HM Treasury

Financial Reporting Advisory Board

Local Government Pension Scheme audit issues

Issue:	Some departments are facing delays in finalising their accounts due to delays in the audit of the Local Government Pension Scheme (LGPS)
Impact on guidance:	No changes to the FReM are proposed at this time, but per the recommendation HM Treasury are proposing to issue an amended accounts direction to the Department for Digital, Culture, Media and Sport (DCMS) and the Ministry of Justice (MoJ) for FY22/23 and FY 23/24 as a temporary solution, and will explore a further more general amendment to the FReM.
IAS/IFRS adaptation?	Potential need for further amendment to pre-existing IAS 19 interpretation in the Financial Reporting Manual (FReM).
Impact on WGA?	Potential need for additional work to ensure pension scheme liabilities remain within the WGA boundary, if suggested approach agreed.
IPSAS compliant?	N/A.
Interpretation for the public sector context?	Potential need for further amendment to pre-existing IAS 19 interpretation in the FReM.
Impact on budgetary and Estimates regimes?	None.
Alignment with National Accounts	No impact on National Accounts.
Recommendation:	The Board supports HM Treasury issuing an amended accounts direction to DCMS and MoJ requiring them to account for obligations to the Local Government Pensions Scheme on a defined contributions basis for 2022-23 and 2023-24, aligning with the treatment for the Principal Civil Service Pension Scheme. The Board also agrees that HM Treasury should explore a further amendment to the FReM requiring that LGPS obligations should generally be accounted for on a defined contributions basis, with defined benefit obligations for the scheme reported at the WGA level.
Timing:	To impact 2022-23 Annual Report and Accounts.

DETAIL

Introduction

1. HM Treasury and the National Audit Office have a shared objective of meeting Parliament's desire for more timely financial reporting, achieving a return to the pre-COVID norm of laying before Summer Recess. For 2021-22, HM Treasury (HMT) has been encouraging departments to lay their Annual Reports and Accounts (ARAs) earlier than for the 2020-21 financial year.

2. Departments are expected to return to a normal pre-recess laying timeline for 2022-23 in order to meet Parliament's expectation for timely financial reporting. However, some departments are facing specific barriers to achieving this, which are beyond their control.

3. Delays in gaining assurances over pension liabilities in respect of the Local Government Pension Scheme (LGPS) are causing delays in audit completion, and are the principal remaining barrier to the Ministry of Justice (MoJ) and the Department for Digital, Culture, Media and Sport (DCMS) returning to pre-Summer Recess.

4. Recognising the value and importance of timely financial reporting to Parliament, HMT is proposing to issue an amended accounts direction for 2022-23 and 2023-24 to MoJ and DCMS as a temporary solution. The wider issues around auditing the LGPS and local government audit delays are expected to continue. HMT will also explore a more general amendment to the FReM allowing LGPS obligations to be accounted for using defined contribution accounting, with defined benefit obligations for the scheme recognised at the Whole of Government Accounts level.

Background to the LGPS audit issue

5. In 2021-22 delays to the audit of Local Government Pension Schemes has resulted in the delay to the laying and publication of the MoJ and DCMS annual reports and accounts.

6. MoJ and DCMS include a share of the LGPS liability in their Consolidated Statement of Financial Position as both have Arm's Length Bodies (ALBs) and agencies whose employees are part of the LGPS. In FY 20-21, MoJ recognised a c£2.4bn net pension liability (£7bn liabilities, £4.6bn assets) and DCMS recognised a £250m liability for LGPS obligations in their ARAs.

7. Annex 2, provided by the National Audit Office (NAO), lists those ALBs with LGPS obligations that are subject to NAO audit- including those in the MoJ and DCMS boundaries. However, it is not a complete list of all entities applying the FReM that have LGPS based obligations. It does not cover academy trusts or sub-components of the DHSC audit which are not audited directly by the NAO e.g. CCGs. It also doesn't include Environment Agency Pension Fund which is part of the LGPS.

8. The NAO has been actively engaging with the relevant audit firms to explore options for bringing forward assurances over relevant LGPS pension funds. Currently, capacity issues mean component auditors will not be able to bring forward the timetables for the necessary assurances for 2022-23, and it is unlikely that the position will improve in the short to medium term due to the ongoing impact of delays in the local government sector. In practice, the NAO are seeing delays in receiving assurances on 2021-22 audits when working to an agreed **post recess** timetable. If the delays caused by the LGPS persist, MoJ and DCMS will be unable to lay their accounts **pre-recess** for 2022-23, with the outlook for 2023-24 likely very similar.

9. The Department for Health and Social Care (DHSC) also has an interest in the LGPS as LGPS assurances are impacting audit completion for entities material to the DHSC group.

10. Academy trusts have an interest in the LGPS, with the net liability currently valued at £14bn per the Sector Annual Report and Accounts (SARA) 2019-20.[1]

11. Academy trusts are not currently facing delays in the preparation of their financial statements due to LGPS data inputs or assurances (as the Department for Education currently include LGPS balances in academy accounts at 31 August), but there are concerns in the sector that there may be delays in the future due to the increasing scale of academy trusts and complexity in the audit of the LGPS pension valuations.

12. The NAO have explored options within the audit market to resolve this issue. Alternative assurance options are limited by the fact that balances to be included in the accounts of central government entities are based on a percentage share of the relevant pension funds and cannot be separately identified or audited. On that basis, assurances need to be derived directly from the relevant pension funds. Options such as engaging the auditors appointed by the local authority fund to do a bespoke piece of work in advance which the NAO could then seek to rely on, or seeking access to perform work directly are therefore duplicative and / or unviable.

13. The departments affected and the NAO are therefore keen to explore other options with HMT, given the potential for the timetable issues to persist in the medium term in the absence of being able to audit the LGPSs in a timely manner.

Options already explored to date

14. HMT have engaged with the NAO, DCMS, MoJ, DHSC and the Department for Education (DfE) on this issue to discuss the best way forward and several options to resolve this issue have been considered.

15. The NAO have explored options within the audit market, such as engaging the auditors appointed by a local authority to do a bespoke piece of work in advance which the NAO could then seek to rely on, but this was considered unviable. This would involve agreement to consolidate the pension figures at a certain point in time and so would not reflect the position at the end of the financial year.

16. The potential for a limitation of scope opinion was also considered for 2022-23 to support a pre-recess timetable but is not favoured by departments or the NAO. In particular, the NAO have concerns that:

    - a decision to qualify by limitation of scope driven by the laying timetable is unusual and potentially precedent-setting as it reflects a management-imposed limitation of scope where a clear opinion could be achieved by taking the time needed to secure the information;
    - any limitation of scope would then recur until such time as timetables can be brought forward and would be outside the control of the audited entities; and

[1] Further Education (FE) colleges also participate in the LGPS. They are currently outside the scope of this amendment. However, the Office for National Statistics is reviewing the classification of FE colleges and if they were reclassified to central government, they would then be impacted by the amendment as well.

- arguments can be made that quality and timeliness of reporting could be better achieved through the proposals set out in this paper.

Proposed next steps

17. There are three options HM Treasury have explored with stakeholders:

    a) Issue an amended accounts direction to DCMS and MoJ only.

    b) Amend the FReM to account for LGPS schemes on a defined contribution basis rather than a defined benefit basis – to bring consistency across entities and with unfunded defined benefit schemes.

    c) Do nothing.

18. Under either Option A or Option B, the change in accounting for LGPS is expected to be implemented retrospectively under IAS 8.

Option A – Amended accounts direction to MoJ and DCMS

19. We have explored the option of whether to issue an amended accounts direction to MoJ and DCMS to provide a temporary solution. Under this option the amended direction would be limited to MoJ and DCMS. DHSC have other issues impeding the timeliness of their accounts laying for 2022-23, and currently LGPS obligations are not causing the same timeliness issues for academies.

20. The amended direction would permit them to use defined contribution accounting for their LGPS obligations in 2022-23 and avoid the assurance delays associated with defined benefit accounting.

21. The departments would be required to include appropriate disclosures in line with IAS 19 to provide users of the financial statements with information on the arrangements between the central government entities and LGPS and also where to find the relevant LGPS accounts.

22. This would bring MoJ and DCMS accounting for LGPS obligations more into line with the far more significant pension arrangements they have in respect of the Principal Civil Service Pensions Scheme (PCSPS). Under the FReM, IAS 19 is interpreted such that employers with employees in the Principal Civil Pension Scheme account for the scheme as a defined contribution plan. IAS 19 is also adapted to apply to the pension scheme themselves as well as employers. This results in the defined benefit obligation being reported in the Civil Service Superannuation Account, under the responsibility of the Cabinet Office, which has its own Supply Estimate and its expenditure is voted by Parliament. Were a defined benefit obligation to be recognised also in departmental accounts then, in effect, the same liability would be reported in two places and the associated expenditure would be voted for twice, which blurs accountability.

23. The amended direction would allow scrutiny of DCMS's and MoJ's core operational performance by Parliament in a timelier manner, which is more relevant and impactful.

24. The direction would be issued for the 2022-23 and 2023-24 financial years. The Treasury would keep the matter under close review. Any proposal to continue the direction beyond 2023-24 would return to the Board.

Option B – Amend the FReM

25. An alternative proposal would be to use an existing IAS 19 interpretation in the FReM, IAS 19 interpretation 1 (see Annex 1), to require all entities who follow the FReM to account for the LGPS as a defined contribution scheme rather than a defined benefit scheme.

26. An amendment in the FReM would apply to all central government departments with employees that are members of the LGPS. This will ensure that if in the future, central government employees move to the LGPS the amendment will apply to those departments as well. It would provide consistency of reporting across central government entities for the LGPS and provide more consistency with unfunded defined benefit schemes, like the Principal Civil Service Pension Scheme.

27. A change in the accounting treatment in the FReM for LGPS would affect the DfE Academies Sector Annual Report and Account (SARA) and so Academies would likely also be affected. DfE's preference would be for consistency between how the LGPS is accounted for in academy accounts and the SARA, which would require an amendment to the Academies accounts direction if this change was implemented in the FReM.

Option C – Do nothing

28. The final option considered was to take no remedial action now. Without action, both DCMS and MoJ are likely to miss the pre-recess deadline for laying their ARAs in 2022-23 and this could continue until the issues within the local government audit market are fully resolved, which will likely take several years.

WGA considerations

29. A consequence of requiring some, or all, departments to account for the LGPS as a defined contribution scheme would be that the consolidation process for the WGA is potentially made more complicated.

30. WGA currently accounts for the LGPS as a defined benefit scheme. Allowing central government bodies to use defined contribution accounting would not remove the requirement for WGA to present the defined benefit obligation.

31. The WGA will need to include the IAS 19 valuation of the LGPS balances for all relevant bodies, which would normally be recorded in the Consolidated Statement of Financial Position of each department.

32. Under either Option A or Option B, there will likely need to be a change introduced to WGA to ensure the LGPS liability is accounted for consistently and accurately. Options for this mechanism include the affected departments and bodies preparing separate WGA returns with defined benefit scheme valuations for their interest in the LGPS, or LGPS funds being designated and fully consolidated within the WGA boundary.

33. Any solution would need to be reviewed periodically as HMT recovers the WGA timetable to ensure that the timeliness issues faced at the departmental level do not simply move to the WGA level.

34. A potential advantage of Option A or Option B from a WGA perspective is that delays in departmental ARAs impact the production of the Whole of Government Accounts (WGA)—so improvements in timeliness could benefit general WGA timeliness.

35. If FRAB decide to pursue Option A or Option B, HM Treasury will further explore the most appropriate solution for WGA accounting for LGPS obligations and will revert to FRAB if needed.

Conclusion and Recommendation

36. The proposed solution to these delays should strike the appropriate balance between the merits, in themselves, of different financial reporting treatments for public sector pension schemes, and the quality implications of untimely reporting.

37. The central government treatment for the LGPS differs from that of certain unfunded pension schemes, such as PCSPS, which are accounted for as defined contribution plans. For the user of central government accounts this arguably gives undue prominence to the LGPS scheme obligations, when at the level of the reporting entity, the way LGPS and PCSPS schemes obligations are managed are broadly consistent.

38. In some instances, there is a balance to strike between the highest quality financial reporting and publishing financial statements in a timely manner to be of the most use to Parliament and to hold departments to account.

39. Since this is the principal remaining barrier to MoJ and DCMS realistically achieving pre-Summer Recess in 2022-23 we **recommend Option A**.

40. HM Treasury does not yet have enough information to determine whether Option B is on balance merited, nor to conclude what the optimal approach under Option B would be to ensure a timely WGA publication that includes LGPS defined benefit obligations. We will return to the Board with further consideration of this option in due course.

Recommendation: The Board supports HM Treasury issuing an amended accounts direction to DCMS and MoJ requiring them to account for obligations to the Local Government Pensions Scheme on a defined contributions basis for 2022-23 and 2023-24, aligning with the treatment for the Principal Civil Service Pension Scheme. The Board also agrees that HM Treasury should explore a further amendment to the FReM requiring that LGPS obligations should generally be accounted for on a defined contributions basis, with defined benefit obligations for the scheme reported at the WGA level.

Annex 1

FReM excerpt

IAS 19 Employee benefits	
Adaptations	(1) The requirements of IAS 19 are to apply to the accounts of the pension schemes themselves as well as to the reporting entities and reportable activities covered by the requirements of the FReM. This includes relevant disclosure requirements. (IAS 19 para 3) (2) In the financial statements of the pension schemes only, contributions from employer and employees are to be shown as income in the statement of comprehensive net expenditure rather than as, respectively, a credit to the pension liability or a deduction from the current service cost. As a consequence, the pension liability will not reflect contributions.
Interpretations	(1) Employers whose employees are members of the pension schemes listed in paragraph 12.1.1 (including the NHS superannuation scheme) shall account for the scheme as a defined contribution plan. (2) IAS 19 requires the present value of defined benefit obligations and, if applicable the fair value of the plan's assets to be determined with sufficient regularity that the amounts recognised in the financial statements do not differ materially from those determined at the reporting period date. This shall be interpreted to mean that the period between formal actuarial valuations shall be four years, with approximate assessments in intervening years. The results of the actuarial valuations may not necessarily feed into the annual report and accounts in the same financial year due to timing differences; instead, entities must ensure the IAS 19 para 58 requirement of amounts recognised being materially correct is met. Acceptable approximations shall include adjusting full valuation results using the latest available membership data. (IAS 19 para 58) (3) The application of a discount rate advised annually by HM Treasury will not apply to funded schemes within central government. Reporting entities with funded schemes should use a discount rate in accordance with IAS 19 as advised by the scheme's actuary. (IAS 19 para 83) (4) Where a central government entity has a share of a local government (or other) pension scheme liability on its statement of financial position, then that entity will use a discount rate determined by the appropriate authority in valuing its share and not the rate advised annually by HM Treasury. (IAS 19 para 83) (5) Voluntary early retirements under scheme rules will be discounted at the pension’s rate and not at the provisions rate

12.1.1 This first section of this chapter deals with pensions accounting by employers, whether they are reporting entities or preparing the financial statements of reportable activities covered by this Manual. The second section deals with pensions accounting by the following public sector pension schemes:

- Principal Civil Service Pension Scheme (PCSPS)
- Alpha Pension Scheme
- Armed Forces Pension Scheme (AFPS)
- NHS Superannuation Scheme
- Teachers' Superannuation Scheme
- United Kingdom Atomic Energy Authority Superannuation Schemes
- Judicial Pension Scheme
- Department for International Development – Overseas Superannuation Scheme
- Research Councils' Pension Scheme
- Northern Ireland DoF Superannuation and Other Allowances
- Northern Ireland HSC Pension Scheme
- Police Service Northern Ireland Pension Scheme
- Northern Ireland Teachers' Superannuation Scheme
- Scottish NHS Superannuation Scheme
- Scottish Teachers' Superannuation Scheme
- Royal Mail Statutory Pension Scheme

Annex 2

The following entities are the components directly audited by the NAO which contain and are called LGPS balances.

This listing therefore does not include entities like academies or CCGs that are not directly audited by the NAO. The listing also captures components only and therefore not the departmental group that these are consolidated into (where this occurs).

Fund	Firm	Departmental group	Audit	Has the audit been certified for 2021-22 as at 4.11.22?	Options available to address the LGPS issue
City of Westminster Pension Fund	GT	DLUHC	Homes England	Yes	FReM or accounts direction
		DLUHC	The Housing Ombudsman	No	FReM only could not use accounts direction
		DLUHC	Regulator of Social Housing	No	FReM or accounts direction
Greater Manchester Pension Fund	Mazars	DHSC	CQC	No	FReM or accounts direction
		MoJ	HMPPS	No	FReM or accounts direction
		DCMS	Science Museum Group	No	FReM or accounts direction
London Pension Fund Authority	GT	DCMS	British Film Institute	No	Accounts preparation is SORP or Companies, cannot be addressed through FReM or AD
		DCMS	English Institute of Sport	No	Accounts preparation is SORP or Companies, cannot be addressed through FReM or AD
		N/A	Food Standards Agency	No	FReM or accounts direction
		DLUHC	Local Government Ombudsman (Commission for Local Administration)	No	Entity can choose preparation basis.

		DCMS	Sport England	No	FReM only could not use accounts direction
		DCMS	UK Anti-Doping Limited	No	Accounts preparation is SORP or Companies, cannot be addressed through FReM or AD
		DCMS	UK Sport	No	FReM only could not use accounts direction
		HMRC	Valuation Office Agency	No	FReM or accounts direction
		DLUHC	Valuation Tribunal Service	No	FReM or accounts direction
		DCMS	Geffrye Museum (Museum of the Home (MOTH) Trust)	No	Accounts preparation is SORP or Companies, cannot be addressed through FReM or AD
	EY	DHSC	Care Quality Commission	No	FReM or accounts direction
	Mazars	DHSC	Care Quality Commission	No	FReM or accounts direction
		MoJ	CAFCASS	No	FReM or accounts direction
		Defra	Seafish Industry Authority	No	FReM or accounts direction
Kent Pension Fund	GT	DfT	Ebbsfleet Development Corporation	No	FReM or accounts direction