settling the liability**

8.3.10 Although employers may settle their liability through recharging arrangements, some of the schemes allow employers to settle their liability either by paying a single lump sum or paying instalments over a short number of years. As arrangements differ between schemes, the Manual gives only general advice.

### ***Schemes which act as a principal***

8.3.11 The instalments or lump sums should be offset against the debtor for the amounts due from employers (see 8.3.5.b above) although the notes to the accounts should show the two elements separately.

8.3.12 For the “pay-as-you-go” arrangements, amounts paid to individuals should be offset against the provision, with amounts recovered from employers serving to reduce the

amount for debtors. As the debtor will already have been set up, billing employers will be on a pro-forma basis to avoid double counting.

### ***Schemes which act as an agent***

- 8.3.13 The instalments or lump sums should be shown separately as a long-term liability which is reduced as the amounts are paid to the employees. However, the instalments or lump sums may often offset a greater value of liabilities and there is thus a cost to the scheme that should be recognised in the Revenue Account. Ideally, the cost should be allocated to individual years on an actuarially determined basis, but in most cases it will be sufficient to take the actual loss in the year – ie the difference between the amounts pre-funded in respect of a given year and the payments made in respect of the respective individuals during the year.
- 8.3.14 Conversely, schemes will benefit if payments to individuals are lower than amounts pre-funded by employers and will record this as a gain (again on an actual basis) if the amounts are not refundable to employers or capable of offset against other individuals.
- 8.3.15 For the “pay-as-you-go” arrangements, amounts paid to individuals should be recovered from employers by setting up a debtor; no amounts will be recorded in the Revenue account.

### **The “80:20” scheme**

- 8.3.16 The “80:20” scheme (now discontinued) applied only to the PCSPS and provided central funding to meet some of the early departure costs incurred by departments. A residual liability under the scheme still exists – it is likely to be extinguished by about 2007 – and will be shown in the balance sheet of the PCSPS as a liability.