

Meeting of the Group Audit and Risk Committee

4.00 pm on Tuesday, 6 October 2020
in MS Teams

Agenda

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19.	Pension assumptions appendices: <ul style="list-style-type: none">• LPFA July 2020 Briefing note• Accounting Glossary and FAQs	3 - 36	RF

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FRS102/IAS19 Glossary and FAQs

The purpose of this note is to provide LGPS Fund employers and their advisers with some further explanatory details about the reports we produce in accordance with Financial Reporting Standard 102 (FRS102) and International Accounting Standard 19 (IAS19).

It is divided into a glossary of terms followed by some frequently asked questions (FAQs). Where certain terms are explained in more detail in the glossary these are highlighted in **bold**.

A topical briefing note discussing assumptions and an indication of the likely trend in results is also issued after each of the main accounting dates. In contrast, this briefing note describes the fundamentals of the accounting standards and is only expected to be updated occasionally (e.g. when the standards change). Please get in touch if you would like a copy of any of these notes.

If you have any questions please get in touch with the Fund in the first instance.

Background

Sponsors of defined benefit pension schemes are required to account for the cost of providing retirement benefits and reserve for any outstanding liabilities associated with the schemes they sponsor. They are also required to make certain disclosures about these schemes in the notes to their accounts.

FRS102 and IAS19 are accounting standards that set out the accounting treatment for retirement benefits. For UK listed companies and local authorities IAS19 applies; for other UK entities FRS102 applies. Companies with overseas parents may need to make disclosures under other standards.

A key feature of both standards is the requirement for liabilities to be valued using a discount rate assumption set with reference to yields on "high quality" corporate bonds.

It should be noted that the actual contribution rates required by employers for each Fund are calculated every three years following a triennial actuarial valuation and these are calculated using assumptions set by the Fund Actuary. The discount rate assumption in particular is generally set with reference to expected future investment returns of the Fund unlike the accounting standards which value the liabilities using solely the yields on corporate bonds.

Therefore, the contribution rates paid by employers are not affected by the accounting results.

Glossary of terms

Included in this section:

- [Actuarial gains & losses](#)
- [Administration expenses](#)
- [Change in demographic assumptions](#)
- [Change in financial assumptions](#)
- [Contributions by employer including unfunded](#)
- [Current service cost](#)
- [Curtailment](#)
- [Defined benefit obligation](#)
- [Demographic assumptions](#)
- [Discount rate](#)
- [Duration](#)
- [Interest cost](#)
- [Interest on assets](#)
- [Net interest on defined liability](#)
- [Past service cost](#)
- [Present value of defined benefit obligation](#)
- [Re-measurements](#)
- [Return on assets less interest/ Return on Fund assets in excess of interest](#)
- [Service cost](#)
- [Settlement](#)
- [Term](#)
- [Unfunded benefits](#)

Actuarial gains & losses

This item reflects the extent to which the movements of the assets and liabilities over the accounting year have not been as assumed at the previous accounting date, and also the effect on the liabilities of changes to the assumptions used to value them.

The components of the actuarial gain or loss on assets are:

- the difference between the actual investment return on the assets over the year, and the interest on assets, plus
- an experience item, if applicable.

The components of the actuarial loss on liabilities are:

- the effect of the change in assumptions used to value the liabilities compared to the previous year, plus
- an experience item, if applicable.

There is a requirement to split the change of assumptions into those of a financial nature (discount rate, assumed future inflation growth etc.) and those of a demographic nature (future mortality rates etc.).

For more details on experience items, please see the ["Gains and Losses"](#) section of the FAQs.

Administration expenses

Both accounting standards require the administration expenses to be recognised when the administration services are provided and to be reported as a separate item in the Profit and Loss (P&L) statement.

Note that this does not include expenses in relation to investment management as this is incorporated in the Return on Fund assets.

Change in demographic assumptions

This shows the impact on the value of the liabilities of any changes in the demographic assumptions since the previous accounting date. More detail is provided on what is included in demographic assumptions is detailed in the [Demographic assumptions](#) section.

The same demographic assumptions may be adopted between triennial funding valuations and so there may not be a change in demographic assumptions item each year.

The demographic assumption which is most likely to have an effect on the value of liabilities are the assumptions in relation to mortality i.e. how long members will live.

For example, when changes in mortality assumptions results in a decrease in the life expectancy of members this will result in a decrease in the value of liabilities. This is because the term that members are expected to live in retirement would be shorter so less benefits will be paid.

Change in financial assumptions

This shows the impact on the value of the liabilities of any changes in the financial assumptions since the previous accounting date.

Financial assumptions reflect market conditions at the accounting date and so are likely to change each year.

The assumptions which have the most significant impact on the value of liabilities are the discount rate and the assumed rate of pension increases.

If the assumed [discount rate](#) is higher than at the previous accounting date this will result in a decrease in the value of liabilities. Conversely, if the assumed rate of pension increases is higher than at the previous accounting date this will result in an increase in the value of liabilities.

Contributions by employer including unfunded

This is the total value of the contributions paid by the employer to the Fund including the normal contributions in respect of benefit accrual by active members, contributions towards any deficit and any early retirement strain contributions. If **unfunded benefits** (usually pensions in payment) are paid through the Fund and are to be included in the accounting report, then payments in respect of unfunded benefits are included here as well.

For more information on the inclusion of **unfunded benefits**, please see the [“Do I need to include unfunded benefits on my balance sheet?”](#) section of the FAQs.

Current service cost

The **current service cost** represents the cost to the employer of the benefits earned by active members during the accounting year calculated on an FRS102/IAS19 basis. This is added to the liabilities and is not the same figure as the employer contributions paid to meet these 'new' benefits. It is calculated using assumptions at the start of the accounting year which means that it is not a fixed percentage of payroll and it is expected to vary from year to year as assumptions change.

Under both standards this is a component of the **Service cost** in the P&L.

Curtailement

These will typically be the FRS102/IAS19 equivalent of early retirement costs. The actual strain payments to the Fund are calculated by the administering authority using a different set of assumptions and so the calculation of this amount under FRS102/IAS19 is unlikely to be the same as the strain payment cash amounts.

Under both standards the loss on these is a component of the **Service cost** in the P&L.

Defined benefit obligation

This is the value of the past service liabilities, calculated using service to the accounting date (estimated where necessary) and allows for several assumptions such as future increases to salaries, future mortality rates, future inflation rates etc. The key assumption used to calculate these liabilities is the discount rate.

Discount rate

Pensions and lump sums will be paid at some point in the future and so a rate known as the **discount rate** is used in order to express these expected future payments as a single current value.

It is analogous to a rate of interest; to illustrate this, if we put £100 into a savings account today, it is expected to grow with interest every year to become a higher amount in the future. Similarly, if we are aiming to have £100 at a future date then we only need deposit a smaller amount now which will accumulate with interest to give £100 later.

A higher **discount rate** means that the future payments have a smaller value now i.e. a lower pension liability.

The accounting standards prescribe that the **discount rate** should be based on market yields at the reporting date of a 'high-quality corporate bond' of equivalent currency and **term** to the scheme liabilities.

The discount rate can be derived using a number of different approaches. The current Barnett Waddingham approach is to use the Single Equivalent Discount Rate (SEDR) method which replaced the spot rate approach. For more information please see the ["What is the difference between the Single Equivalent Discount Rate \(SEDR\) and Spot rate approach for deriving the discount rate?"](#) section of the FAQs.

Duration

When we talk about the **duration** of the liabilities we mean the average time to payment of benefits. This is used interchangeably with the **term** of the liabilities.

Demographic assumptions

These are the assumptions used to generally provide estimates of the likelihood of benefits and contributions being paid and for how long. This consists of all the non-financial assumptions used to value the liabilities including the mortality assumptions (i.e. how long members are likely to live for), the rates of members retiring early and the rate at which members exchange pension for cash at retirement.

The same demographic assumptions may be adopted between triennial funding valuations, however, if there are changes in an employers' membership, or the population as a whole, it may be appropriate to review demographic assumptions.

Interest cost

Over the accounting year the existing pension benefits come closer to payment than they were at the start, and so the value of the liabilities increases as a year's worth of interest is added on. This forms part of the **net interest on defined liability** (in the P&L).

Interest on assets

The expected return on assets has been replaced with an interest on assets item which is calculated with reference to the **discount rate**. It is therefore based solely on the expected returns on corporate bonds. This forms part of the **net interest on defined liability** (in the P&L).

Liabilities

These are also referred to as the **defined benefit obligation**.

Net interest on defined liability

The accounting standards assume that assets increase in line with the **discount rate**. This is combined with the **interest cost** on liabilities to form the net interest on the defined liability which is a component of the P&L.

Past service cost

Additional benefits granted during the accounting year give rise to a **past service cost**, for example, an employer decision to award additional service to a retiring employee.

Under both standards this is a component of the **Service cost** in the P&L.

Present value of defined benefit obligations

This is also referred to as the past service liabilities. This is the value of the benefits accrued by all members to date, calculated using service to the accounting date and allows for several assumptions such as future increases to salaries, future mortality rates, future inflation rates etc. The key assumption used to calculate the value of these liabilities is the **discount rate**.

Re-measurements

Re-measurements are recognised in Other Comprehensive Income and is effectively the total of the **actuarial gains and losses** from the changes in the assets and liabilities over the accounting period. This will include the investment return on the assets in excess of interest, change in assumptions (financial and demographic) as well as any experience adjustments. More detail about this is in the "[Gains and Losses](#)" section of the FAQs.

Return on assets less interest/ Return on Fund assets in excess of interest

This item is the investment return on Fund assets above (or below) that which was assumed at the previous accounting date. The investment return on Fund assets is net of investment management expenses and is provided in the 'Assets' section of your report. Under IAS19 and FRS102 the interest/assumed return on assets is the discount rate assumed at the previous accounting date.

If the return on Fund assets is higher than the discount rate assumed at the previous accounting date this will result in an actuarial gain. Conversely, if lower than the discount rate this will result in an actuarial loss.

The magnitude of this item will be dependent on how much the actual return on Fund assets differs from the discount rate at the previous accounting date.

Service cost

Service cost is a component of the P&L and includes current service cost, past service cost and any actuarial gains or losses on settlements and curtailments.

Settlement

A **settlement** will generally occur where there is a bulk transfer of members in to or out of the Fund or an employer's share of the Fund. The **settlement** loss or gain reflects the difference between transferred asset share, and the value of the transferred liabilities when calculated on an FRS102/IAS19 basis. This value may be different when compared to figures calculated for non-accounting purposes due to different assumptions being used.

Under both standards this is a component of the **Service cost** in the P&L.

Term

Please see definition of **duration** above.

Unfunded benefits

Unfunded benefits are pensions arising from additional service awarded on a discretionary basis e.g. Compensatory Added Years (CAY) pensions. Such benefits are usually charged to the employer as they are paid. Other **unfunded benefits** include gratuities and enhanced teacher's pensions which are recharged to the employer, and pensions in respect of some other public sector pension schemes.

This is in contrast to funded pensions, which are paid for out of the assets of the Fund, and which the employer has responsibility for funding by paying contributions to the Fund.

Frequently asked questions (FAQs)

Included in this section:

- [How are my assets calculated?](#)
- [What is the Defined Benefit Obligation and how is this calculated?](#)
- [Do I need to include unfunded benefits on my balance sheet?](#)
- [What is the difference between assumptions for an ongoing funding valuation and an accounting valuation?](#)
- [What is the difference between the Single Equivalent Discount Rate \(SEDR\) and Spot rate approach for deriving the discount rate?](#)
- [Why is the inflation assumption different to current inflation levels?](#)
- [How much scope is there for 'tweaking' the assumptions?](#)
- [Why is the current service cost different from the contributions paid?](#)
- [Why is the current service cost different from the previous year?](#)
- [What if the reported contributions paid are different to the actual contributions paid?](#)
- [How are settlements/curtailments/past service costs treated under IAS19?](#)
- [What is an experience gain or loss?](#)
- [What does actual less expected return on Fund assets mean?](#)
- [Why is there an experience gain or loss on the assets?](#)
- [Why is there an experience gain or loss on the liabilities?](#)
- [What is the change in assumptions?](#)
- [What is the impact of the recent GMP equalisation ruling?](#)
- [Does the McCloud judgement have any impact on LGPS liabilities?](#)
- [Is the Projected unit method being used?](#)
- [How are Investment expenses allowed for?](#)
- [What checks are carried out on the data underlying the calculations?](#)

Balance sheet

How are my assets calculated?

The assets shown are an estimate of the employer's notional share of the total Fund assets at the accounting date. A full assessment of each employer's asset share is made at each triennial valuation. For interim FRS102/IAS19 reporting the approach is to take the asset share at the start of the accounting year and roll this forward to allow for the employer's own cashflows to and from the Fund during the year and actual (or estimated) Fund returns.

Thus, the employer's asset share is not a fixed percentage of the Fund and is expected to vary over time.

The assets will change from year to year: increasing with contributions paid into the Fund and investment returns earned; and decreasing as benefits (such as lump sums and pensions) are paid out of the Fund.

More details on how we calculate employers' assets can be found in the below [Appendix](#)

What is the Defined Benefit Obligation and how is this calculated?

The Defined Benefit Obligation is the accounting label for what is usually known as the value of the pension liabilities of the employer. The pension liabilities are the promised benefit payments (e.g. pensions, lump sums) due in the future from the Fund to its members. The Defined Benefit Obligation is the value of these liabilities calculated using a set of assumptions on an FRS102/IAS19 basis, which includes how these payments will increase over time both before and after retirement, how long they will be paid out for (i.e. how long each member is likely to live for) and the **discount rate** to apply to them to give a current value.

The Defined Benefit Obligation depends on the amount of the benefits so will increase as benefits are accrued and reduce as benefits are paid out. The value will also increase or decrease as the assumptions used to calculate their value change. For example, if the **discount rate** assumption decreases, the Defined Benefit Obligation will increase. Therefore, even if your assets have performed well, if the Defined Benefit Obligation increases at a rate faster than the assets increase, then the deficit on the balance sheet will increase.

Do I need to include unfunded benefits on my balance sheet?

Unfunded benefits may be paid through the Fund and recharged to the employer.

FRS102 and IAS19 both state that all retirement benefits should be accounted for when the member earns the benefit and not when it is paid by an employer. Therefore when a member retired and was awarded **unfunded benefits** the value of all future payments should have been taken into account at the point of retirement. This value would generally be expected to reduce over time as the benefits are paid out.

We can only value unfunded benefits that we are aware of and usually these will be those that are paid via the Fund.

Assumptions

What is the difference between assumptions for an ongoing funding valuation and an accounting valuation?

Contributions payable by employers are derived using the assumptions from the ongoing funding valuation and this is essentially the purpose of the ongoing valuation. An accounting valuation is prepared to meet statutory disclosure requirements and is included in the employer's annual accounts. Therefore, the purposes are different.

The results from the two valuation types can be significantly different due to the different assumptions used.

The assumptions adopted for an ongoing funding valuation are set by the Fund Actuary following discussion with the administering authority and in line with the LGPS Regulations. Broadly, they are set with reference to the long-term expected cost of providing LGPS benefits and take into account the investment strategy of the Fund and the expected return on each asset class that the Fund invests in.

In contrast, FRS102 and IAS19 are fairly prescriptive accounting standards which aim to allow employers' pension obligations to be compared with each other.

Generally, the demographic assumptions used for both valuations are the same and determined every three years as part of the ongoing triennial valuation. The main area where funding valuations for our Funds and accounting valuations differ is in the derivation of the **discount rate**.

For ongoing valuations, the **discount rate** adopted is based on the expected investment return of the assets actually held by the Fund. For FRS102/IAS19, the **discount rate** is required to be determined with reference to the market yield on 'high quality' corporate bonds and with consideration of the **duration** of the employer's liabilities. Generally, corporate bond yields will be lower than the return assumed for an ongoing valuation as the Fund is likely to invest in a mixture of assets include higher return seeking assets such as equities and property. Therefore we would expect that employers' costs and liabilities under FRS102/IAS19 to be higher than those calculated in an ongoing funding valuation if the **discount rate** used is lower.

However, it is important to note that the accounting position has no bearing on the amounts that the employers actually pay into the Fund, this being determined with reference to the ongoing funding position with contributions being reviewed every three years as part of the triennial valuation.

What is the difference between the single equivalent discount rate (SEDR) and spot rate approach for deriving the discount rate?

The spot rate is derived by looking at each employer's projected cashflows and determining the duration of these cashflows – broadly speaking the number of years until the average benefit payment is made. The duration is typically 15-20 years. We would then take the annualised Merrill Lynch AA rated corporate bond yield curve and look up the yield at that duration on the curve.

The single equivalent discount rate or SEDR approach has been developed over the last few years. Under this approach, rather than discount future cashflows with a single **discount rate** equal to the spot rate on the yield curve, this approach estimates the single equivalent rate that would produce the same liability as discounting each individual projected cashflow using a yield curve for AA rated bonds. So we use the 1 year yield to discount cashflows in year 1, the 2 year yield for cashflows in year 2 and so on and then see what liability value is then generated and then work out what single equivalent discount rate gives you the same answer.

Depending on the shape of the yield curve, what curve you use in the first place, the bonds underlying that curve and how you fit the curve to the data points, you are unlikely to get the same discount rate under each approach although the difference should not usually be that significant.

In our view either of these approaches satisfy the requirement of paragraph 85 of IAS19 as indeed would some other alternatives. Given the nature of the wording in IAS19, and as with most assumption setting processes, there is no singularly "correct" approach.

We have taken a similar approach to the derivation of the inflation assumption which we refer to as the single equivalent inflation rate (SEIR). For more information please see ["Why is the inflation assumption different to current inflation levels?"](#)

Why is the inflation assumption different to current inflation levels?

The current level of inflation that is widely reported each month is a measure of how prices have increased in the recent past, usually over the last year. However, in order to project cashflows to and from the Fund over the future lifetime of the Fund, we are interested in what inflation will do in the future and therefore we have to make an assumption about expected future levels of inflation over the long term. We do this by using information published by the Bank of England.

Similar to the SEDR approach, the SEIR adopted is such that the single assumed rate of inflation results in the same liability value (when discounted using the yield curve valuation described above) as that resulting from applying the BoE implied inflation curve.

How much scope is there for 'tweaking' the assumptions?

One of the objectives of FRS102 and IAS19 is to ensure that organisations all account for pension costs on a consistent market-related basis so there is not intended to be a huge amount of scope to deviate away from typical market assumptions. We do provide a recommended set of assumptions but the employer is ultimately responsible for the assumptions that are adopted.

One key area in which the employer can exercise more control is the assumption about future levels of pay increases and they will have more knowledge of likely future pay awards for their staff.

Pension costs

Why is the current service cost different from the contributions paid?

Contributions are required from the employer to meet the cost of the benefits being earned by current employees, and to pay off any past service deficit. Minimum contributions are certified when a new employer joins the Fund and then again at each triennial valuation. These certified contributions are calculated using assumptions made at each valuation and reflect, amongst other things, the return assumed to be earned by the assets actually held by the Fund.

The **current service cost** in FRS102/IAS19 only includes the employer cost of benefits being earned by current employees and does not include the cost of paying off any past service deficit. The assumptions used for FRS102/IAS19 are usually different to those used for the triennial valuation. In particular, the **discount rate** is prescribed by FRS102/IAS19 and is unlikely to reflect the Fund's actual asset allocation. This means the **current service cost** calculated for FRS102/IAS19 is likely to be different to the cost covered by the certified minimum contributions.

Why is the current service cost different from the previous year?

The **current service** cost is the cost of benefits accrued over the period based on the assumptions at the start of the period i.e. the assumptions at the previous accounting date.

Therefore this will be affected by:

- the difference in the assumptions adopted at the previous accounting date compared to the assumptions adopted at the accounting date preceding the previous accounting date; and
 - the change in payroll over the accounting period compared to that over the previous accounting period.
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What if the reported contributions paid are different to the actual contributions paid?

The discrepancy may be because cashflows for less than the full twelve months were provided in order to enable us to produce figures in the timescales required. We can revise the disclosure to take account of the actual contributions paid but we recommend that you agree with your auditor that this is necessary on the grounds of materiality.

How are settlements/curtailments/past service costs treated under IAS19?

On 7 February 2018, the International Accounting Standards Board (IASB) issued amendments to the IAS19 standard which now requires that when determining any past service cost or gain or loss on settlement that the net defined benefit liability is remeasured using current assumptions and the fair value of plan assets at the time of the event. This applies for all accounting periods starting on or after 1 January 2019.

Common events for LGPS employers that this amendment may apply to include outsourcings, academy conversions and unreduced early retirements.

The amendment complicates the accounting disclosure as additional calculations are required to determine the cost before and after each event, and to rebase the standard roll forward approach on updated assumptions based on each event date. The amendment does, however, note that the extra remeasurement does not need to be applied where the application of that remeasurement is immaterial. The assessment of materiality will be subject to each employer and auditor's discretion. We can provide additional information to help assess materiality but we cannot conclude whether an event is material or not. If relevant, the employer should also consider any guidance in relation to this set out by The Chartered Institute of Public Finance & Accountancy (CIPFA) in its *Code of Practice on Local Authority Accounting in the United Kingdom 2019/20* note.

Our default approach for IAS19 reports will be to assume that all events are material and therefore will adopt the approach set out in the IAS19 amendment. If the employer does not want to treat all the events in this way then we would strongly recommend the employer reviews the events with their auditor in advance of the preparation of their report.

Please note that there is no explicit requirement to treat events in such a way under the FRS102 standard and therefore our standard approach for FRS102 reports is to not remeasure at each event date but we would be happy to treat differently as required.

Gains and losses

What is an experience gain or loss?

The first accounting report prepared following a triennial valuation includes an experience item. Accounting reports are prepared each year using a number of estimates and approximations in the roll-forward process on both the assets and the liabilities. This experience adjustment is essentially a correction of the estimates made in the previous accounting reports leading up to the triennial valuation.

What does actual less expected return on Fund assets mean?

The "expected" return on the Fund assets for a year is simply based on the **discount rate** assumption at the start of the year. If actual Fund returns, net of investment management expenses, have been higher than the **discount rate** assumption this figure will be positive but if they were lower this will be negative.

Why is there an experience gain or loss on the assets?

To determine the employer asset share for an accounting report we are provided with various pieces of financial information, including contributions received, benefits paid and a recent total Fund value. These cashflows may only be for part of the accounting year, and the total Fund value may be at a date earlier than the accounting date. This total Fund value will not be a fully audited number and is unlikely to be exactly accurate. We pro rata the cashflows if necessary to get full year numbers, and roll forward the assets with market returns to get an estimate of the asset value as at the accounting date.

However, at a triennial valuation we do get full cashflow data for each year and actual audited Fund asset values. We then determine each employer's asset share accurately at the triennial valuation date and the experience item emerges as the difference between the three years' worth of estimated rolled-forward assets and the accurate figure. At the triennial valuation we may also adjust employer assets if necessary to take into account any transfers or outsourcings that may not have been resolved in time to be included in the relevant accounting years.

Why is there an experience gain or loss on the liabilities?

To determine the value of the employer liabilities for an accounting report we roll forward the results from the most recent funding valuation, using the financial and demographic assumptions set for accounting purposes.

Therefore, after each triennial valuation we recalculate the accounting liabilities using up to date membership data and results. An experience item emerges as the difference between the actual experience of the members of the Fund, and the experience that had been assumed for them in the previous accounting reports. For example, if members died earlier than assumed this will result in an **actuarial gain** as the liabilities will be lower than estimated in the roll forward, or if members received higher than assumed salary increases then there will be an **actuarial loss** as the liabilities will be higher than estimated.

What is the change in assumptions?

This is a combination of the impact on the value of the liabilities due to any changes in the financial and demographic assumptions since the previous accounting date. See the [change in demographic assumptions](#) and [change in financial assumptions](#) sections above for more detail.

What is the impact of the recent GMP equalisation ruling?

It is our understanding that HM Treasury have confirmed that the judgement “does not impact on the current method used to achieve equalisation and indexation in public service pension schemes”. More information on the current method of equalisation of public service pension schemes can be found [here](#).

On 22 January 2018, the Government published the outcome to its *Indexation and equalisation of GMP in public service pension schemes* consultation, concluding that the requirement for public service pension schemes to fully price protect the GMP element of individuals’ public service pension would be extended to those individuals reaching State Pension Age (SPA) before 6 April 2021. HM Treasury published a Ministerial Direction on 4 December 2018 to implement this outcome, with effect from 6 April 2016. Details of this outcome and the Ministerial Direction can be found [here](#).

Our valuation assumption for GMP is that the Fund will pay limited increases for members that have reached SPA by 6 April 2016, with the Government providing the remainder of the inflationary increase. For members that reach SPA after this date, we have assumed that the Fund will be required to pay the entire inflationary increase. Therefore we do not believe we need to make any adjustments to the value placed on the liabilities as a result of the above outcome.

Does the McCloud/Sargeant judgement have any impact on LGPS liabilities?

The recent Court of Appeal judgment on the McCloud and Sargeant cases, relate to age discrimination against the age-based transitional provisions put into place when the new judicial pension arrangements were introduced in 2015. The members argued that these transitional provisions were directly discriminatory on grounds of age and indirectly discriminatory on grounds of sex and race, based on the correlation between these two factors reflected in the judicial membership. The Tribunal ruled against the Government, deeming the transitional provisions as not a proportionate means of achieving a legitimate aim.

The Government subsequently applied to the Supreme Court to appeal the judgement but their application was denied on 27 June 2019. On 16 July 2020, the Government published a consultation on the proposed remedy to be applied to LGPS benefits in response to the McCloud and Sargeant cases. The consultation closes on 8 October 2020 and the final remedy will only be known after the consultation responses have been reviewed and a final set of remedial Regulations are published.

The Scheme Advisory Board, with the consent of MHCLG, had commissioned GAD to report on the possible impact of the McCloud case on LGPS liabilities – in particular those liabilities to be included in local authorities' accounts under IAS19 as at 31 March 2019. This followed the April 2019 CIPFA briefing note which said that local authorities should consider the materiality of the impact. GAD have now issued their report dated 10 June 2019, which is intended to help authorities assess that materiality.

The potential cost of the judgement on the liabilities is very much dependent on the membership profile of the employer and assumed future salary increases. For example, for an employer who has a high proportion of active members (and very few deferred and pensioner members), and a salary increase assumption of CPI + 1.5% p.a. the outcome of the McCloud judgement could increase the employer's liabilities by around 3% according to the GAD analysis. However, for an employer with a small proportion of active members and a salary increase assumption equal to (or less than) CPI, the impact of the McCloud judgement is likely to be negligible.

We have taken the view to include an allowance for the McCloud judgement as a default unless an employer chooses to opt out.

Is the Projected unit method being used?

We use the Projected unit method in our calculations.

How are Investment expenses allowed for?

Investment expenses are included in the estimated return on fund assets. Therefore, the 'Return on assets less interest' element of the asset reconciliation and includes allowance for Investment expenses.

This is not included in 'Administration expenses' and are therefore not contained within in the Profit and Loss statement but is included in the Re-measurements in other comprehensive income.

What checks are carried out on the data underlying the liability calculations?

One of the key items of data underlying our calculations is the member data used for the starting point of the liability roll forward. The member data is generally that from the most recent actuarial valuation and therefore has been passed through a vigorous data checking process as part of the valuation. As the member data has been sufficiently cleansed for the purpose of the actuarial valuation, we believe it is also reasonable for the purpose of the accounting roll forward. The key checks carried out on the data include:

- Consistency of static member data items (such as sex and date of birth) to previous valuation
- Consistency of changeable member data items to previous valuation. For example:
 - Reasonable change in salary for active members
 - Reasonable level of accrual for active members
 - Deferred and pensioner member pensions have increased as expected based on LGPS pension increases
- Reconciliation of employer membership to ensure that all previous members accounted for (or no longer in data as expected) and new members look reasonable

Appendix 1 Employer asset allocation

One of the most common questions we are asked by employers is how their asset amount has been calculated. This short paper sets out exactly how we do this and is aimed at both employers and their advisers.

Notional assets

Assets are not separately held for each employer; the Fund holds assets in respect of all the employers in the Fund and each employer has a notional share of these assets. For example, the contributions an employer makes into the Fund are not paid into a separate employer account and invested independently, but are paid into the Whole Fund along with all other employers' contributions and invested as a whole. However, they are taken into account when calculating a notional asset figure for actuarial valuations and employer work.

Asset Calculation – Actuarial Valuations

Assets are fully re-apportioned at each triennial funding valuation. To do this for an employer, we accumulate the notional market value of assets from the previous funding valuation with respect to the Fund's returns from the published accounts. We also allow for the cashflows in respect of the employer which include employer and employee contributions, pensions and retirement lump sums paid, and transfers in and out etc. If we know the exact date of the cashflow then we allow for this in our calculation, otherwise we assume the cashflow occurs halfway through the year. This will include any notional transfers within the Fund between the employers, even though no actual cash has been paid into or out of the Fund.

We also adjust the assets by a smoothing factor to be consistent with our measurement of the liabilities. We essentially look at the asset value over each day for the six month period around the valuation date (based on published market indices) and take the average.

Asset Calculation – Accounting valuations

In order to calculate asset values for accounting valuations, the starting point is the most recent valuation and the process is then similar to the above but may involve approximations. For example, if the Fund's actual returns have not yet been calculated for any period, we will calculate the notional return based on suitable market indices.

We use the estimated market value for FRS102 and IAS19 calculations therefore no smoothing factor is applied.

Auditor views

Auditors continue to look for greater accuracy in the roll forward approach used to calculate employers' results. This includes the approach used to determine each employer's share of fund assets at the accounting date.

Given the tight timescales for employers to submit their final accounts we appreciate that it is not always possible to wait until a fund's net asset statement at the accounting date is available to begin producing accounting disclosures. As a result, we request details of funds' assets at the most recent date available and, for the remaining period, we assume that returns are in line with relevant market indices.

In order to reduce the chance of having to revise any reports we recommend that employers engage with their auditors and the administering authority of the fund as early as possible to ensure they are comfortable with the information being used to calculate results.

Accounting reporting as at 31 July 2020

Employer briefing note post-accounting date

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Accounting reporting as at 31 July 2020

A number of LGPS employers, in particular universities and colleges, prepare accounting disclosures as at 31 July each year and these may be in accordance with the IAS19 or FRS102 standard, depending on the employer.

Some universities also get disclosures using the US FAS standard which are produced using the same data and assumptions as the FRS102/IAS19 disclosures but have a different presentation and involve a different allocation of pension costs between the various parts of their accounts. This note is only in relation to the main FRS102/IAS19 results.

This note outlines some of the changes to the key financial assumptions that are used in preparing the IAS19 and FRS102 accounting numbers since the last reporting date as well as information on asset performance over the period.

This note complies with Technical Actuarial Standard 100: Principles for Technical Actuarial Work (TAS 100).

Unless requested otherwise, we prepare our reports based on our standard approach. We therefore recommend employers discuss this note with their auditors to check that the standard approach is appropriate.

How has the accounting position changed?

Prior to the year-end we provided a note setting out the intended derivation of our assumptions and possible outcomes using market conditions at 31 May 2020. As we have now passed the year-end, we can now provide our final conclusions based on market conditions at 31 July 2020.

As LGPS Funds are usually invested in a range of asset classes, the performance of the assets may be quite different from that of the accounting liabilities (which are linked to corporate bonds, as set out below) and so the results can be very volatile from year to year.

This note discusses our recommended assumptions for the exercise, however the responsibility for setting assumptions ultimately belongs to the employer and, therefore, if an employer was to request alternative assumptions then we would be happy to use these in producing our report. The assumptions in this report are therefore the standards that we intend to use unless instructed otherwise. We believe that these assumptions are likely to be appropriate for most employers but we have not consulted with each employer in setting these.

The change in the balance sheet position over the year is mainly dependent on the answers to three key questions and this report is split into these three sections:

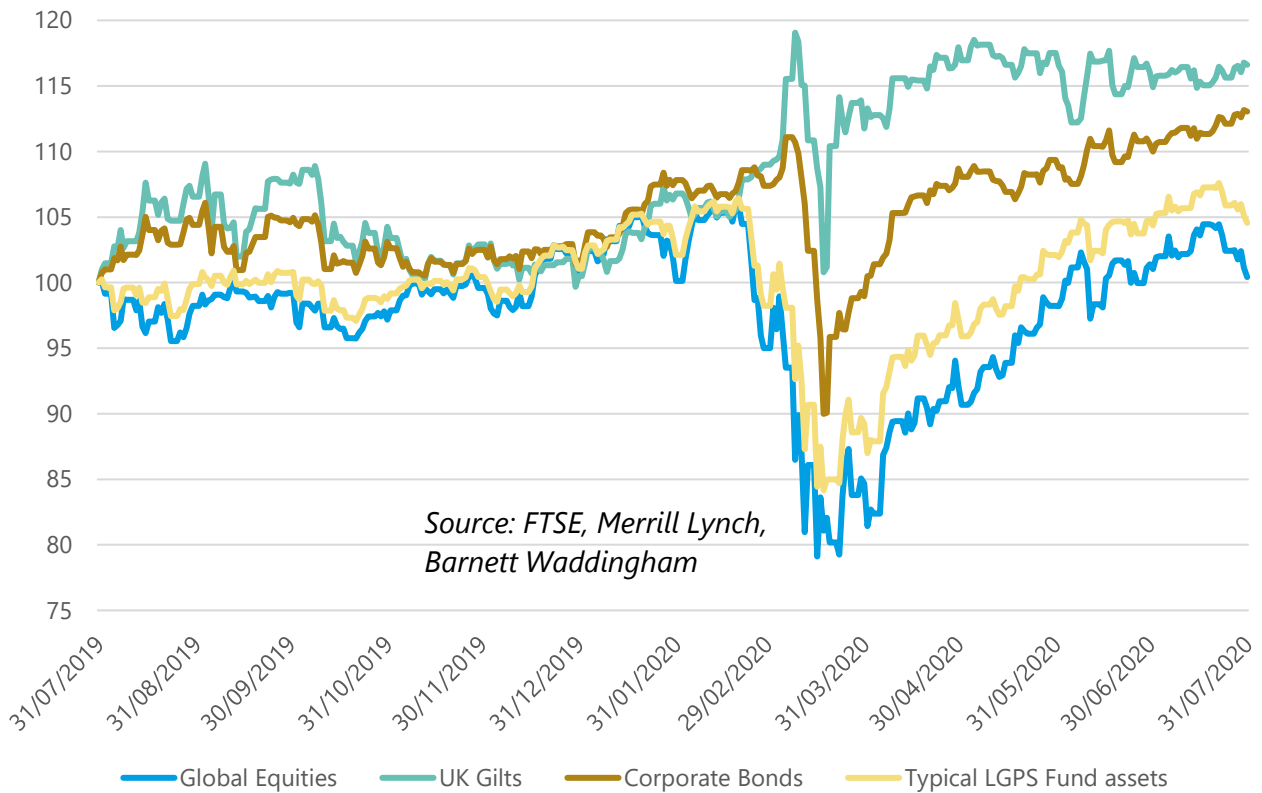
- What were asset returns for the twelve months to 31 July 2020?
- What were corporate bond yields as at 31 July 2020?
- What were market expectations of inflation as at 31 July 2020?

We appreciate that some of the terminology in this report may not be familiar and therefore we would recommend also reading our Glossary and FAQs document for a more detailed explanation on some of the jargon used here. This document has been circulated with this briefing note but please get in touch with the Fund if you would like a copy.

Please let your usual Barnett Waddingham contact know if you have any queries.

Asset returns

The following chart plots returns from the major asset classes since 31 July 2019 alongside the return that would have been achieved by a Fund invested 75% in global equities, 20% in corporate bonds and 5% in gilts.



Asset performance has been volatile over the year to 31 July 2020, particularly in February and March as a result of the COVID-19 crisis. Based on market indices, and the asset allocation outlined above, a typical LGPS Fund might have achieved a return of around 5% for the year to 31 July 2020. However, given the level of volatility seen in the markets, this could vary considerably depending on each Fund's investment strategy.

If Fund returns have been around this level, asset returns will have been higher than the discount rate assumed at the previous accounting date. If the actual return for the year is higher than the previous discount rate, this will lead to an actuarial gain on the assets and decrease the deficit.

However, the overall position is also influenced by the effect of market movements on the assumptions used to place a value on the defined benefit obligation. This is discussed in the next section.

Changes to financial assumptions

The key financial assumptions required for determining the defined benefit obligation under either accounting standard are the discount rate, linked to corporate bond yields, and the rate of future inflation. These assumptions are discussed below.

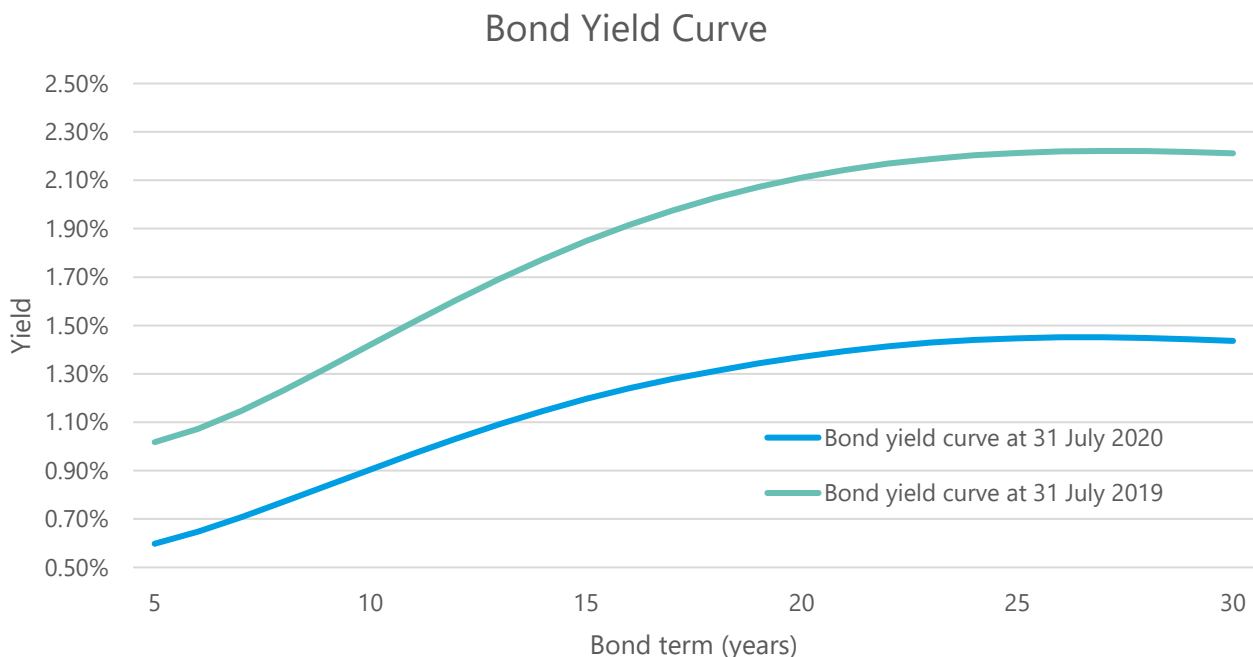
Discount rate

Under both the FRS102 and IAS19 standards the discount rate should be determined by reference to market yields at the end of the reporting period on high quality corporate bonds. The approach we adopted to derive the appropriate discount rate at the previous accounting date is known as the Single Equivalent Discount Rate (SEDR) methodology. We intend to adopt the same approach for assumptions used for accounting disclosures at 31 July 2020.

We use sample cashflows for employers at each duration year (from 2 to 30 years) and derive the single discount rate which results in the same liability value as that which would be determined using a full yield curve valuation (essentially each year's cashflows has a different discount rate). This discount rate is known as the SEDR. In carrying out this derivation we use the annualised Merrill Lynch AA rated corporate bond yield curve and assume the curve is flat beyond the 30 year point.

The standard assumptions set for an employer will be based on their individual duration. For example, an employer with an estimated liability duration of 13 years will adopt assumptions consistent with those derived using the 13 year cashflows.

The below graph shows the bond yield curve at the last accounting date along with the yield curve at 31 July 2020:



These curves reflect the yields that underlie the SEDR calculations and are not the estimates of the standard discount rate assumption. Sample SEDR assumptions are set out in the table below.

You will see that the bond yield at 31 July 2020 is lower than at 31 July 2019 at all terms. As a result, the discount rate assumed for employers will be lower than that assumed at the previous accounting date. All else being equal, a lower discount rate will result in a higher value being placed on the defined benefit obligation.

Sample SEDRs are set out in the table below based on market conditions at 31 July 2020, with the equivalent 31 July 2019 SEDRs also shown for comparison:

Duration (years)	31 July 2020	31 July 2019
10	1.15%	1.85%
15	1.30%	2.00%
20	1.35%	2.10%
25	1.40%	2.15%

Assumptions are rounded to the nearest 0.05%.

The below table sets out the estimated effect of the change in discount rate assumed based on the same sample durations:

Duration (years)	Estimated effect of change in discount rate on employer's liabilities
10	Increase of 7%
15	Increase of 11%
20	Increase of 16%
25	Increase of 20%

The actual effect of the change in the discount rate assumption will depend on each employer's membership and the assumption to be adopted this year compared to last year.

Inflation expectations

Whilst the change in corporate bond yields is an important factor affecting the valuation of the liabilities, so too is the assumed level of future inflation as this determines the rate at which active members' CARE benefits and deferred and pensioner members' benefits increase.

IAS19 suggests that in assessing future levels of long-term inflation we should use assumptions that would result in a best estimate of the ultimate cost of providing benefits whilst also giving consideration to the gilt market (in line with general price levels) to give us an indication of market expectation. FRS102 simply refers to a best estimate of the financial variables used in the liability calculation.

Pension increases in the LGPS are expected to be based on the Consumer Prices Index (CPI). As there is limited market information on CPI-linked assets, to derive our CPI assumption we first make an assumption on the Retail Prices Index (RPI) then make an adjustment.

Retail Prices Index (RPI) assumption

Similar to the SEDR approach described above we intend to adopt a Single Equivalent Inflation Rate (SEIR) approach in deriving an appropriate RPI assumption.

The SEIR adopted is such that the single assumed rate of inflation results in the same liability value (when discounted using the yield curve valuation described above) as that resulting from applying the BoE implied inflation curve. As above, the Merrill Lynch AA rated corporate bond yield curve is assumed to be flat beyond the 30 year point and the BoE implied inflation curve is assumed to be flat beyond the 40 year point.

We have made no allowance for an inflation risk premium. This is consistent with that assumed at the previous accounting date.

Consistent with the SEDR approach, assumptions are rounded to the nearest 0.05% and we intend to use sample cashflows for employers at each duration year (from 2 to 30 years) in deriving the assumptions for employers.

Sample SEIRs are set out in the table below based on market conditions at 31 July 2020, with the equivalent 31 July 2019 SEIRs also shown for comparison:

Duration (years)	31 July 2020	31 July 2019
10	3.15%	3.50%
15	3.15%	3.45%
20	3.05%	3.40%
25	3.00%	3.35%

Difference between RPI and CPI

In March 2019, the UK Statistics Authority proposed changing the way that RPI is calculated; specifically that the calculation methodology should be aligned with the CPIH, the Consumer Prices Index including owner occupiers' housing costs. Consent was sought from the government, and in September 2019 the Chancellor responded to say that he was unwilling to introduce such a change any earlier than 2025, and would consult publicly on when between 2025 and 2030 the change should be introduced.

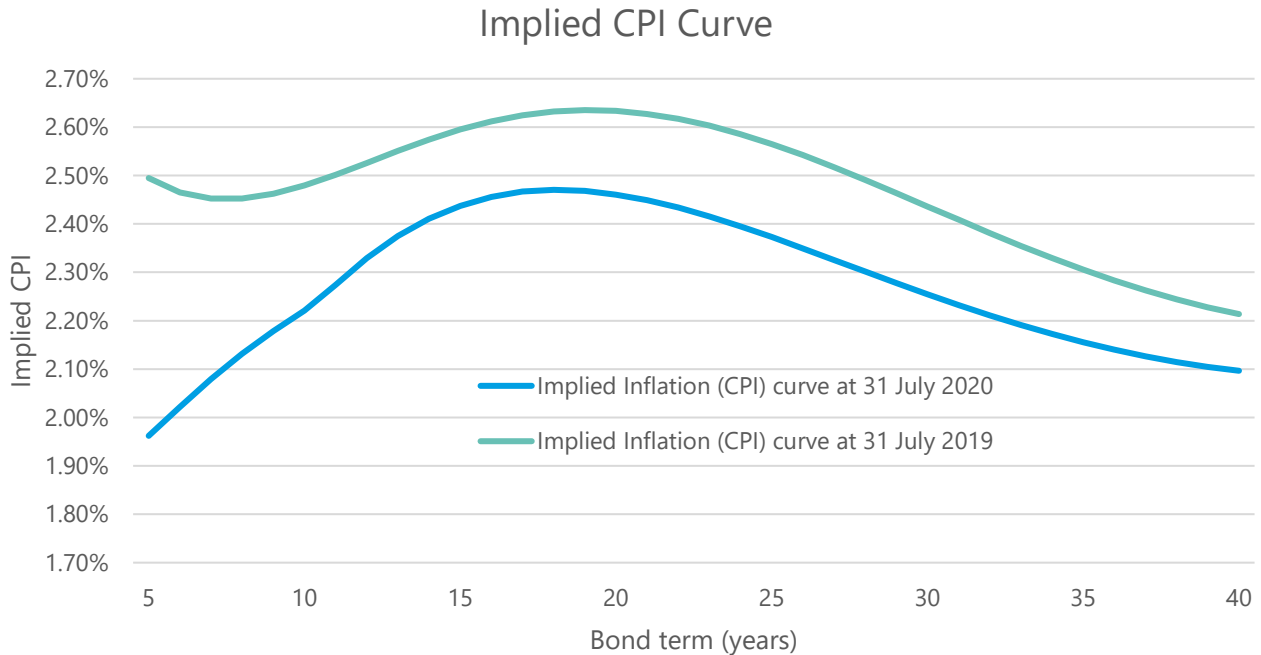
The proposed change to the calculation methodology is likely to reduce future RPI increases as CPIH inflation is generally expected to be lower than RPI. If the proposal goes ahead, RPI will change and therefore so will the gap between RPI and CPI and so we consider this proposed change in our assumption of the difference in RPI and CPI.

We believe the market has already started to react in that market implied RPI is now lower to reflect the potential change. Market implied inflation fell by around 0.1% p.a. at all terms on 17 January 2019, following the original House of Lords report on the change to RPI. A further fall was then seen on 4 September 2019 at terms above 8 years following the response from the Chancellor on the topic as mentioned above. Overall, we estimate the combined fall in market implied inflation to be between 0.1% - 0.2% for terms between 10 and 30 years.

In calculating the implied CPI curve, we are therefore reducing our assumption on the difference in RPI and CPI for the purpose of the 31 July 2020 accounting exercise. Based on movements seen in the markets so far, we have assumed that the annual increase in CPI will be 1.0% lower than the market implied increases in RPI for each year to 2030, and will reduce to 0.7% lower than market implied RPI inflation thereafter. At the last accounting date, the assumption was that the annual increase in CPI will be 1.0% lower than the market implied increases in RPI for each future year.

Consumer Prices Index (CPI) assumption

The resulting implied CPI curve at 31 July 2020 is shown below along with the implied CPI curve at the last accounting date for comparison:



These curves reflect the yields that underlie the SEIR calculations and are not the estimates of the standard CPI inflation assumption. Sample SEIR assumptions are set out in the table below.

Using a similar approach described above to calculate the SEIR for our RPI assumption, we have calculated a single equivalent rate of CPI increase that results in the same liability value as would be calculated by applying the above implied CPI curve.

As shown above, the implied CPI curve at 31 July 2020 is lower than that at 31 July 2019 at all terms. As a result, the assumed level of future pension increases will be lower than that assumed at the previous accounting date. All else being equal, this will result in a decrease in the value of employers' liabilities.

The below tables set out the assumed pension increase (CPI) assumptions at sample durations, as well as the estimated effects due to the change in the inflation assumption from last year's standard assumption to this year's:

Duration (years)	31 July 2020	31 July 2019
10	2.25%	2.50%
15	2.30%	2.45%
20	2.25%	2.40%
25	2.20%	2.35%

Duration (years)	Estimated effect of change in inflation on employer's liabilities
10	Decrease of 2%
15	Decrease of 2%
20	Decrease of 3%
25	Decrease of 4%

The actual effect of the change in pension increase assumption will depend on the assumption to be adopted this year compared to last year.

Comparing the equivalent RPI rates with the equivalent CPI rates, this results in an implied difference between RPI and CPI of 0.8% p.a. (for employers with durations of 19 years or above) to 1.0% p.a. (for employers with durations of 5 years or below). For most employers, this is a reduction from the previous year's assumption which was a difference of 1.0% p.a. at all durations.

Due to the nature of SEDR and SEIR methodology, the assumptions derived are dependent on the sample cashflows used and as a result different cashflows of similar liability durations may result in alternative assumptions. Therefore, another actuary replicating the same approach set out above may derive different assumptions from those set out above. Reasonableness checks have been carried out on the cashflows used.

Salary increases

Although future benefits are not linked to final salary, benefits accrued up to 31 March 2014 will continue to be linked to the final salary of each individual member. Therefore we still need to set an appropriate long-term salary increase assumption.

Where an employer has requested a bespoke salary increase assumption last year, if still appropriate, we will continue the same salary increase assumption at 31 July 2020. For all other employers, we will adopt the standard approach set out below.

For English Funds, we intend to use the salary increase assumption from the 2019 actuarial valuation. For all English Funds, this means assuming that salary increases are in line with CPI plus 1.0% p.a. with no additional allowance for a promotional salary scale. For the employers adopting our standard salary increase assumption last year, this assumption has been updated from a short term increase in line with CPI for the period to 31 March 2020 and CPI plus 1.5% p.a. thereafter in addition to a promotional salary scale.

For Scottish Funds, our standard approach remains consistent with the 2017 actuarial valuation and is in line with CPI plus 1.0% p.a. in addition to a promotional salary scale. This is consistent with the standard approach last year.

The salary increase assumption is the assumption that employers are most likely to request a specific approach for in line with their own expectations and we are happy to discuss this as required.

Bespoke financial assumptions

As mentioned above, the responsibility for setting assumptions ultimately belongs to the employer and therefore if an employer was to request alternative assumptions then we would be happy to use these in producing our report. The approaches described above are the standard approaches we will adopt to derive financial assumptions, however, we are happy to advise individual employers on the range of assumptions they may be able to adopt.

As part of this advice we are able to provide employers with a deficit modeler which provides an indication of the impact of any changes to their accounting position.

If you would like more information on the options available to employers regarding bespoke assumptions please feel free to contact publicsector@barnett-waddingham.co.uk or your usual Barnett Waddingham contact. However, please be aware that both requesting and receiving advice on bespoke assumptions will incur additional fees.

Mortality assumption

The key demographic assumption is the mortality assumption and there are two main steps in setting this assumption:

- Making a current assumption of members' mortality (the base mortality); and
- Projecting these current mortality rates into the future, allowing for further potential improvements in mortality. Future members' mortality is almost impossible to predict and therefore there is a lot of judgement involved and we naturally have to refine our view on this over time.

The mortality assumptions adopted for our Fund's triennial funding valuations were best estimate assumptions and we will, therefore, be using the same assumptions as standard for accounting. As part of the valuation, analysis was carried out by our specialist longevity team to assess the best estimate mortality assumption based on each Fund's experience and industry knowledge.

For Scottish Funds, our standard approach is to adopt the same assumption as that adopted at the last accounting date. For most employers, this is a base mortality assumption in line with the Fund's 2017 actuarial valuation, projected in line with the CMI_2018 Model published by the Continuous Mortality Investigation (CMI).

For English Funds, our standard approach is to update the mortality assumption to be based on those adopted for the Fund's 2019 actuarial valuation. In most cases, this will mainly be an update to the base mortality assumption and retention of the CMI_2018 projection model that most employers adopted at the last accounting date. The variables underlying the CMI_2018 Model will, however, be updated in line with those adopted for the Fund's 2019 actuarial valuation.

Other levers

2019 valuation update (English Funds)

The results for each employer in English Funds will incorporate the results of the 2019 valuation, which could have a positive or negative effect. The effect will depend on how experience over the intervalation period has differed from that assumed.

Service accrued over the period

The change in employers' deficits will also be affected by the difference in the cost of benefits accrued over the period and the level of contributions paid by the employer and employees.

The service cost accrued over the year is based on the assumptions at the start of the period, i.e. at the previous accounting date. Employers' contributions may consist of contributions towards funding any deficit as well as funding the cost of benefits being accrued on an ongoing funding basis. These contributions are likely to have been calculated using different assumptions than under IAS19/FRS102 and may therefore differ from the service cost calculated for the period.

Depending on the membership profile of the employer; the cost of benefits accrued over and above the level of contributions paid may have a more significant effect on the level of deficit than the change in financial assumptions and investment performance.

Treatment of settlements and curtailments

Employers accounting under the IAS19 standard

On 7 February 2018, the International Accounting Standards Board (IASB) issued amendments to the IAS19 standard which now requires that when determining any past service cost or gain or loss on settlement that the net defined benefit liability is remeasured using current assumptions and the fair value of plan assets at the time of the event. This applies for all accounting periods starting on or after 1 January 2019 and therefore will apply for the year to 31 July 2020 accounts.

Common events for LGPS employers that this amendment may apply to include outsourcings and unreduced early retirements.

The amendment complicates the accounting disclosure as additional calculations are required to determine the cost before and after each event, and to rebase the standard roll forward approach on updated assumptions based on each event date. The amendment does, however, note that the extra remeasurement does not need to be applied where the application of that remeasurement is immaterial. The assessment of materiality will be subject to each employer and auditor's discretion. We can provide additional information to help assess materiality but we cannot conclude whether an event is material or not.

Our default approach for IAS19 reports will be to assume that all events are material and therefore will adopt the approach set out in the IAS19 amendment. We will provide each administering authority with a summary of the events we are aware of and these will be communicated to each employer. If the employer does not want to treat all the events in this way then we would strongly recommend the employer reviews these events with their auditor in advance of the preparation of their report.

Unless instructed otherwise we will proceed with our default approach and please note that additional fees will apply, details of which can be provided by the administering authority.

Employers accounting under the FRS102 standard

We note that the FRS102 standard is silent on the treatment of settlements and curtailments, and in particular there is no explicit requirement to adopt a similar approach to that set out above for the IAS19 standard.

Therefore, our default approach for FRS102 reports is to not remeasure the net defined benefit liability at the event date, and this is consistent with the approach at the last accounting date.

We are happy to adopt an approach in line with that set out above for the IAS19 reports if requested by the Employer, but please note that that will incur additional charges.

McCloud/Sargeant judgement

If at the last accounting date allowance was made for McCloud in an employer's IAS19/FRS102 report then no explicit adjustment will be made in our results this year. At the last accounting date, our standard approach unless requested otherwise was to include allowance for McCloud so we expect most employers this year will fall under this category.

On 16 July 2020, the Government published a consultation on the proposed remedy to be applied to LGPS benefits in response to the McCloud and Sargeant cases. The consultation closes on 8 October 2020 and the final remedy will only be known after the consultation responses have been reviewed and a final set of remedial Regulations are published. We do not believe there are any material differences between the approach underlying our estimated allowance and the proposed remedy. A more detailed analysis at this stage would require a significant volume of member data which is not yet available. Therefore, we do not intend to make any further adjustment in light of the ongoing consultation at the accounting date.

If no allowance was made at the last accounting date, then our default approach will be to include an allowance this year based on GAD's analysis (further details can be found in Appendix 3) and the individual assumptions and membership profile of the employer. The effect on the employer's liabilities will be shown as a past service cost.

This will be the default approach unless employers opt out.

In order to reduce the chance of having to revise any reports we recommend that employers engage with their auditors in advance of their year-end to make them aware of our intended approach.

Please contact the administering authority of the Fund to confirm the relevant fees.

Overall expected results

What does this all mean when we bring it all together?

The first caveat is that no employer is average and so any prediction of what might apply to an average employer will not apply to every, or possibly any employer.

The effect of the changes in the financial assumptions on an employer's liabilities are dependent on the assumptions adopted as well as the specific duration of the employer's liabilities. Typically, employers with greater liability durations are more sensitive to changes in financial assumptions as benefits will be paid over a longer term. The table below describes the estimated effects for employers with liability durations of exactly 10, 15, 20 and 25 years:

Duration (years)	Estimated effect of change in financial assumptions on employer's liabilities
10	Increase of 5%
15	Increase of 8%
20	Increase of 13%
25	Increase of 16%

Based on market conditions at the accounting date, employers of all durations would see an increase in the value of the defined benefit obligation. In addition, the value of liabilities will increase with interest accumulated over the year.

However, there will be other factors affecting the change in an employer's accounting position including (but not limited to) the effects of:

- For English funds, updating to the 2019 valuation results
- Any updates to the demographic assumptions (in particular for English funds, updating to be in line with those adopted for the 2019 valuation)
- Fund asset performance
- Employer cashflows, in particular the difference in the cost of benefits accrued over the period and the level of contributions paid by employers and employees

Appendix 1 - Auditor views

It should be highlighted that auditors continue to look for greater accuracy in the roll forward approach used to calculate employers' results. This includes the approach used to determine each employer's share of fund assets at the accounting date and roll forward employers' liabilities.

Asset roll forward

Given the tight timescales for employers to submit their final accounts we appreciate that it is not always possible to wait until a fund's net asset statement at the accounting date is available to begin producing accounting disclosures. As a result, we request details of funds' assets at the most recent date available and, for the remaining period, we assume that returns are in line with relevant market indices.

In order to reduce the chance of having to revise any reports we recommend that employers engage with their auditors and the administering authority of the fund as early as possible to ensure they are comfortable with the information being used to calculate results.

Liability roll forward

To calculate the value of employers' liabilities we carry out a full valuation of membership data at least every three years (as part of the triennial valuation). We then 'roll this forward' to each subsequent accounting date, allowing for the actual cashflows paid into and out of the fund in respect of the individual employer.

In addition we allow for any curtailments as a result of unreduced early retirements we are made aware of. Similarly we allow for any settlements we are made aware of such as those resulting from outsourcings or bulk transfers.

We do not, as standard, allow for actual inflation experience between full member valuations. The effect of actual experience compared to what was assumed is typically included within the experience item when full valuations are incorporated into accounting disclosures.

However, if employers wish us to allow for actual inflation experience over the inter-valuation period we would be happy to do so. It should be noted that this does fall outside the scope of what is covered in our standard report fee and will therefore incur additional fees.

Appendix 2 - Adjustments to fees

The Fund will communicate fees to employers however we would like to make you aware that there may be additional fees if there are particular features or events for an employer which need to be taken into account.

As examples of this:

- where an employer chooses their own assumptions;
- if there are additional calculations to be carried out if a surplus is revealed;
- when there are any staff transfers/movements to allow for;
- allowance for actual inflation experience;
- if additional disclosures are required;
- an employer asks to receive their report by a particular deadline; or
- if auditors ask queries following receipt of the report.

Please get in touch with the Fund for further information on fees.

Appendix 3 – Supreme Court ruling in McCloud/Sargeant case

Background

Two employment tribunal cases were brought against the Government in relation to possible discrimination in the implementation of transitional protection following the introduction of the reformed 2015 public service pension schemes from 1 April 2015. Transitional protection enabled some members to remain in their pre-2015 schemes after 1 April 2015 until retirement or the end of a pre-determined tapered protection period. The claimants challenged the transitional protection arrangements on the grounds of direct age discrimination, equal pay and indirect gender and race discrimination.

The first case (McCloud) relating to the Judicial Pension Scheme was ruled in favour of the claimants, while the second case (Sargeant) in relation to the Fire scheme was ruled against the claimants. Both rulings were appealed and as the two cases were closely linked, the Court of Appeal decided to combine the two cases. In December 2018, the Court of Appeal ruled that the transitional protection offered to some members as part of the reforms amounts to unlawful discrimination.

On 27 June 2019 the Supreme Court denied the Government's request for an appeal in the case. On 16 July 2020, the Government published a consultation on the proposed remedy to be applied to LGPS benefits in response to the McCloud and Sargeant cases. The consultation closes on 8 October 2020 and the final remedy will only be known after the consultation responses have been reviewed and a final set of remedial Regulations are published.

Government Actuary's Department (GAD) impact analysis

The Scheme Advisory Board, with consent of the Ministry of Housing, Communities and Local Government (MHCLG), commissioned GAD to report on the possible impact of the McCloud/Sargeant judgement on LGPS liabilities, and in particular, those liabilities to be included in local authorities' accounts as at 31 March 2019. This followed an April 2019 CIPFA briefing note which said that local authorities should consider the materiality of the impact. This analysis was to be carried out on a "worst-case" basis, (i.e. what potential remedy would incur the highest increase in costs/liabilities). The results of this analysis are set out in GAD's report dated 10 June 2019.

Although GAD were asked to carry out their analysis on a "worst-case" basis, there are a number of other potential outcomes to the case which would potentially inflict less cost to the Employer. For example, the solution proposed by the Government would only apply the underpin to all members who were active on 31 March 2012. This would have less impact than GAD's scenario (which also includes any new joiners from 1 April 2012).

IAS19/FRS102 requires us to place a best estimate value on liabilities and costs. Consistent with the approach we adopted for the McCloud impact estimates made last year, we will adjust GAD's estimate to include only members that were active on 31 March 2012. This is in line with that proposed in the Government's consultation.

GAD's analysis compared the cost of the old pre-2014 final salary scheme with the new CARE scheme. The key parameter in assessing this cost is the assumed level of future salary increases in excess of CPI. GAD considered the following two scenarios:

1. Salaries increase at CPI plus 1.5% – on this scenario GAD assessed the average cost of implementing their worst-case scenario to be 3.2% of active liabilities at 31 March 2019 and the impact on service cost (i.e. the cost of benefits accruing) to be 3.0% of active payroll.

2. Salaries increase at CPI plus 0% p.a. – on this scenario GAD assessed the average cost to be less than 0.1% of active liabilities at 31 March 2019 and the impact on service cost to be less than 0.1% of payroll.

For the purpose of our impact estimate we will make an allowance to reflect each employer's own salary increase assumption.