

IFRS is coming to pension scheme accounts

UK accounting standards are giving way to a tiered system whereby 'publicly accountable' entities are required to report under IFRS.

Although pension scheme accounts rarely attract public interest, the UK Accounting Standards Board (ASB) proposals on the future of UK GAAP would require pension schemes to comply with the more onerous requirements of reporting under full EU-adopted IFRS.

ASB consulting on the future of UK GAAP

Following the widespread international acceptance of IFRS and the creation of an IFRS standard for small and medium entities, the ASB is consulting on the future of UK GAAP. Its proposals would create a 3-tier structure, based on public accountability. One of the definitions of a publicly accountable entity is one that holds assets in a fiduciary capacity for a wide group of outsiders. The ASB believes that pension schemes are deemed to fall in this definition, reiterating the view that *'the objective of pension plan financial statements is to provide information about the financial position, performance and changes in financial position of a pension scheme that is useful to members, and those who act in their interests, in making economic decisions and assessing the stewardship of trustees'*¹.

How does this impact pension schemes?

By law, pension schemes report under the Statement of Recommended Practice (SORP). The SORP is an interpretation and application of UK GAAP. Therefore, when the main UK GAAP statements are rescinded, the SORP would need to be revised to tie it to the new reporting framework, i.e. EU-adopted IFRS.



What are the likely key changes?

The ASB believes that users of financial statements need information about an entity's exposure to risks and how these are managed. The SORP currently includes limited quantitative and qualitative disclosure on the risks arising from financial instruments. Risk disclosures for pension schemes adopting IFRS will need to be enhanced, including:

- Greater qualitative disclosures on exposures to particular risks, and the objectives, policies and processes for managing those risks;
- Quantitative disclosures on risk management including sensitivity analysis; and
- Inclusion of a fair value hierarchy of investments, providing users with information about the basis of valuation and the extent to which it derives from the market.

Recognition and measurement criteria

We do not envisage any fundamental changes to contributions and benefits accounting. Investment accounting for pension schemes is fundamentally already aligned to IFRS investment accounting with recognition on a bid price basis and changes in fair value taken through the income statement – for pension schemes, the fund account.

¹ Source: The Accounting Standards Board October 2010 Exposure Draft: *The Future of Financial Reporting in the UK and Republic of Ireland*

Rekindling the actuarial liabilities debate

In their current form pension scheme accounts effectively show only one half of the balance sheet – the assets held to meet benefit liabilities, but not the benefit liabilities themselves. IFRS allows but does not mandate the inclusion of actuarial liabilities in the audited financial statements. Whilst the ASB continues to favour recognising actuarial liabilities in pension scheme accounts, it recognises further work is necessary to accommodate the purpose of the accounts (stewardship or general purpose?), the “ownership” of the liability (employer or the scheme?) and considers the expense of quantifying and auditing actuarial liabilities compared to the benefit to users of including them in the financial statements.

It has always been our opinion that actuarial liabilities meet the definition of a liability for pension schemes and should therefore be included in scheme financial statements. If the SORP is revised to bring it into line with IFRS, this debate will likely be rekindled. We will continue to actively contribute to this debate.

Disclosing employer guarantees as an asset

The debate over actuarial liabilities has also raised the notion that, conceptually, the employer’s covenant should be recognised as an asset in the pension scheme’s financial statements. There is widespread acceptance that this presents a number of practical difficulties, including the cost of measurement of an asset based on the employer’s creditworthiness and the employer’s desire for confidentiality. An alternative approach, to require narrative disclosure of how the difference between the assets and liabilities will be funded, is gaining greater support in the industry:

What do pension schemes need to be considering?

The implementation of full scope IFRS is expected for scheme years ending December 2013, dependent on changes to the law and the SORP. There are a key number of areas Trustees should already be considering:

Is there a sufficient level of management information already available?	The need for enhanced disclosures for investments is reliant on the aggregation of data on risk management and measurement. Trustees will need to consider their processes in detail.
Are the scheme’s administrators and accountants ready?	The changes will require additional disclosures and a revision to the presentation of the financial statements, in particular with IFRS 7.
Can your investment managers/custodians provide you with fair value hierarchy support?	Our wider experience with auditing fair value hierarchy disclosures for our financial services clients highlights the varying quality of information available from investment managers/custodians. Key areas of challenge have been the need to clearly agree criteria for grouping assets into levels based on their basis of valuation, for example, bonds which are rarely traded on public markets.

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