HM Treasury

Public Expenditure System (PES)

[Edited by Monitor for use by NHS foundation trusts]

PES (2015) 08 2 December 2015

DISCOUNT RATES FOR POST-EMPLOYMENT BENEFITS, GENERAL PROVISIONS AND FINANCIAL INSTRUMENTS: ANNOUNCEMENT OF RATES

Background

1. The post employment benefit discount rate is used for two main purposes in financial reporting:

- **Unfunded public service pensions schemes** – valuing pension scheme liabilities, calculating the interest costs on the stock of pension scheme liabilities (the equivalent of unwinding the discount as existing liabilities roll forward one year); and calculating the current service cost (the cost of accruing liabilities).

- **Early departure provisions** – valuing early departure provisions and unwinding the discount on those provisions.

2. The general provisions discount rates are used to discount future cash flows related to provisions recognised in accordance with IAS 37.

3. The financial instrument discount rate is used for some financial instruments in accordance with the requirements of the Financial Reporting Manual.

4. This paper announces the change in these discount rates from 31 March 2016.

New rates to be applied as at 31 March 2016

Post-employment benefits

5. The discount rate for post employment benefits will change from 1.30 percent real to 1.37 percent real with effect from 31 March 2016.

6. The appropriate interest rate to be used in assessing interest costs of scheme liabilities for 2016-17 is 3.60 percent (see Annex A: *Financial assumptions based on market conditions as at 30 November 2015* for a list of all necessary figures and a comparison with prior year)

Superannuation Contribution Adjusted for Past Experience (SCAPE) and other discount rates

7. Various arrangements are in place for setting employer pension contributions (or ASLCs) in unfunded schemes that require a discount rate. Most of these arrangements are based on the

SCAPE methodology that uses a fixed real discount rate. These arrangements are unaffected by the discount rate used for IAS 19 purposes. Schemes and their actuaries should continue to use existing arrangements.

Local Authorities

8. This guidance does not apply directly to local authority schemes and the unfunded liabilities of police and fire authorities. Those schemes should follow guidance provided by CIPFA.

Funded schemes

9. The application of a discount rate based on returns from AA corporate bonds at 30 November each year will not apply to funded schemes within central government. In accordance with IAS 19, they should use a discount rate based on returns from AA corporate bonds at 31 March each year (or their financial year-end if different).

General provisions

10. There are three rates provided for general provisions:

Short-term rate: A real discount rate to be applied to the cash flows of general provisions in a time boundary of between 0 and up to and including 5 years from the Statement of Financial Position date.

Medium-term rate: A real discount rate to be applied to the cash flows of general provisions in a time boundary of after 5 and up to and including 10 years from the Statement of Financial Position date.

Long-term rate: A real discount rate to be applied to the cash flows of general provisions in a time boundary exceeding 10 years from the Statement of Financial Position date.

11. The real discount rates to be applied at 31 March 2016 to determine the net present values of provisions are:

Rate	**Real rate**
Short-term	-1.55%
Medium-term	-1.00%
Long-term	-0.80%

12. The change in discount rates could result in non-cash negative AME. In accordance with the Consolidated Budgeting Guidance this benefit cannot be used to fund genuine AME cash expenditure.

Financial Instruments

13. The real financial instrument discount rate is to be applied in accordance with Financial Reporting Manual's adaptation of IAS 39 and the Consolidated Budgeting Guidance in respect of financial transactions.

The FReM states:

Where future cash flows are discounted to measure fair value, entities should use the higher of the rate intrinsic to the financial instrument and the real financial instrument discount rate set by HM Treasury (promulgated in PES papers) as applied to the flows expressed in current prices.

14. The real financial instrument discount rate to be applied at 31 March 2016 is 0.7. The rate as applied to flows expressed in current prices is RPI + 0.7, where the financial instrument is index

linked to RPI. Where the financial instrument is not linked to an inflationary index, and a nominal rate is required, 3.7% may be used.

15. Non-cash gains or losses that score in budgets arising from this change (which is a change in estimation and not a change in accounting policy) should be scored to AME. Negative AME arising from the change cannot be used to fund cash AME expenditure or lending.

Annex A: *Financial assumptions based on market conditions as at 30 November 2015 related to post employment benefit discount rate*

Market conditions as at	30 Nov 2015	30 Nov 2014
Nominal discount rate	3.60%	3.55%
Rate of RPI inflation	3.20%	3.20%
Rate of CPI inflation	2.20%	2.20%
Discount rate net of CPI	1.37%	1.30%