FRAB (151) 07
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Financial Reporting Advisory Board Paper

Treatment of local government pensions within health accounts

Issue:	Delays in local auditors certifying local government pension scheme accounts is causing delays to a very small number of local health body accounts. Due to how assurance flows up in the Departmental group, this causes disproportionate delays to national and Departmental accounts. This paper proposes changing the accounting for these schemes in health accounts, with recommendations for disclosure requirements. The change would be reflected in the DHSC Group Accounting Manual (GAM) via a late update to 2023/24.
Impact on guidance:	The GAM applies the principles of the FReM for the DHSC Group
IAS/IFRS adaptation?	The GAM follows the adaptations and interpretations in the FReM. The proposal in this paper would be departure from the FReM which is immaterial to the Departmental accounts.
Impact on WGA?	The matter is immaterial to the Departmental accounts so no adverse impact on WGA is anticipated.
IPSAS compliant?	N/A
Interpretation for the public sector context?	The GAM follows the adaptations and interpretations in the FReM. The proposal in this paper would be departure from the FReM which is immaterial to the Departmental accounts.
Impact on budgetary regime?	No impact. The budgetary regime already treats such schemes as if they were defined contribution schemes.
Alignment with National Accounts – ESA 10?	No impact. The national accounts already treats such schemes as if they were defined contribution schemes.
Impact on Estimates?	N/A
Recommendation:	FRAB is asked to approve this amendment to the GAM.

DETAIL

Background

1. The Department of Health and Social Care (DHSC)'s Group Accounting Manual (GAM) incorporates the requirements of the Financial Reporting Manual (FReM) for DHSC group bodies, interprets them as appropriate, and provides additional guidance relevant to the NHS. It is subject to approval by FRAB each year.

2. The GAM requires NHS bodies to treat defined benefit pension schemes where their share of assets and liabilities can be identified as defined benefit schemes under IAS 19, meaning that the pension assets and obligations are included on the balance sheet. This is consistent with the FReM.

3. Delays in local government pension scheme audit opinions means that where pension assets are material to the local NHS body / DHSC arms-length body (ALBs) accounts, this delays the audit opinion for the NHS body / ALB which consequently delays national accounts and reporting to Parliament.

4. At FRAB 148 in November 2022 HM Treasury presented a paper exploring amending the treatment of local government pension schemes in certain central government accounts due to similar delays and made recommendations on the treatment in the accounts of certain government departments. That paper argued there was benefit in bringing those departments' accounting for local government pensions more into line with the arrangements they have under the Principal Civil Service Pensions Scheme (PCSPS). For this paper we acknowledge the difference between LGPS interests and the NHS pension scheme (treated in the same way as PCSPS) and do not seek to equate them. This paper sets out a rationale for a proposal based on weighing up the importance of timeliness in financial reporting.

Assurance flows and size of issue

5. Local NHS provider accounts are subject to external audit by an audit firm. These accounts are submitted to NHS England who prepare the consolidated NHS provider accounts which is subject to audit by the National Audit Office (NAO). The consolidated provider accounts are a significant component to the DHSC group accounts, also audited by the NAO.

6. Until a local NHS provider audit is signed by the auditor (and associated group reporting provided to the NAO), the NAO have no assurance over any part of those accounts. Therefore even where the affected pension numbers are small in the context of national materiality, the entirety of the local body's accounts are unaudited. If these entities are then material to the consolidated provider accounts and there are no suitable alternative procedures possible, the NAO cannot issue its audit opinion on the consolidated provider accounts. While the consolidated provider accounts group remains unaudited, the DHSC group accounts also cannot be finalised.

7. These delays to NHS entity accounts with such local government pension interests did not arise prior to three years ago. Audit firms tell us the reason for the change is a combination of (1) expanded audit work on pensions following regulatory challenge, (2) delays in pension

fund accounts being signed off consistent with wider delays in local government accounts preparation and audit, and (3) firms having a changed approach to risk management which has reduced the appetite for early assurance reporting between firms.

8. We have tentatively explored alternative options to break this link. One potential option would be for an affected trust to account for the pension scheme off balance sheet and take qualified accounts on the basis of implementing an accounting policy that is not consistent with the GAM. A discussion at the Public Accounts Committee on 16 March 2023 included the PAC expressing potential acceptance of such an approach. This approach has been tested with an impacted NHS foundation trust and they were rightly concerned about the implication of qualified accounts given the CFO's professional responsibilities, together with how this might be perceived by users of financial statements and other stakeholders regardless of how this is described and therefore not receptive to this proposal.

9. We have also explored whether there could be additional audit reporting, based on group reporting principles in commercial group audits where the auditor issues earlier reporting to a higher materiality to support national group accounts in advance of a later full audit opinion (for an additional fee). The audit firm did not express a desire to explore this option.

10. Total expenditure in the DHSC group accounts is £129 billion (2022/23 numbers). Total operating expenditure in the consolidated provider accounts is £121 billion, comprising 212 NHS provider organisations. Total gross assets in the consolidated provider accounts is £89 billion. Within this, there are 14 providers with on-balance sheet pensions, with total gross assets of £233 million: being 0.26% of total gross assets. At some of these 14, the pension assets and obligations are locally immaterial. The total charge recognised in the statement of comprehensive income for on balance sheet pensions is £9 million. Total employer contributions in year (2022/23) are £4 million. While this is not charged to expenditure under IAS 19, it does illustrate the relative size of pensions in relation to the wider entities: £4m is equivalent to 0.003% of consolidated providers' operating expenditure.

11. However, due to the assurance flows described in paragraph 6, this has a disproportionate impact on financial reporting timeliness for the entire group. Taking one provider as an example with gross pension assets of £61 million, this is above local materiality. The deadline for audited NHS accounts for 2022/23 was 30 June 2023. The local auditor received assurance from the pension fund auditor in October 2023 and the Trust auditor finalised its opinion at the start of November 2023. The Trust has gross income and expenditure of £1.7 billion and gross assets of £0.6 billion. As such the Trust's income and expenditure is individually material to the consolidated provider accounts, and its balance sheet comprises a significant portion of national materiality which presents a challenge to finalising the consolidated provider accounts and therefore the DHSC group accounts. Other affected trusts' accounts are still awaited.

Evaluating the issue

12. We have no reason to believe that any of the matters described in paragraph 7 that are contributing to this delayed financial reporting are going to change in the immediate future. We therefore need to evaluate whether relatively small transactions and balances arising from local government pensions delaying national reporting to Parliament is the right thing.

13. It is noted that the national accounts, following the European System of Accounts (ESA) standards and the budgeting framework, treat such pensions based on their cash cost and so recognise the employer contributions in expenditure rather than charges on an IAS 19 basis. NHS England's oversight of providers treats pensions consistently with this: this recognises that the NHS body has no control over the actuarial numbers that arise, these arise at the very end of the financial year, cannot be planned for, and does not reflect the operating performance of the entity. However, it is not for the Department or NHS England to judge the usefulness of IAS 19 application: as adopters of IFRS we accept that IAS 19 reporting of pensions represents the best quality of financial reporting.

14. The IFRS Conceptual Framework sets out the characteristics of useful financial reporting. One of these characteristics is timeliness. DHSC has given commitments to the Public Accounts Committee to bring forward the publication of the DHSC group accounts. However, given the circumstances set out in this paper, this would not be possible before November in any given year, some four months after the Summer Parliamentary recess that is the aim for central government accounts. It is DHSC and NHS England's view that this does not strike the correct balance between financial reporting quality and timeliness, given the relatively small balances and transactions that on-balance sheet pensions represent for the NHS and DHSC group and the limited management control over the impact on local accounts.

15. Delays in financial reporting also affect local accountability and local NHS bodies making their accounts available to users. For two affected NHS foundation trusts, due to delayed assurance on local government pensions the local auditors expect to finalise the 2022/23 accounts opinion in December 2023. This is six months later than the NHS accounts deadline of June 2023, delaying local reporting to governors and other stakeholders. This means that not only are accounts opinions delayed, but wider local audit reporting such as the use of resources conclusion and recommendations are delayed, which delays accountability and entities' opportunity to take action.

Proposal

16. FRAB approval is sought for a change in accounting treatment in the GAM to depart from the FReM and require NHS bodies with interests in local government pension schemes to account for them on the basis of the current cost to the entity; that is, recognising the employer contributions in expenditure as incurred. We will adapt the relevant parts of IAS 19 paragraph 148(d) on disclosures for plans treated as if they were defined contribution schemes to form mandatory disclosures in the audited accounts To support the provision of information to users, in addition we would also require preparers to include, where material, the most recently available actuarial information within the annual report, marked as not subject to audit. This will give information on the entity's applicable portion of scheme assets, obligations and net surplus/deficit but not subject to audit therefore not delaying audit sign off of the accounts. As part of this proposal DHSC will ask HM Treasury to give an equivalent direction to DHSC for its accounts as a derivation from the FReM. The impact on the whole of government accounts would be highly immaterial as set out above. We consider that this provides useful information to users but in a way that is proportionate given the balances involved, both locally and nationally.

17. If accepted, this would be applied in the GAM from 2024/25 and applied to 2023/24 as a mid-year update. This proposal will be consulted upon as part of the 2024/25 GAM consultation that will take place in early 2024. This would then be a relevant part of plans to bring 2023/24 national financial reporting in health to be more timely and meet DHSC's commitments to Parliament.

18. The proposal in this paper is not time limited; it is proposed as a permanent change. However it is intended that this would be kept under review: if the circumstances in paragraph 7 were to change such that full IAS 19 accounting would no longer be a material delay to financial reporting, we would undertake to consult FRAB on reversing this change. We will also feedback to FRAB on the nature of the responses received on the proposal in the GAM consultation.

19. FRAB is asked to approve the proposal outlined in paragraph 16. Subject to that approval, FRAB will see further detail in the GAM that is presented for comment and approval to FRAB in March.