Waverley Borough Council Pool

LGPS accounting obligations under IAS19: Summary of key changes to 31 March 2021 balance sheet

Purpose and scope

This paper has been commissioned by and is addressed to Waverley Borough Council Pool ("the Employer"), who participate in the Local Government Pension Scheme (LGPS) as an employer within the Surrey Pension Fund ("the Fund"). Its purpose is to assist the Employer and its directors / auditors in their understanding of the impact of key changes to the Employer's IAS19 disclosures, as at 31 March 2021. This paper should not be shared beyond the Employer and its auditors – see the "Reliances and Limitations" section below.

This paper relies on, and should be read in conjunction with, the Employer's IAS19 Results Schedule (as at 31 March 2021), the Accounting Covering Report (as at 31 March 2021), the Fund's 2019 Funding Valuation Report and the Employer's individual 2019 valuation Results Schedule (where applicable). In particular, the key purpose of the Accounting Covering Report is to further help auditors and employers understand the methodology, data and assumptions used in preparing the accompanying Results Schedule. Some key audit topics to highlight are:

- RPI reform in Section 4;
- Recent court cases impact (e.g. GMP equalisation, McCloud, Goodwin) in Section 5;
- IAS19 amendments and Cost Cap in Section 6.

Summary of results

The Employer has recently been provided with their IAS19 Results Schedule as at 31 March 2021, which details their current LGPS pension obligations within the Fund. These results are summarised below:

Closing balance sheet as at	31 March 2021	31 March 2020
Assets (£000)	131,786	102,772
Obligations (£000)	211,610	168,418
Net Liability / Asset (£000)	(79,824)	(65,646)

The key changes over the period that have impacted the above balance sheet movement are discussed below.

Key changes over the period

The Employer's IAS19 balance sheet reconciliation disclosure comprises three sections:

- Profit & Loss account (P&L)
- Cashflows
- Other Comprehensive Income (OCI)

P&L and Cashflows

The P&L includes the approximate Employer share of the cost of benefits accruing ('Current service cost') and interest costs over the period. These figures are prepared using the assumptions at the start of the accounting period and should be broadly in line with the projections made in the Employer's 2020 IAS19 report (unless pensionable payroll over the year has proved to be markedly different to last year's estimate).

Please note, any changes in financial assumptions over the period (as discussed under 'OCI' below) have had no impact on this year's P&L, however they will impact next year's P&L, as per the projected pension expenses section of the Employer's Results Schedule.

Where the Employer experienced any unreduced early retirements (and these were notified to us by the Fund), the estimated impact of these events is contained in the P&L as a 'Past service cost'.

Where the Employer has requested allowance of any bulk transfers **out** or **in** of staff, the estimated impact of these events is contained within the P&L (as 'Effect of settlements') or within the Cashflows (as 'Effect of business combinations and disposals') respectively.

Where the Employer has experienced early retirement(s) and/or bulk transfers ('events') over the period, we have not remeasured the P&L at the date of these events, as noted in the IAS19 Plan Amendments Appendix in the Employer's Results Schedule.

Cashflows are as provided by the Fund on behalf of the Employer or estimated where noted.

The Employer's cost of benefit accrual ('Current service cost') will typically be higher than the cash contributions paid by the Employer over the period (unless the Employer is paying significant Secondary contributions or funding towards a low risk exit basis). All else being equal, this results in a worsening of the balance sheet position. Further details on the key differences between funding and accounting assumptions are set out on page 3.

OCI

Apart from the above, the impact of the change in the closing balance sheet position has been largely driven by changes in the OCI, specifically:

Change in financial assumptions (c.£39,910k **loss** on the balance sheet)
The assumptions adopted for preparing the Employer's latest accounting disclosures are summarised below:

Period ended	31 March 2021	31 March 2020
Pension Increase Rate (CPI)	2.85%	1.90%
Salary Increase Rate	3.75%	2.80%
Discount Rate	2.00%	2.30%

The approach to setting these accounting assumptions at 31 March 2021 is set out in the Covering Report. If the Employer would like to explore the options available to them and the possible impact of adopting alternative assumptions to those stated above, please contact us at LGPSCentralAccountingTeam@Hymans.co.uk.

The change in financial assumptions adopted for period ending 31 March 2021 can be approximately broken down as follows:

Pension Increase Rate – Market derived CPI inflation has risen over the period, which has led to a 0.95% increase in this assumption. This has served to increase the Employer's obligations and led to a loss of around £27,720k on the balance sheet.

The change in the CPI inflation assumption is a result of underlying changes in market implied RPI, coupled with a change in the derivation of the CPI assumption from the previous year (due to the government's RPI reform announcements in November 2020). The breakdown of the impact of these components is as follows:

1 Market implied RPI has risen over the period, which has led to a 0.5% increase in this assumption. This has served to increase the Employer's obligations and led to a loss of around £14,560k on the balance sheet.

2 The derived gap between RPI and CPI reduced since the previous accounting period, which has led to a 0.45% increase in the pension increase assumption. This has served to increase the Employer's obligations and led to a loss of around £13,160k on the balance sheet.

Salary Increase Rate – the salary increase assumption has risen over the period by 0.95% in line with CPI inflation (as above), which underpins the Fund’s standard salary increase assumption. This has served to increase the Employer’s obligations and led to a loss of around £2,500k on the balance sheet.

Discount rate – The corporate bond yield (upon which the discount rate is derived) has fallen over the period, which has led to a 0.3% reduction in this assumption. This has served to increase the Employer’s obligations and led to a loss of around £9,690k on the balance sheet.

Changes in demographic assumptions (c.£2,210k **loss** on the balance sheet)
As noted in the Results Schedule, the longevity assumptions have changed from the previous accounting period to reflect the latest available mortality improvement tables. This update has served to increase the Employer's obligations and led to a loss of around £2,210k on the balance sheet on the balance sheet.

Other experience (c.£1,850k **gain** on the balance sheet)
‘Other experience’ captures any adjustments made to the rollforward approach to allow for actual experience over the period. In the year immediately following a triennial funding valuation this item can be large as three years of actual membership experience flows through the accounts. However, in years 2 (which is the period the Results Schedule covers) and 3 following the funding valuation, the rollforward calculations do not make allowance for actual experience other than those noted below.

Actual pension increase order – The actual PI order for April 2021 was 0.5%, which is lower than the pension increase rate assumption of 1.90% built into the obligations at the start of the accounting period. The impact of applying this lower increase assumption for serves to reduce the obligations by the order of 1%.

Unfunded pensioners – Where the Employer has unfunded pensioners (as noted in the Results Schedule) and experienced more (less) unfunded pensioner deaths over the period, this will give rise to a (typically small) experience gain (loss) on the balance sheet.

Return on assets excluding amounts included in net interest (c.£27,930k **gain** on the balance sheet)
Any excess return (over and above the expected accounting return, i.e. the discount rate at the start of the accounting period) is recognised in the OCI. The total investment return achieved by the Fund over the accounting period was 29.6%, compared to an expected accounting return of 2.30%, which led to a gain of around £27,930k on the balance sheet.

Funding versus accounting assumptions

The actuarial assumptions adopted by the Fund for funding purposes are different to those prescribed for preparation of accounting disclosures. In particular, the funding discount rate (future investment return) assumption is currently higher than the discount rate adopted for accounting purposes. All else being equal, this places a higher value on pension obligations when using the accounting assumptions compared to the funding assumptions. This means that, for the average LGPS employer, their accounting balance sheet will be worse than their funding position.

It is important to note that cash contribution requirements are set by the Fund with reference to the Employer's funding position only; the accounting position does not affect the cash contributions the Employer needs to pay to the LGPS.

Next steps

We recognise the difficulties that the specialist nature of pension disclosures can cause once a year and would be happy to arrange a 3-way call with the Employer and their auditor to discuss this paper in greater detail and answer any further questions they may have on alternative assumptions advice or to assist with preparation of their year-end accounts. Please let me know if this would be beneficial.

Reliances and limitations

This paper has been prepared for Waverley Borough Council Pool for the purpose described above. It has not been prepared for use for any other purpose and should not be so used. The paper should not be disclosed to any third party except as required by law or regulatory obligation or with our prior written consent; however, it can be shared with the Employer's auditor. We accept no liability where the paper is used by or disclosed to a third party unless we have expressly accepted such liability in writing. Where this is permitted, the paper may only be released or otherwise disclosed in a complete form which fully discloses our advice and the basis on which it is given. This report proportionately complies with Technical Actuarial Standard TAS 100 (Principles for Technical Actuarial Work).

Craig Alexander FFA

15 April 2021

For and on behalf of Hymans Robertson LLP