

leading the debate on public sector pensions

Public sector pensions can be an emotive issue. Richard Harbord makes the case for a balanced study into long term pension provision.

■ **The subject of pensions for public sector workers is clearly a very controversial and emotive subject. It has become even more so as we move into recession and outside commentators complain about the 'gold plated' pension provisions for the public sector.**

The critics maintain that whereas pensions were once seen as some kind of compensation for the comparatively low pay in the public sector, circumstances have changed and a major re-think is now needed. According to the *Daily Telegraph* there are over 1000 town hall workers earning more than £100,000 per annum. On the other hand the Transport and General Workers Union asserts in its briefings that the average local government pension is around £3,800 per annum which reflects the large numbers of part-time lower paid workers that local government employs.

In the face of all this it is very difficult to see what the truth is and where pension policy should take us.

different structures

One of the difficulties about such a subject is that commentators insist on talking about

public sector pensions as if they were all the same scheme and of course that is not so and furthermore the structure of the various pension funds varies considerably.

This is not an article to discuss the various arrangements currently in place but it should be noted that the arrangements vary considerably from the Local Government Pension Scheme, which is a funded scheme. In essence this means that the contributions of employees and employers are ring fenced, kept as a separate fund by each major local authority and actually invested.

The main criticism levelled at this Scheme is that the employers' contribution has risen considerably over the years, something that is of course met by the taxpayer. The scheme has recently altered to increase contribution rates from employees on a tapering scale. The pension age is also to rise and with other changes the strategy is to maintain the scheme but to lessen the cost.

At the other end of pension fund provision are the pay as you go schemes found in the Police and most of central government. In these schemes the contributions and pension costs are all met each year from the revenue account of the organisation concerned. This can be very volatile and means that over time an increasing proportion of the budget falls to be met from current revenues.

In between there are schemes like the Teachers Pension Fund which is a notional funded scheme and so on.

The point is that it is not right to talk about the public sector as a whole but there is a need to be a little more targeted to produce reasonable debate.

The Pensions Policy Institute notes that as a proportion of GDP, unfunded pension funds in

the public sector will move from 1.5% to 2.3% over the next 30 years. This is after the £13bn savings in costs largely found by extending normal pension age.

transparency

One of the other major criticisms made by commentators including the political parties over the last few years has been the lack of transparency in accounting for pensions in the public sector. This is not a criticism that accountants working in the public sector would recognise or agree with.

The 14 main unfunded central government schemes covering some 5.5m employees have moved from cash accounting to resource accounting and then in 2004 to a form of financial statement which takes elements of the Pensions SORP and the Accounting Standards Board Financial Reporting Standard 17.

These mean that every year each scheme publishes:

- a FRS 17 compliant valuation of scheme liabilities
- the current service cost (growth of liabilities from another year's active service)
- level of contributions needed to balance against actual level of contribution collected
- total cash outflows and inflows.

This is a very comprehensive set of data which enables reasonable conclusions to be drawn.

LGPS

The other major public sector scheme is the Local Government Pension Scheme (LGPS), covering 4m employees and pensioners. The LGPS produces accounts in accordance with



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LAASAC Code of Practice which takes its pensions' guidance from the Pensions SORP which is the industry standard for private sector schemes as well.

From 2008/09 local authority administering bodies must also publish a comprehensive report including an actuarial statement, investment policies etc.

Included in the accounting guidance is the need to follow FRS 17 and the levels of disclosure in local government accounts compare well with the private sector.

The following of the requirements of FRS 17 have in themselves caused difficulties for local authorities. FRS 17 is the accounting standard for pension costs. Prior to its implementation it had only been necessary to show cash contributions into pension schemes as a pension cost in year end accounts.

Although a complex standard, FRS 17 has a simple mission which is that an organisation should account for retirement benefits when the commitment to give them arises even if they will not come into effect for many years.

Thus the value of pensions accrued together with the value of assets set aside to meet these liabilities is shown in an actuarial statement to the balance sheet.

This did, of course lead to local authorities showing for the first time large deficits often far in excess of the total reserves of the local authority. This has in turn caused considerable disquiet, particularly with overseas funders, who felt that this showed authorities as being in effect insolvent. It therefore has to be understood that it is a snapshot of the fund at balance sheet date showing all liabilities which will in the normal course of events be met steadily over a period of time, and met by new assets.

recent changes

Changes have been made to public sector schemes recently including extending normal pension age and reducing the possibility of easy early retirement, but there is no doubt that there are difficulties ahead. An immediate difficulty is that in the next year an actuarial

review is statutorily required in the LGPS and with the current investment climate that will hardly bring good news. Although investment is long term and we hope that fund investments will recover to their former levels, the news of even larger deficits in the short term will add to the clamour for reform.

There has been pressure for a commission to be set up and the Conservative Party has indicated a major reform of final salary schemes. A move to an average salary scheme or something similar will be raised again.

fundamental review

However, there does need to be a much more fundamental review of pension provision and central government support for the longer term. It is a much talked about matter that people are living longer and the demography indicates that in 30 years' time more people will be on pensions.

In addition the costs of social care and health care will climb steeply. The fundamental question is will the basic state pension be adequate to cope or will there have to be a major rise in pension credits in order that people can live comfortably in their old age? Will this support be lessened or worsened by supporting the current final salary schemes in both the private and public sector?

There is a real need to have a balanced study into pensions in the longer term. ■

Richard Harbord is an independent finance consultant and member of the ACCA UK Public Sector Network Panel