



HM TREASURY

Financial Reporting Advisory Board Paper

UPDATE ON DISCUSSIONS ON CHANGING DISCOUNT RATE FOR PUBLIC SECTOR PENSIONS

Issue:	An update on the discussions concerning the rate for discounting pension liabilities
Impact on guidance:	None at present.
IAS/IFRS adaptation?	N/A
IPSAS compliant?	N/A
Interpretation for the public sector context?	N/A
Impact on budgetary regime?	To be discussed with GEP, but budgetary impacts are expected to be minimal.
Alignment with National Accounts	No: National Accounts measure the cash flows (pension payments).
Impact on Estimates?	Yes: changing the discount rate affects the interest charge (unwinding the discount) and (perhaps) the current service cost. The change to the pension liability resulting from the change in the discount rate is taken to reserves and does not affect Estimates.
Recommendation:	The FRAB is invited to note the recent developments.
Timing:	2006-07

DETAIL

Background

1. At its meeting on 8 May 2006, the FRAB agreed that the real rate of 2.8 per cent used at present to discount pension liabilities should be reviewed for 2007-08, and raised the possibility that it should also be reviewed for 2006-07.

2. Following discussions with colleagues in the Treasury, the Government Actuary's department and some of the pension schemes, we have agreed that it would be possible to review the discount rate annually without undue complications for the budgeting and Estimates processes.
3. In England, budgets and Estimates for a given financial year are normally finalised just ahead of the start of that year. As the process takes several weeks to complete, fixing a discount rate based on returns from AA corporate bond rates at 31 January each year would enable the budgets and Estimates for the year beginning in the following April to be completed within the agreed timetable, as well as being used in the calculation of the pension liability at 31 March. Thus a rate determined at 31 January 2007 would be used to determine the budgets and Estimates for 2007-08 as well as the pension liability at 31 March 2007 for use in the annual accounts for 2006-07. Although the rate used in the accounts would be two months out of date, it is considered that such a time lag is acceptable, although the FRAB's views on this would be welcomed.
4. The alternative would be to use the rate at 31 January for budgeting and Estimating purposes, with the rate at 31 March being used for the annual accounts. This would then require a supplementary Estimate to reassess the interest charge and current service costs to reflect the new discount rate; this is considered to be an unnecessary complication.
5. Although this arrangement satisfies the timetable for preparing the budgets and Estimates in England, representatives from the devolved administrations have commented that they operate to a different timetable. For Scotland and Northern Ireland, the budgets for a given year have to be submitted in the previous December (thus the budgets for 2007-08 would be submitted in December 2006). The alternatives seem to be either to agree a discount rate in time for the effect to be reflected in the budgets (say October) or to have an Autumn Budget Revision to reflect the new discount rate. The former approach would mean that the figures at the year end for inclusion in the annual accounts would be some five or six months out of date; it has been argued that the latter approach, by highlighting the effect of the change, might attract press or political interest. At the time of writing, we have not yet resolved how best to address this problem, although early indications are that using a 31 January rate for all schemes would be preferable.

Impact on disclosures in resource and other accounts

6. Changing the discount rate would have only a marginal impact on the disclosures in resource and other accounts (ie changes to reflect the new rate).

IAS/IFRS compliance

7. The use of a AA corporate bond rate assessed annually is compliant with IAS19 and FRS17.

IPSAS compliance

8. There is no IPSAS on this topic.

Proposed text for the shadow Government Financial Reporting Manual

9. No amendments to the FreM are proposed at present.

Impact on the budgetary regime

10. To be discussed with GEP, but any impact on the budgetary regime is expected to be minimal.

Summary and recommendation

11. This paper notes developments in the discussions on reviewing the rate used to discount pension liabilities. The FRAB is invited to note progress and comment on the proposal to use a rate determined at 31 January for both budgets/Estimates purposes and for the annual accounts. The FRAB is also invited to note that the implications for the devolved administrations have still to be resolved.

HM Treasury
29 June 2006