Skills
Funding
Agency

Accounts Direction Handbook

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October 2010

This Handbook is of interest to principals and chief executives of colleges, finance directors at colleges, financial statements auditors, directors of funding bodies, local authorities and other key organisations in the learning and skills sector.

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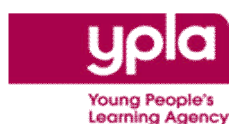

Accounts Direction Handbook 2009/10

Addendum - October 2010

We set out below an update on a small number of areas to inform the completion of 2009/10 college financial statements and external audits. These reflect issues which were subject to further discussion/clarification at time of the original issue of the 2009/10 Accounts Direction Handbook (ADH) in May 2010 or deal with emerging developments since that date.

Enhanced pension (EPP) spreadsheet use and disclosures

The EPP spreadsheet was written as the CPI change issue was arising and with the intention of replicating the previous format of the spreadsheet. In the CPI version, the resulting change in net liabilities was described as a STRGL movement but as the Handbook itself discusses, many EPP provisions are derived from previous restructuring rounds and as such could be deemed to be termination related benefits and accounted for under FRS 12. As such the movement in the provision would be taken through the I&E account in full and no part would be reported in the STRGL.

The disclosures of key assumptions for the EPP in Casterbridge College also use terminology which is not directly related to that found in the spreadsheet.

Disclosure requirements for assumptions:

(m) the principal actuarial assumptions used as at the balance sheet date, including, where applicable:

(i) the discount rates;

(ii) the expected rates of return on any assets of the scheme for the periods presented in the financial statements;

(iii) the expected rates of salary increases (and of changes in an index or other variable specified in the formal or constructive terms of a scheme as the basis for future benefit increases);

(iv) retirement healthcare cost trend rates; and

(v) any other material actuarial assumptions used.

The discount rate would fall under i) and inflation would fall under iii). It is usual to see discount and inflation disclosed however as the discount and inflation rate can be obtained from the interest rate and net interest rate:

Discount rate = Interest rate

Inflation = Interest rate less Net Interest rate

The mortality tables used were the S1A tables with year of birth and a 95% scaling factor, with a medium cohort improvement and a 1% per annum minimum improvement rate:

Expected Life Expectancy for someone aged 65 in 2009:

Males	21.73
Females	24.50

Expected Life Expectancy for someone aged 65 in 2019:

Males	22.71
Females	25.47

The above data are provided to assist colleges in making the appropriate disclosures in their accounts regarding key financial and other assumptions underpinning provision and for no other purpose.

Impact of the change to CPI for future pension increases

UITF Draft Abstract Information Sheet 90 was issued on the 13 October and is available online. Responses are requested by 10 November. The Final Abstract is envisaged to be published before the end of 2010 and will be the final determinant as to the accounting treatment required it is hoped.

The CFDG is considering issuing guidance around the accounting for the change that will arise from the draft Abstract and the BUFDG ASG has already issued an early form of that to its members. The whole subject is one of widespread debate without a clear consensus on the issues including the timing of recognition and the obligation to change.

The draft Abstract proposes that where there is a change in the obligation to the member, there is a benefit change which is accounted for as a past service cost. Where the obligation to the member is not changed, any change in the Scheme liabilities arises from a change in assumptions applied to measure those liabilities. The key to the accounting is whether there is a change in the members' obligation.

The UITF are proposing an approach that reflects the following:

- If the pension scheme rules/trust deed explicitly link pension increases to RPI and the scheme rules then change this to CPI, this should be treated as a change of benefit and any past service credit arising posted to I&E. This change should be recognised in the accounting period when necessary consultations have been concluded. Consultations are concluded when the change has been agreed and announced, likely to be 2010/11;

- If the scheme rules are silent on specifying an index but where there is a general presumption of an annual cost of living increase any change in measurement of inflation such as the change from RPI to CPI should be treated as a change of assumption with the credit taken through the STRGL;

- If the scheme rules are silent on specifying the index but where there is a constructive obligation to pay pension increases linked to RPI then the change to CPI should be treated as a change of benefit and any past service credit arising booked to I&E.

The key judgmental area therefore if the Abstract is finalised as drafted will be whether there is a 'constructive obligation' for the college to pay RPI for pension increases. The key clauses within the appendix to the draft Abstract that cover this are:

> *A9. The UITF noted that the distinction between changes in benefits arising when a trust deed is specifically linked to RPI, compared to changes in benefits with an unspecified measure of inflation, should be considered in terms of whether the obligation to the member is being changed.*
>
> *A10. The UITF noted that a constructive obligation to the member for pensions linked to RPI could exist where the RPI is not embedded into the trust deed but where associated literature made reference to the RPI or where the general understanding of scheme members was that increases would be calculated using the RPI. The nature of any constructive obligation to members could vary*

and would depend on a number of factors, including the nature and content of the communications with members.
Consideration would need to be given to whether any associated literature made reference to the RPI or whether the general understanding of scheme members was that increases would be calculated using the RPI. However, a feature of a constructive obligation would be that the agreement of scheme trustees and/or members would generally be needed before any change could be made.

Most if not all FE Colleges have their local LGPS as the main scheme for providing non academic retirement benefits. These schemes in turn have the same legislative origin and share the same rules to all intents and purposes. These clearly do not have an explicit link to RPI but instead refer to the Pensions (Increase) Acts of 1971 and 1974 which ultimately lead to the annual Pensions Increase (Review) Orders issued by Statutory Instrument (SI) around the end of the year. It is these SIs that use the RPI at 30 September each year and are intended to use CPI hereafter.

The same cannot be said for the pension scheme literature that accompanies the LGPS in each area and which may form a key source of evidence for determining whether a constructive obligation has been created.

For reference, the criteria for a 'constructive obligation' are set out in Paragraph 20 of FRS17 (and taken in turn from FRS 12) which states:

"Defined benefit scheme liabilities should be measured on an actuarial basis using the projected unit method. The scheme liabilities comprise:

(a) any benefits promised under the formal terms of the scheme; and
(b) any constructive obligations for further benefits where a public statement or past practice by the employer has created a valid expectation in the employees that such benefits will be granted."

As a result, each college will have to examine its own circumstances and draw a conclusion as to whether there is a constructive obligation or not and present that case to their auditors. What will be paramount is that whichever treatment is adopted, then the rationale for that treatment should be explicitly summarised in the accounts of the College. The auditors may also require the rational to be confirmed in their letters of representation.

With regards to the timing of the change, the Abstract notes that accounting treatment should be adopted with immediate effect (after finalisation). Paragraph 9 states that:

" *where Scheme liabilities are not linked to at least RPI an entity should use assumptions that reflect market expectations at the balance sheet date, in accordance with paragraph 23 of FRS 17. The ministerial announcements in July 2010,[for public sector schemes the announcement has made on 22 June 2010 as part of the Emergency Budget] will form a reasonable basis for a change in market expectations regarding inflation to be assumed in calculating pension obligations under FRS 17."*

This is interpreted to mean that the changes are to be incorporated into the 2009/10 accounts for LGPS schemes, with <u>no</u> reason to defer adoption until 2010/11. The timing of the issue of the Final Abstract will be critical here as it is likely to coincide with the majority of College Corporation meetings to approve accounts. Governors should be forewarned that the accounting treatment used in their own accounts may have to change before signatures are applied if the Abstract is published beforehand.

Suggested accounts disclosures

College should include the rationale within the pensions note, below the table where the gain is shown (if a STRGL movement)/as part of exceptional item note, or pensions note if not sufficiently material to be an exceptional item (if taken through I&E account). Additional disclosures/comments can be made in the OFR or elsewhere as the College considers appropriate.

Please note the suggested narrative below cover all options and will need amending depending upon:

- the type of scheme (LGPS or Occupational – June or July announcements)
- and whether the College is taking the credit to I&E account or to the STRGL

In [its June 2010 budget / July 2010], the Government announced that it intended for future increases in [public sector/ occupational] pension schemes to be linked to changes in the Consumer Prices Index (CPI) rather than, as previously, the Retail Price Index (RPI). The College has considered the [LGPS / College scheme name] scheme rules and associated members' literature and has concluded that [this change is a change in benefits and so has recognised the resulting credit in the Income & Expenditure account / as a result, a revised actuarial assumption about the level of inflation indexation should be made, with the resulting gain recognised through the Statement of Total Recognised Gains and Losses ('STRGL')]. At the date of these financial statements, the Urgent Issues Task Force (UITF) is in the process of consulting widely on the accounting treatment for this change and is expected to issue a final Abstract towards the end of 2010. Should the Abstract call for a different accounting treatment it may be necessary to reflect any change as a prior period adjustment in the financial statements for the following year.

Finance record entries

The Finance Record was not written with this kind of debate in mind and does not specifically allow for the varying treatments adopted to be disclosed separately. It is too late to issue a revised version to enable that so it is suggested that colleges either enter the CPI credit arising, in Schedule 2, Miscellaneous, Line 13c (cell D38) together with any other Past Service adjustments that may have arisen (to cover the I&E treatment) or in Line 13g (cell D42) Actuarial Gains/Losses together with any other gains and losses arising (where the STRGL route has been determined).

In order to reconcile the audited results to the reported position at Table 1, Line 18 (cell C36), colleges may need to enter the narrative to explain the difference (this will be the only occasion when it would be required) in cell D36. Where the Past service gain is coupled with Past Service costs for other reasons this year, Colleges may find it helpful to add that relevant narrative to Line 13c on Schedule 2, Miscellaneous (cell E38). Similarly where the Actuarial Gains and Losses line is used, an explanation of the main components should be added to the narrative cell E42.

Lennartz scheme adjustments accounting treatment

With the expected change in the standard rate of VAT applicable from 1 January 2011, colleges with Lennartz schemes in place will cet par find that the annual repayments will increase. Colleges should take independent professional advice as to the best course of action to deal with this scenario but will likely need to adjust the carrying value of the Lennartz creditor. The corresponding entry is currently believed to be a non cash addition to fixed assets to match the original asset capitalised, though some commentators argue that it is akin to a finance charge as HMRC now state that the balance is not VAT and therefore not irrecoverable VAT under FRS 15. Whichever approach is taken though, colleges should ensure it is clear in the accounts and Finance Record as to the reasoning and approach taken.

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