

## Pension Liabilities: Accounting for McCloud and Sargeant Judgements in 2019/20

Briefing from the CIPFA Pensions Panel and Local Authority Accounting Panel

**March 2020**

This briefing is intended to assist local, police and fire authorities and LGPS funds in commissioning the forthcoming IAS19 valuations for inclusion in the 2019/20 statements of accounts and an appropriate accounting treatment for the 2019/20 annual accounts. It does not amend the 2019/20 Code of Practice (the Code) requirements.

Preparation of the statement of accounts is the responsibility of the responsible financial officer (RFO)<sup>1</sup>, which involves commissioning expert advice in a number of areas including actuarial advice. Notwithstanding that actuarial valuation is a specialist area, it is the responsibility of the RFO to ensure that the assumptions are relevant and specific to their authority.

### Background

The McCloud and Sargeant Judgements concerned the introduction of career average revalued earnings (CARE) pension schemes to replace the former final salary based pension schemes as part of the Hutton recommendation to reform public service pension schemes. Under the changes introduced to each scheme, members were required to transfer to the new schemes from the transition date of the new schemes summarised below.

Scheme	England	Wales	Scotland	Northern Ireland
LGPS	1 April 2014	1 April 2014	1 April 2015	1 April 2015
Police	1 April 2015			
Firefighters	1 April 2015			

There was protection provided for older members under each scheme. The McCloud and Sargeant Judgements have upheld the claimants' cases that the method of implementation of the new schemes discriminated against younger members.

When the CIPFA Bulletin 03 and the CPN Briefing were issued in April 2019 it was unclear whether the Government would be successful in their appeal against the McCloud and Sargeant Judgements, and what financial impact the Judgements might have on the police, firefighters and local government pension schemes.

As a result, reporting of the impact of the Judgements varied from disclosing a contingent liability to revised IAS19 valuations accompanied by narrative explanation.

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<sup>1</sup> In England and Wales, RFO is defined in Regulation 2 of The Accounts and Audit Regulations 2015 and The Accounts and Audit (Wales) Regulations 2014 respectively. In Scotland, for RFO read "proper officer" as defined in Regulation 3 of The Local Authority Accounts (Scotland) Regulations 2014. In Northern Ireland for RFO read "chief financial officer" as defined in Regulation 2 of The Local Government (Accounts and Audit) Regulations (Northern Ireland) 2015

## **Aim**

The aim of this bulletin is to provide practitioners with a consistent approach to valuing and accounting for the impact of the Judgements in the 2019/20 accounts. This may also be helpful for auditors and actuaries.

## **Impact of the Judgements**

The Government were refused leave to appeal the McCloud and Sargeant Judgements on 27 June 2019. This means that the various parties return to the respective employment tribunals to formulate a remedy which will resolve the age discrimination of the pension changes.

Whilst the McCloud and Sargeant Judgements are concerned with the judges and uniformed police and firefighters pension schemes, the Chief Secretary to the Treasury announced on 15 July 2019 that the rulings would apply to all public service pension schemes. As a result each scheme is expected to produce its own solution to meet the implications of the two Judgements, but it is expected that these are likely to apply the same principles as the remedies for the judges and police schemes, which are possibly not expected to be developed until well into 2020/21 or 2021/22.

## **Financial impact in 2018/19**

In 2018/19, authorities were advised to consider whether the Judgements would have a material impact. To assist authorities in that assessment, the Government Actuary's Department (GAD) was commissioned to estimate the impact of the Judgements on the IAS19 liabilities within the LGPS based on a scheme-wide assessment. GAD reported 10 June 2019 that the impact would increase liabilities by between 0.1% and 3.0% of liabilities. It is worth noting that the GAD report was based on scheme-wide assumptions and was intended to be used by authorities to indicate whether they might have a material issue and, if so, follow up with their actuaries for a more detailed calculation.

In practice, the impact was significantly higher where:

- a significant proportion of the workforce for an employer was below age 40 – in this case there will be a greater impact on liabilities;
- there had been above average salary progression since 1 April 2014.

In addition for the unfunded police and firefighters pension schemes, the increase in the IAS19 liability was higher at 5-7%.

## **Legal obligation**

Para 6.4.3.1 of the Code of Practice on Local Authority Accounting in the United Kingdom 2019/20 requires authorities to account for post-employment benefits for Defined Benefit schemes where there is either a legal or a constructive obligation.

Whilst the regulations underpinning the LGPS, police and firefighters pension schemes have not been amended yet, the two tribunals clarify that a liability was owed under age-discrimination legislation giving rise to a legal obligation. Furthermore the 15 July 2019 announcement by the Chief Secretary to the Treasury that the McCloud and Sargeant Judgements would apply to all public service pension schemes creates a legal obligation. Therefore for 2019/20 the IAS 19 valuation of post-employment benefit liabilities in all three schemes should take into account the impact of the McCloud and Sargeant Judgements.

## Valuing the obligation

As details of the remedy for the schemes has not been drafted this creates a lot of uncertainty about the basis for valuing the impact of the Judgements on the pension schemes. Nonetheless estimation needs to be undertaken by actuaries based on the membership profile of the scheduled or admitted body, rather than the scheme or Fund as a whole. Therefore when commissioning IAS19 valuations, RFOs should be engaging actuaries to provide materially accurate valuations using assumptions specific to each body, the body's membership profile and the body's own materiality level.

At present, it is clear that all members of the schemes who fell outside the transitional arrangements for all three schemes at the relevant transition date will need to have their benefits brought up to the level of members in their scheme who were protected under those arrangements. However, it is unclear about what else will be in scope of the revised schemes. Areas of uncertainty include:

- Transfers within and between schemes and funds;
- Impact on survivor benefits which may have started since the transition date;
- Impact on pension sharing on divorce liabilities since the transition date.

## Accounting

Where authorities had included the impact of the McCloud/Sargeant judgements in the 2018/19 IAS19 liability, then changes in the liability arising from changes in assumptions in 2019/20 should be treated as an actuarial gain/loss within remeasurement of the defined benefit liability (asset) and reported in Other Comprehensive Income and Expenditure within the Comprehensive Income and Expenditure Statement (CIES) in the 2019/20 statement of accounts (see Code paragraph 6.4.3.2(d)(i)).

However where authorities had not amended the IAS19 reporting in 2018/19, inclusion of an allowance for the impact of the McCloud/Sargeant judgements will be the recognition of a past service cost and reported within the surplus/deficit on the provision of services in the CIES in the 2019/20 statement of accounts (see Code paragraph 6.4.3.2(c)(ii)).

In addition, practitioners should consider the need to disclose information about the basis of estimation of the IAS 19 liabilities with reference to the McCloud/Sargeant Judgements where these might have a significant risk of material adjustment to the carrying amount of the IAS 19 liabilities (see Code paragraph 3.4.2.90).

## Events after the reporting period

As previously noted, the timetable for changes to the legislation for each of the three schemes is uncertain. However, it is expected that proposals to provide a remedy for the uniformed firefighters and police schemes may be drafted this summer, which may be after 31 March 2020, but before the accounts are authorised for issue.

Paragraph 3.8.2.11 of the Code states that "published statements of accounts shall reflect events after the reporting period up to the date the accounts were authorised for issue". Therefore practitioners, particularly at fire and police authorities, should keep developments of the pension schemes under review. If changes to any of the schemes are proposed which could materially affect the figures disclosed at the reporting period, practitioners should consider the need to account for an event after the reporting period in accordance with section 3.8 of the Code.

The Code specifies the following authorised for issue dates for each of the territories in the UK:

Territory	Relevant Statutory Provisions	Authorised for issue	Date
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England	The Accounts and Audit (England) Regulations 2015	The date of confirmation by the RFO before the Statement of Accounts is approved by members	31 July
Wales	The Accounts and Audit (Wales) Regulations 2014, as amended in 2018	The date of certification by the RFO before the Statement of Accounts is approved by members	15 September
Scotland	The Local Authority Accounts (Scotland) Regulations 2014	The date of certification by the Section 95 officer immediately after the Annual Accounts are approved by the authority (or an audit committee or equivalent).	30 September
Northern Ireland	The Local Government (Accounts and Audit) Regulations (Northern Ireland) 2015	The date of certification by the CFO before the Statement of Accounts is approved by members	30 September

## Conclusion

In view of the uncertainty over the scope of the possible changes to the police, firefighters and local government pension schemes and to provide consistency of reporting, RFOs are advised to commission IAS19 liabilities to take account of the McCloud and Sargeant Judgements to the extent that these restore the pension rights of scheme members who fell outside the transitional arrangements for each of the schemes at the transition date.

The view is that this will probably account for the majority of any increase in the liabilities arising from changes to the schemes arising from the two Judgements and that the uncertainties about what else might change is unlikely to have a material impact on the IAS19 valuations for 2019/20.

Practitioners should also consider the need to account for an event after the reporting period if changes to any of the schemes are proposed which could materially affect the figures disclosed at the reporting period before the accounts are authorised for issue.

As the scope of the remedies takes shape over the coming months, then assumptions will be revisited in 2020/21 and successive years.