Cheshire East Council

31 March 2024 asset ceiling considerations

Purpose and scope

This paper has been commissioned by and is addressed to Cheshire East Council (the Employer), who participate in the Local Government Pension Scheme (LGPS) as an employer within the Cheshire Pension Fund (the Fund). Its purpose is to provide the Employer with asset ceiling calculations for its 31 March 2024 year end LGPS disclosures, using specific methodology requested by the Employer.

This paper relies on, and should be read in conjunction with, the Employer's 31 March 2024 IAS19 Results Schedule, the accompanying Accounting Covering Report and the Fund's 2022 Funding Valuation Report.

Background

Under the Employer's accounting standard, a net asset restriction may apply; the chosen accounting treatment is ultimately a decision for the Employer for its own accounts. It is important to note that there is no definitive correct answer or approach for an employer to adopt in their accounts. The various accounting standards only set out high level principles, which are therefore open to a wide range of interpretation regarding methodology and are also dependent on employer-level factors.

However as at the time of writing this report, and following discussions with key LGPS audit practitioners, we understand the following Employer instructed approach may be **an** acceptable methodology for an LGPS employer open to new entrants. Note the asset ceiling methodology/calculations set out in this paper may be different to those adopted by the Employer for its 2023 year-end as LGPS practitioner views have evolved significantly over the past year.

What do the accounting standards say?

IAS 19 (Paragraph 8)

"The surplus is the present value of the defined benefit obligation less the fair value of plan assets."

"The net defined benefit asset is the surplus, adjusted for any effect of limiting a net defined benefit asset to the asset ceiling.

"The asset ceiling is the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan."

IFRIC 14 IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction

"Minimum funding requirements exist in many countries to improve the security of the post-employment benefit promise made to members of an employee benefit plan. Such requirements normally stipulate a minimum amount or level of contributions that must be made to a plan over a given future period. Therefore, a minimum funding requirement may limit the ability of the entity to reduce future contributions."

IFRIC 14 asks employers to analyse minimum funding requirement contributions split between future service and past service elements.

Under IAS19, IFRIC 14 requires an additional liability to be recognised where agreed past service contributions would give rise to a future surplus and not be available after they are paid (i.e. available as a refund or reduction in future contributions).

Employer instructed methodology

The economic benefit available as a refund

The instructed methodology assumes that the Employer has no unconditional right to a refund from the Fund and therefore there is no economic benefit available as a refund.

To receive any refund, the employer would need to end its ongoing participation in the fund. Any exit credit due (ie refund of funding surplus on cessation) would be determined in line with the LGPS regulations, the fund's own funding strategy statement (which each fund drafts and amends itself) and the fund's own cessation policy, which may include discretionary elements. Further, please note that certain employers are expected to participate in the LGPS indefinitely (eg scheduled bodies).

The Employer (and its auditor) may wish to investigate this economic benefit route further, considering its own individual circumstances when determining an asset ceiling. For example, by assessing its funding position on the Fund's funding assumptions (which may be ongoing or low risk funding valuation assumptions).

The economic benefit available as a contribution reduction

The instructed methodology assumes that economic benefit is available to the Employer as a reduction in future contributions.

The effect of a minimum funding requirement on the economic benefit available as a reduction in future contributions

The instructed methodology considers future service contributions as a minimum funding requirement. We understand there is broad consensus among LGPS practitioners and various external documents (eg CIPFA 'Bulletin 15 - Reporting of pensions surpluses and IFRIC 14', PwC's 'Review of IAS19 reporting at 31 March 2024 for National Audit Office, Audit Scotland and Audit Wales') to support this.

Agreed past service contributions which may give rise to an additional liability

The instructed methodology considers past service contributions as a minimum funding requirement. Again, we understand there is broad consensus among LGPS practitioners to support this.

Past service contributions, where positive, are used to determine if there is an additional liability to recognise under IAS19.

For reference only, please note that under FRS 102, no additional liability can be recognised as a result of agreed past service contributions (i.e. the additional liability is £0).

Employer instructed calculation (economic benefit available as a reduction in future contributions)

We have been instructed to calculate the economic benefit available as a reduction in future contributions as:

A. Present value of future service costs

   less

B. Present value of future service contributions.

For A:

- Present value calculated over the expected life of the employer (ie in line with now established LGPS audit and practitioner views, an indefinite period for an LGPS employer open to new entrants).

- Future service cost calculated using the 31 March 2024 IAS19 assumptions (ie the Employer's projected 2024/25 service cost from the 31 March 2024 IAS19 Results Schedule

For B:

- Present value calculated over same period as A above.
- Future service contributions are assumed to be equal to the Employer's funding valuation primary rate (ie the Employer's primary rate from the Fund's 31 March 2022 funding valuation Rates and Adjustments Certificate).
- The primary rate is adjusted downwards by any negative funding valuation secondary rate for the funding valuation time horizon period.
- Any negative funding valuation rate is assumed to continue in payment at the final certified rate of the most recent funding valuation Rates and Adjustments Certificate for the Employer's funding valuation time horizon.
- The primary rate is not remeasured using market conditions (on IAS19 or funding valuation assumptions) as at the accounting year end date.

The economic benefit available as a reduction in future contributions cannot be negative (eg where B is greater than A, the economic benefit available as a reduction in future contributions is £0).

Employer instructed calculation (agreed past service contributions which may give rise to an additional liability)

We have been instructed to calculate the present value of past service contributions calculated over the Employer's funding valuation time horizon. Where:

- Past service contributions are assumed to be equal to the Employer's funding valuation secondary rate.
- Past service contributions assumed to continue in payment at the final certified rate of the most recent funding valuation Rates and Adjustments Certificate (the 2025/26 secondary rate) for the Employer's funding valuation time horizon.

Employer information

The Employer information used in the instructed asset ceiling calculation is set out in Appendix 1. This is a combination of figures from the Employer's Results Schedule and information from the latest funding valuation.

Asset ceiling calculations

The asset ceiling calculation worked example for the Employer, using the instructed methodology is set out in Appendix 2.

In line with now established LGPS audit and practitioner views, the asset ceiling calculations do not take account of the Employer's unfunded benefits (compensatory added years / CAYs). The asset ceiling calculation is to restrict the amount of net asset (relative to funding obligations) the Employer can disclose.

As noted previously, there is no single correct methodology. As examples only, a non-exhaustive list of possible variations include:

- Present value of future service costs and/or contributions calculated over a different future time period (eg perpetuity, future working lifetime, contract length) because of an employer's interpretation of its expected life in the plan and whether it is open or closed to new entrants (or open to new entrants but not actively admitting).
- Where there are negative past service contributions, future service contributions adjusted downwards over a different period to the funding valuation time horizon, or not adjusted downwards at all.

- Different view taken on the split of Employer contributions which are considered to be future service or past service elements.
- For additional liability considerations, different past service element contributions being allowed for after the end of the current Rates and Adjustments Certificate; or only being considered until the end of the current Rates and Adjustments Certificate.

Next steps

Following receipt of the paper:

1. we strongly recommend the Employer discusses this complex topic with its auditor before deciding on a net asset restriction with its own accounts. Ultimately, the Employer's auditor must be comfortable with the approach taken to sign off the accounts.
2. if the Employer has a known, fixed end date when it will definitively end its participation in the Fund, the time periods used in the asset ceiling calculations may need revisited as the result could be materially different.
3. the Employer and its auditor may wish to arrange a call with one of our specialist LGPS accounting actuaries for further assistance.
4. on request, we can produce a further 2023/24 results schedule to reflect the Employer's final decision regarding its 31 March 2024 asset ceiling adjustment.

Reliances and limitations

This paper has been prepared for Cheshire East Council for the purpose described above. It has not been prepared for use for any other purpose and should not be so used. The paper should not be disclosed to any third party except as required by law or regulatory obligation or with our prior written consent; however, it can be shared with the Employer's auditor. We accept no liability where the paper is used by or disclosed to a third party unless we have expressly accepted such liability in writing. Where this is permitted, the paper may only be released or otherwise disclosed in a complete form which fully discloses our advice and the basis on which it is given. This report proportionately complies with Technical Actuarial Standard 100 (TAS 100).

Adrian Loughlin FFA

21 May 2024

For and on behalf of Hymans Robertson LLP

Appendix 1 – Employer Information

Below is a summary of the Employer's figures which may be used in the calculations when determining the economic accounting benefit:

31 March 2024 accounting Results Schedule information

Assets	£1,663,634,000
Funded Obligations	£1,383,756,000
Net Asset (before any asset ceiling adjustments)	£279,878,000
Discount rate assumption	4.85% p.a.
Salary increase rate assumption	3.45% p.a.
2024/25 projected service cost %	18.4% p.a.
2024/25 projected pensionable payroll	£140,447,000
2024/25 projected service cost £	£25,853,000

Projected employer contributions

Future service element (primary rate % x projected pensionable payroll)	£29,494,000
Where there are agreed negative secondary rates, the primary rate is adjusted downwards by the 2025/26 negative secondary rate (in % of pay terms)	

31 March 2022 funding valuation information

Funding 'time horizon'	Future working lifetime	Open or closed to new entrants
20 years	7 years	Open

The certified contribution rates for the Employer are as follows:

Year ending 31 March	Primary Rate (%)	Secondary Rate (% and/or £)	Total Rate (% and/or £)
2024	21.0%	5.7%	26.7%
2025	21.0%	4.2%	25.2%
2026	21.0%	2.7%	23.7%

Appendix 2 – Asset ceiling worked example

In line with now established LGPS audit and practitioner views, the asset ceiling calculations do not take account of any of the Employer's unfunded benefits (compensatory added years / CAYs). The asset ceiling calculation is to restrict the amount of net asset (relative to funding obligations) the Employer can disclose.

The worked example balance sheets below are based on the closing net position (excluding unfundeds) shown in the Employer's 31 March 2024 Results Schedule. Where the Employer has unfunded obligations, these would be added to the final net position once any asset ceiling/additional liability adjustments have been applied.

All monetary figures are rounded to the nearest thousand for consistency with the Employer's Results Schedule.

Worked example – annuity calculations

To calculate a present value of a future set of cash flows, we calculate an annuity based on the above 31 March 2024 discount rate and salary increase assumptions. The results on the different future periods are as follows:

Period	Perpetuity	Funding 'time horizon'	Future working lifetime (FWL)
Annuity	71.4	17.5	6.7

Worked example (economic benefit available as a reduction in future contributions)

The economic benefit available as a reduction in future contributions is calculated as:

A. present value of future service cost
less
B. present value of future service contributions

⇩

A. annuity (in perpetuity) x 2024/25 future service cost
less
B. annuity (in perpetuity) x future service element employer contribution

⇩

A. 71.4 * £25,853,000 = £1,845,904,000
less
B. 71.4 * £29,494,000 = £2,105,872,000
equals
-£259,968,000

As B is greater than A, the economic benefit available as a reduction in future contributions is floored at £0.

Worked example (agreed past service contributions which may give rise to an additional liability)

Present value of agreed past service contributions has been calculated to be:

C. £68,302,000

These agreed past service contributions (C) have been committed to be paid to the Fund and are added to the net asset position. This position is then compared against the economic benefit available as a reduction in future contributions to determine if there is an additional liability to recognise.

	£
Net asset	279,878,000
Expected net asset once agreed past service contributions are paid	348,180,000
Economic benefit available as a reduction in future contributions	0
Additional liability	(348,180,000)

As the economic benefit available as a reduction in future contributions is lower, there is an additional liability to recognise and an adjustment of £348,180,000 is required to the Net Asset / Liability for the effect of the asset ceiling.

Worked example (adjusted balance sheet position)

If the employer restricts its net asset position in line with the instructed methodology, it is our understanding the Employer's closing 31 March 2024 balance sheet may be amended as follows:

	£
Net Asset (unadjusted)	279,878,000
Effect of the asset ceiling on net asset / liability	(348,180,000)
Net Asset/(Liability)	(68,302,000)

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