



HM TREASURY

Financial Reporting Advisory Board Paper

IAS 26 – ACCOUNTING AND REPORTING BY RETIREMENT BENEFIT PLANS

Issue:	The application of IAS 26 to entities and other funds, accounts and flows covered by the requirements of the IFRS-based Government Financial Reporting Manual.
Impact on guidance:	The proposed text in Annex A relates to the shadow FReM.
IAS/IFRS adaptation?	Yes – the IAS is to apply to early departure costs.
IPSAS compliant?	N/A
Interpretation for the public sector context?	Yes: some of the options in IAS26 are restricted to ensure compliance with current practices.
Impact on budgetary regime?	To discuss with GEP, but there should be no impact on the budgetary regime.
Alignment with National Accounts	National accounts reflect cash flows for pensions – but the implementation of IAS26 will not affect current arrangements.
Impact on Estimates?	None
Recommendation:	The FRAB is recommended to consider the points made in the following paragraphs and, subject to their comments, to approve the proposed wording for the IRS FReM.
Timing:	Not yet known: depends on future decision on date for moving to EU-adopted IFRS.

DETAIL

Background

1. IAS 26 *Accounting and Reporting by Retirement Benefit Plans* applies to the financial statements of retirement benefit plans and thus has limited application to the entities, funds, accounts and flows covered by the IFRS FReM. It will be of relevance to the resource accounts prepared by the major

schemes within central government¹. Guidance on the form of pension scheme accounts is currently given in the SORP *Financial Reports of Pension Schemes* (July 1996).

2. As nothing in IAS 26 would require any changes to the current format of the pension scheme accounts, implementation of IAS 26 should be straightforward. For the avoidance of doubt, the amendments to the FrEM clarify that the pension scheme accounts should include a report of the scheme's managers, and a report of the scheme's actuaries as well as the normal primary statements and supporting documents; IAS26 does not address the preparation of these statements.

3. There are, however, a few areas where IAS 26 provides options, and the proposed wording for the FrEM will limit those options to ensure consistency with current practices. These areas are:

- a. The scope of IAS 26 is restricted to retirement benefits. As some of the pension schemes accounts also reflect transactions relating to benefits payable under early departure terms, the FrEM will make it clear that such transactions should continue to be reflected in the pension scheme accounts. Although the treatment of "termination benefits" is covered in IAS19, its requirements relate to the accounts of employers, whereas this section of the FrEM will apply to the accounts of the pension schemes themselves;
- b. IAS 26 permits the use of both the current salary method and the projected salary method to determine the actuarial present value of promised retirement benefits. Current practice is to use the projected salary method (described in FRS 17 as projected unit method) and the FrEM will make it clear that the use of the current salary method is not allowed;
- c. IAS 26 allows the financial statements to include information about the actuarial present value of promised retirement benefits in (a) a statement of net assets, (b) as a note to the accounts or (c) in a separate actuarial report. Pension scheme accounts currently show the pension provision as a liability on the balance sheet and the FrEM will clarify that options (b) and (c) are not permitted.

Impact on disclosures in resource and other accounts

4. There should be no change to the disclosures required in pension scheme accounts. [This comment is made on the assumption that the revised disclosures under FRS17 will have been adopted by the time that the shadow FrEM becomes effective – this point will need to be clarified in due course.]

IAS/IFRS compliance

5. To the extent that transactions relating to benefits payable under early retirement schemes will be recognised in the financial statements of the pension schemes, the proposals are an adaptation of IAS 26. There are no other adaptations.

¹ The major schemes within central government are: Armed Forces Pension Scheme, Judicial Pension Scheme; NHS Superannuation Scheme, Overseas Superannuation Scheme (Department for International Development); Principal Civil Service Pension Scheme; Research Councils' Pension Scheme; the Teachers' Superannuation Scheme and the United Kingdom Atomic Energy Authority Superannuation Schemes.

IPSAS compliance

6. There is no IPSAS on this topic.

Proposed text for the shadow Government Financial Reporting Manual

7. See Annex A for the proposed amendments to the shadow FReM.

Impact on the budgetary regime

8. To discuss with GEP, but there should be no impact on the budgetary regime.

Summary and recommendation

9. This paper considers the implementation of IAS 26 and concludes that, as the current form and content of pension scheme accounts are consistent with the requirements of IAS, implementation should be straightforward. There are a few areas where IAS 26 allows optional treatments and the FReM will need to limit those options to ensure compliance with the current arrangements.

10. The FRAB is invited to consider the points made and, if they agree, approve the proposed wording of the FReM to allow the implementation of IAS 26.

HM Treasury

June 2006

PROPOSED TEXT FOR THE SHADOW GOVERNMENT FINANCIAL REPORTING MANUAL

IAS 26 Accounting and Reporting by Retirement Benefit Plans

Applicability

0.0.0 IAS 26 applies, as adapted and interpreted, to the financial statements prepared by the unfunded pension schemes in central government, ie

- Armed Forces Pension Scheme;
- Judicial Pension Scheme;
- NHS Superannuation Scheme,
- Overseas Superannuation Scheme (Department for International Development);
- Principal Civil Service Pension Scheme;
- Research Councils' Pension Scheme;
- Teachers' Superannuation Scheme, and
- United Kingdom Atomic Energy Authority Superannuation Schemes.

Objectives of IAS 26

0.0.0. The standard provides guidance on the form and content of the financial statements prepared by retirement benefits plans. It complements IAS 19 which deals with the determination of the cost of retirement benefits in the financial statements of employers.

Adaptation of IAS 26 for the public sector context

0.0.0 The following adaptation apply to the entities noted in paragraph 0.0.0 above:

- IAS 26 does not apply to forms of employment benefit other than retirement benefits. However, where schemes currently report separately transactions relating to termination benefits (also known as early departure costs or compensation payments) they should continue to do so. The treatment of such costs will depend on whether the scheme acts as a principal or agent, and whether or not the early departure costs (however described) are regarded as retirement benefits and included within the pension provision. Guidance on the accounting arrangements for termination benefits is given below.

Interpretations of IAS 26 for the public sector context

0.0.0 In applying IAS 26, entities should be aware of the following interpretations for the public sector context as they apply to the ***disclosures*** required by the IAS.

- a) Paragraph 18 of IAS 26 allows the present value of the expected payments by a retirement benefit plan to be calculated and reported using either current salary levels or projected salary levels. Central government pension schemes are to calculate and report the present value of the expected payments using projected salary levels, ie the option of using current salary levels is not available.
- b) Paragraph 17 of IAS 26 allows information concerning the actuarially determined present value of promised retirement benefits to be disclosed (a) as part of the statement of net assets (b) by way of note, or (c) in a separate actuarial report which is attached to the accounts. Central government pension schemes are to disclose the actuarially determined present value of promised retirement benefits within the balance sheet, ie options (b) and (c) are not available.

Other requirements

Content of the financial statements

0.0.0 Although not addressed specifically in IAS 26, the financial statements prepared by pension schemes shall, as at present, include:

- 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]²Revenue Account
- A [combined] Balance Sheet;
- A [combined] Cash Flow Statement;
- Notes.

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

² These statements are described as "Combined" if the statement refers to both pensions and early departure costs.

Termination benefits (also known as early departure costs or compensation payments)

0.0.0 The accounting treatment of termination benefits by **employers** is dealt with in IAS 19 (see 0.0.0). For convenience, termination benefits are paid to the individuals concerned using the arrangements for paying pensions, with the amounts being recharged to employers. Ideally, separate statements for these transactions should be prepared, but for historical reasons, it is appropriate to prepare statements showing both pension transactions and those relating to termination benefits. For this reason, the following paragraphs describe the treatment of termination benefits in the accounts of the pension schemes, notwithstanding that IAS26 does not address this issue. As the arrangements for paying termination payments and their recovery from employers may differ from scheme to scheme, the following guidance is of a general nature and may need to be interpreted to reflect individual circumstances.

Agent or principal?

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

Schemes acting as an agent

0.0.0 The balance sheet should recognise and measure only a current asset or liability being any timing differences between amounts due to former employees and their recovery from employers. It will not recognise either the total liability to former employees or the total amount recoverable from employers.

0.0.0 The revenue account will show only any costs falling to the scheme such as differences between any amounts pre-funded and the offsetting liability.

Schemes acting as a principal

0.0.0 The balance sheet should recognise and measure:

- A provision representing the total future liability to former employees. Depending on the terms of the regulations relating to the compensation arrangements, this provision may be incorporated into that for pensions; and
- A sum representing the total amounts due from employers where those amounts are recharged to employers on a regular basis.

Pre-funding the liability

0.0.0 Some schemes permit employers to pre-fund their liabilities either by means of a lump sum, or paying instalments over a short number of years.

Schemes which act as an agent

0.0.0 The instalments or lump sums should be shown separately in the balance sheet as a long-term liability which is reduced as the amounts are paid to the employees. Where the instalments or lump sums received offset a greater value of liabilities, there will be 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.

0.0.0 Conversely, schemes will benefit if payments to individuals are lower than amounts pre-funded by employers, and will record this as a gain (on an actual basis) if the amounts are not refundable to employees or capable of being offset against other individuals.

Schemes which act as a principal

0.0.0 Amounts receivable from employers by way of a capitalised payment to discharge their liability are to be regarded as special pension scheme contributions in the Revenue account.

0.0.0 Amounts receivable from employers on an on-going basis are to be regarded as "other income" in the Revenue account.