Annexe

Spring Budget Revision 2022/23

IAS 19 - Pension Costs

AUDIT SCOTLAND

Prepared by Audit Scotland
December 2022

Introduction

1. In accordance with Scottish Government advice to meet additional unbudgeted pension charges this paper details Audit Scotland's 202/23 Spring Budget Revision (SBR) proposal to meet these non-cash accounting costs.

Background

2. Bodies funded by Parliamentary Vote, such as Audit Scotland, only have authority to spend the resources voted to them in one financial year. Any request for additional resources in-year must be requested as part of either the Autumn Budget Revision (ABR) or Spring Budget Revision (SBR) and approved by Parliament.

3. Certain types of expenditure requiring budget revisions, including pension charge adjustments, are treated for budget purposes as Annually Managed Expenditure (AME) rather than falling within the Departmental Expenditure Limit (DEL). The overall AME cover for Scotland is re-determined once a year in late autumn, with the changes agreed with HM Treasury then being available for inclusion in the SBR.

Spring Budget Revision - IAS19 Pension Costs proposal

4. Our SBR proposal requests £5.2 million to meet increased non-cash pension accounting charges that will arise in 2022/23.

5. Audit Scotland operates two pension schemes. Our main pension scheme is the Local Government Pension Scheme in Scotland administered by the Lothian Pension Fund. All new employees are enrolled in this scheme as part of the auto enrolment pension legislation.

6. The second scheme is the Principal Civil Service Pension Scheme (PCSPS). Audit Scotland operate this scheme as a closed scheme – the members of the scheme are employees who have legacy terms and conditions following their transfer to Audit Scotland from the National Audit Office on the establishment of Audit Scotland in 2000. The numbers of staff in this scheme have been reducing as staff retire or leave Audit Scotland – currently there are four members of staff who are part of this scheme. In addition to those staff who have legacy rights, the Auditor General for Scotland is separately enrolled in the PCSPS as part of their terms and conditions of appointment.

7. The PCSPS is an unfunded multi-employer defined benefit pension scheme. The liability for payments under this scheme rests with the Government and Audit Scotland is not required to disclose or record information in respect of this scheme. These arrangements are consistent with those applying to the Scottish Government and many Government Agencies and NDPB's.

8. The Local Government Pension scheme is a funded, defined benefit pension scheme and the assets and liabilities of our section of the scheme are separately recorded. As a result Audit Scotland has to meet the accounting and disclosure requirements of International Accounting Standard 19 (IAS 19). This requires the preparation of actuarial reports at each year-end that

value assets and liabilities of the scheme as well as identifying the in-year costs of providing the pension service earned during the year.

9. A key factor in determining the values and costs is the discount rate used in the calculations. The rate used is driven by interest rates and bond returns and low interest rates push up the costs of providing pension service. The calculated values are very sensitive to small movements in the rates – 0.1% of a movement in the real discount rate is estimated to add 2% to the liabilities of the scheme.

10. Information provided from our actuaries to meet year-end accounting and disclosure requirements includes a projection of pension cost items for the following year. The report on the projection for 2022/23 was available in May 2022 well after the submission of our budget proposals for 2022/23. This means it is very difficult to predict the impact of pension accounting adjustments as part of the annual budgeting process.

11. Pension accounting adjustments required in respect of IAS 19 can generate favourable and unfavourable variances. The accounting adjustments are notional and do not generate cash movements.

12. In previous submissions we have advised the possibility of adverse adjustments in future and the consequent need to request additional budget cover through the AME process to balance our accounts. In 2021/22 the scheme actuary's initial estimate was £6 million more than the pension charge assumed in the budget for the year. With the agreement of the SCPA and the Scottish Government's Finance Directorate additional cover of £6 million was provided in the SBR 2021/22 through the AME arrangement to ensure sufficient budget was available to cover the in-year pension cost.

13. For 2022/23 we anticipate that the IAS 19 pension adjustment will again be adverse and will require an additional charge over and above the budget provision held for the contributions we will make for the year. Based on the Actuary's report presented in May 2022 the estimated pension service cost for 2022/23 is £5.2 million higher than the available budget.

14. The charge is driven by the continuing impact of low net discount rates used to value pension liabilities which increase future pension liability forecasts and in turn the estimates for in year pension service costs – this rate increased to -0.50% at March 2022 compared to a rate of -0.85% at March 2021.

15. It is essential that Audit Scotland has sufficient budget cover to meet the unpredictable non-cash expenditure arising from the IAS 19 pension adjustments required under the FReM. Audit Scotland is unable to carry forward reserves and any significant shortfall has the potential to leave us in the unacceptable position of a final outturn deficit.

16. The expectation of continuing low interest rates in the next few years will lead to large accounting adjustments in 2023/24 and beyond. In such circumstances further requests for budget revisions to meet additional pension charge adjustments will be required in the future.

Conclusion

17. The Spring Budget Revision - IAS 19 Pension Costs proposals presented in this paper will:

- provide non-cash AME funding of £5.2 million to allow Audit Scotland to meet increased non-cash pension charges that will occur in 2022/23.