

REPORT TO GOVERNANCE & AUDIT COMMITTEE

REPORT OF: Head of Finance

REPORT NO: HOF 191

DATE: 15th March 2012

TITLE:	UNDERLYING ASSUMPTIONS TO BE USED TO CALCULATE IAS19 PENSION FIGURES IN 2011/12 STATEMENT OF ACCOUNTS	
KEY DECISION OR POLICY FRAMEWORK PROPOSAL:	None	
PORTFOLIO HOLDER: NAME AND DESIGNATION:	Cllr Mike Taylor Assets and Resources Portfolio Holder	
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INITIAL IMPACT ASSESSMENT:	N/A	Full impact assessment Required: N/A
Equality and Diversity		
FREEDOM OF INFORMATION ACT:	This report is publicly available via the Local Democracy link on the Council's website: www.southkesteven.gov.uk	
BACKGROUND PAPERS	None	

1. RECOMMENDATION

- 1.1 It is recommended that Governance & Audit Committee approve the IAS19 (International Accounting Standard 19) assumptions to be used in the production of the 2011-12 Statement of Accounts.

2. PURPOSE OF THE REPORT

- 2.1 The purpose of this report is to allow the Committee to consider the assumptions the pension fund actuary proposes to use in preparing the IAS 19 figures to be reported in the annual Statement of Accounts. It is an audit requirement that those charged with governance have the chance to consider these assumptions.

3. BACKGROUND

- 3.1 IAS19 - Employee Benefits is one of the financial reporting standards with which we must comply when producing our annual Statement of Accounts.
- 3.2 The basic requirement of IAS19 is that an organisation should account for retirement benefits when it is committed to give them, irrespective of when they are paid out.
- 3.3 To calculate the cost of earned benefits for inclusion in the Statement of Accounts, the scheme actuaries use certain assumptions to reflect expected future events which may affect the cost. The assumptions used should lead to the best estimate of the future cash flows that will arise under the scheme liabilities. Any assumptions that are affected by economic conditions should reflect market expectations at the balance sheet date.
- 3.4 SKDC will use the calculated costs and the underlying assumptions, based upon the advice of the actuary of the Lincolnshire County Council Pension Fund and the administering authority (Lincolnshire County Council), in preparing the annual Statement of Accounts.
- 3.5 A formal actuarial valuation is carried out every three years, the last being as at 31st March 2010. The figures produced for 31st March 2012 are estimates based on the last full actuarial valuation rolled forward and allowing for any change in the underlying assumptions.
- 3.6 Financial Assumptions for 2011-12

Price Inflation – this allows for the effect of inflation on salary growth. At 31st December 2011 this was 3.1%. (At 31st March 2011 it was 3.0%).

Pension Increase Rate –Public sector pension increases are now linked to the Consumer Prices Index (CPI) rather than the Retail Prices Index (RPI). In the current economic climate it is difficult to predict what rates will apply at 31st March 2012. At 31st December 2011 CPI was 4.2%, (31st March 2011 2.8%).

Salary Increase Rate – reflects the expected rate of growth in pensionable pay, allowing for increases over and above inflation, eg career progression. Due to the public sector pay restrictions put in place by the Government in summer 2010 this will be restricted to 1% until 2015. (At 31st March 2011 it was 1%). After 2015 the rate will revert to RPI plus 1% or 1.5% plus an allowance for promotional salary increases. Based on market conditions as at 31st December 2011, in 2015 this would be 4.1% or 4.6%, plus an allowance for promotional salary increases.

Expected Return on Assets – This reflects the interest earned and changes in values of the investments within the scheme and will be based on market values as at 31st March 2012. (At 31st March 2011 it was 7.5%). At 31st December 2011, the expected return on equities was 6.1% per annum

Discount Rate – this allows for the effect of inflation on the liabilities in the scheme. The assumption as at 31st December 2011 was 5.2%, (down from 5.5% at 31st March 2011).

All the calculations will be reviewed by the Actuary as at 31st March 2012 to confirm that there have been no material changes to the rates to be used over the three months since December, and to calculate final figures.

3.7 Demographic Assumptions

Pensioner Mortality – this impacts on the length of time pensions are expected to be payable. For the 2011/12 accounts the mortality assumptions are to be based on the same analysis used in 2010/11. At the present time, the life expectancy figures are not available, but will be calculated as at 31 March 2012.

Commutation – this allows for the effect of future retirees choosing to take a larger initial lump sum and reduced annual pension. As at 31st March 2011 the assumptions were 25% of members who joined the scheme prior to 1st April 2008 and 63% of members who joined since that date. These ratios are not expected to change for the 2011/12 accounts.

Other demographic assumptions are used e.g. Rates of withdrawal from the scheme, number of ill-health early retirements etc. These assumptions are based on past experience and will not change from those used in 2010/11.

3.8 Financial Impact

Appendix A shows the rates used as at 31st March 2011, the rates as at 31st December 2011, the direction of the movement to date and the impact of each of those movements on the Council's accounts.

The effect of the expected increase in the assumed inflation rate is likely to be a higher charge in the Council's Comprehensive Income & Expenditure Statement for the cost of future pensions. The charge for 2010-11 was £2.217 million.

The expected increase in pensions would lead to an increase in the liability on the balance sheet.

An decrease in the expected return on assets would also have a negative impact causing the pension liability on the balance sheet to increase from £22.549 million.

The reduction in the discount rate used to calculate the value of the liabilities will have the opposite effect of reducing the liability held in the balance sheet.

It is therefore possible that in the 2011/12 financial accounts, the annual charge made within the accounts will be higher than in 2010/11 and the liability on the balance sheet will increase. However, market conditions at 31st March 2012 could change dramatically and the impact on the accounts is therefore far from certain.

4. OTHER OPTIONS CONSIDERED

None.

5. RESOURCE IMPLICATIONS

All of the figures relating to IAS 19 are simply accounting adjustments made to comply with accounting standards and have no direct impact on resources. The amount charged to the General Fund Balance is the actual amount paid out in employers contributions and not the charge calculated in accordance with IAS19. The liability shown in the balance sheet is an estimate based on assumptions and would only ever become payable if the Council ceased as a going concern..

6. RISK AND MITIGATION (INCLUDING HEALTH AND SAFETY AND DATA QUALITY)

None.

7. ISSUES ARISING FROM EQUALITY IMPACT ASSESSMENT

None.

8. CRIME AND DISORDER IMPLICATIONS

None.

9. COMMENTS OF FINANCIAL SERVICES

Prior to the compilation of the statement of accounts for 2011/12 it is important that members of Governance and Audit Committee have the opportunity to discuss and comment on the underlying financial assumptions made by the actuary in respect of the Council pension fund. These assumptions, if agreed, will have an impact on both the comprehensive income and expenditure account and the balance sheet for the financial year 2011/12.

10. COMMENTS OF LEGAL & DEMOCRATIC SERVICES

Assumptions will be subjective. They are a forecast of what might happen within the year.

11. APPENDICES:

Appendix A - Financial Assumptions

APPENDIX A

IAS 19 ASSUMPTIONS FOR 2011/12 STATEMENT OF ACCOUNTS

<u>Financial Assumptions</u>	<u>Rate As At 31/03/11 (%)</u>	<u>Rate as at 31/12/11 (%)</u>	<u>Movement</u>	<u>Financial Impact</u>
Price Inflation	3.0	3.1	↓	Increase in charge for cost of future pensions
Pension Increase Rate	2.8	4.2	↓	Increase in liabilities
Salary Increase Rate	1.0	1.0	0	No change
Expected Return on Assets	7.5	6.1	↑	Increase in liabilities
Discount Rate	5.5	5.2	↓	Reduction in liabilities