

# Spring Budget Revision

## 2016/17

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## Introduction

This paper details Audit Scotland's 2016/17 Spring Budget Revision (SBR) proposal which relates to pension charges.

## Background

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 funding in-year must be requested as part of either the Autumn Budget Revision (ABR) or Spring Budget Revision (SBR) and approved by Parliament.

Audit Scotland is required under the Public Finance and Accountability Act broadly to break even taking one year with another. Audit Scotland is not able to carry forward reserves, and using the Budget Revision process is the only mechanism available to allow Audit Scotland to access unutilised resources from prior years to help balance one year with another.

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.

The timetable for the completion of the SBR process published by the Scottish Government's finance department requires Audit Scotland to submit its proposed budget amendments by 11 January 2017.

## Spring Budget Revision proposal

Our SBR proposal requests £1,041k to meet an increased non cash pension accounting charge that will arise in 2016/17.

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.

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 nine 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 the terms and conditions of appointment.

The PCSPS is an unfunded multi-employer defined benefit pension scheme for which employers are unable to identify their respective share of the underlying assets and liabilities. 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. As a result these organisations do not have pension accounting issues to address as part of the annual budgeting and financial reporting processes.

Our Local Government Pension scheme is a funded, defined benefit pension scheme and the assets and liabilities of our portion of the scheme are identified. 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.

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. Low interest rates push up the costs of providing pension service. The calculated values are very sensitive to small movements in the rates – 0.5% of a movement in the real discount rate is estimated to add 12% to the liabilities of the scheme.

As a result it is very difficult to predict the impact of pension accounting adjustments as part of the annual budgeting process. Information from our actuaries is provided once a year as part of each year-end and includes a projection of pension cost items for the following year. The report on the projection for 2016/17 was available in April 2016 well after the submission of our budget proposals for 2016/17 in November 2015.

Pension accounting adjustments required in respect of IAS 19 have generated both favourable and unfavourable variances in our accounts and over the past ten years have generated net cumulative surpluses of £4.2m. The values have been as follows:-

	£k
2015/16	(1,826) unfavourable
2014/15	(1,518) unfavourable
2013/14	(1,089) unfavourable
2012/13	(11) unfavourable
2011/12	289 favourable
2010/11	6,516 favourable
2009/10	(225) unfavourable
2008/09	784 favourable
2007/08	423 favourable
2006/07	875 favourable
<b>Total</b>	<b>4,218 favourable</b>

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The large favourable adjustment recorded in 2010/11 was as a result of the UK Government's decision to revise the basis of annual pension uplifts from RPI to CPI.

The accounting adjustments are notional and do not generate cash movements. As a result, when favourable, we have not sought to carry forward the sums involved.

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. This was the case in the last three years when based on the scheme actuary's report pension charges were estimated to be £1,045k (2013/14), £1,716k (2015/16) and £1,966k (2015/16) more than the budget sums provided in the budgets for those years. With the agreement of the SCPA and the Scottish Government's Finance department the requested additional funding cover was provided.

For 2016/17 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 April 2016 the estimated costs for 2016/17 will be £1,041k higher than the available budget. As a result we request that our 2016/17 budget is increased by £1,041k in the 2016/17 SBR. On the advice of the Scottish Government Finance department this adjustment will be dealt through the Annually Managed Expenditure (AME) process agreed with HM Treasury.

The increased charge is driven by the continuing impact of low net discount rates used to value pension liabilities. Low rates increase future pension liability forecasts and in turn the estimates for in year pension service costs. This rate was 1.2% at March 2016.

The expectation of continuing low interest rates in the next few years may require similar large accounting charge adjustments in 2017/18 and beyond. In such circumstances further requests for budget revisions to meet additional pension charge adjustments may be required in the future.

## Conclusion

The Spring Budget Revision proposals presented in this paper will:

- provide non cash funding of £1,041k to allow Audit Scotland to meet increased non cash pension charges that will occur in 2016/17 as a result of accounting adjustments required under IAS 19.