ICAEW REPRESENTATION 97/14

STATEMENT OF RECOMMENDED PRACTICE: FINANCIAL REPORTS OF PENSION SCHEMES

ICAEW welcomes the opportunity to comment on the exposure draft *Statement of Recommended Practice: Financial Reports of Pension Schemes* published by the Pensions Research Accountants Group on 16 April 2014, a copy of which is available from this link.

This response reflects consultation with the Pensions subcommittee of the ICAEW Business Law Committee and with the Financial Reporting Faculty. The Business Law Committee includes representatives from public practice and the business community and is responsible for ICAEW policy on business law issues and related submissions to legislators, regulators and other external bodies. The Financial Reporting Faculty is recognised internationally as a leading authority on financial reporting and, through its Financial Reporting Committee, is responsible for formulating ICAEW policy on financial reporting issues and makes submissions to standard setters and other external bodies on behalf of ICAEW. The Faculty provides an extensive range of services to its members including providing practical assistance with common financial reporting problems.

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MAJOR POINTS

1. We appreciate that the investment risk disclosures for pooled investment vehicles set out in section 3.16 of the draft SORP are driven by the requirements of FRS 102. However, we do not consider that the Financial Reporting Council has made the case for the benefits of the additional information for users of pension scheme accounts. We have concerns that the depth of detail proposed for investment risk disclosures for pooled investment vehicles set out in section 3.16 of the draft SORP could be expensive to provide with little or no increase in usefulness for the members of many schemes.

2. Given the cost of obtaining information and making disclosures over and above previous requirements, it is important that the SORP does not gold plate the requirements of FRS 102 itself.

3. The proposed SORP appears to state that the basis for the approach to be used in assessing the risks attaching to a pooled investment vehicle should depend on the trustees' intentions in holding the investment. We do not agree that the purpose of an investment affects the actual risks that the investor is exposed to simply by holding that investment.

RESPONSES ON PARTICULAR ISSUES RAISED IN THE INVITATION TO COMMENT

Annuities

4. Paragraph 3.12.22 states that, if an annuity value (ie, the gross value, not the value net of the liabilities for which the annuity has been purchased) determined in accordance with FRS 102 is considered insignificant in relation to the Statement of Net Assets of the scheme and the costs of obtaining it outweigh the benefits of including the value, the annuity is not valued in the Statement, and a note to this effect is included in the financial statements. We are not convinced that it is appropriate for the SORP to use cost/benefit considerations as a basis for non-disclosure of 'insignificant' amounts. It is generally acknowledged that the treatment of immaterial items may depart from accounting standards without affecting the truth and fairness of the accounts, and so we consider that no reference to a cost/benefit assessment is required. If, however, this cost/benefit wording is retained in the SORP, then guidance should be given on how trustees should assess what the 'benefits' are, and how they are to be measured. Otherwise the statement is meaningless and should be omitted.

5. As noted in paragraph 3.12.18, FRS 102 requires annuities to be stated at fair value, which is the present value of the related obligation. However, we do not consider that the SORP should prescribe how the present value of the related obligation is to be calculated, as different bases may be appropriate for different policies and the relative value of the policies to the fund as a whole. We recommend instead that the SORP allows the trustees to exercise their judgment as to the most suitable basis in the circumstances. For example, where the intention is to hold an annuity in the longer term (which is likely to be the case in practice), it may be appropriate to base the valuation of annuities on that incorporated in the latest triennial valuation of the scheme. The greater the relative value of the annuities to the scheme as a whole, the more likely it will be that a more detailed method will be required to establish the fair value between triennial valuations, rather than relying on a simple roll-forward from the latest available valuation. The reference to the latest triennial valuation could also be used in para 3.12.22 to help set a clear and consistent benchmark for all trustees in assessing if the value of annuity contracts is likely to be significant.

6. It would be helpful if the SORP also commented on the key risk associated with the annuity asset being that of failure of the product provider (credit risk). If there are collateral arrangements in place, then these too should be disclosed in the accounts.

Investment risk disclosures

7. We recognise the role of the SORP in interpreting the requirements of FRS 102, but we question the value of the proposed investment risk disclosures in the absence of similar quantified information on risks associated with DB scheme liabilities, particularly as many schemes now include at least an element of liability interest rate and inflation risk matching in their investment strategies. Trustees will realistically not have the option of voluntarily including such quantified risk disclosures relating to liabilities in the audited accounts, as this would bring the liability figures themselves into the scope of the annual audit.

8. Obtaining and organising the information will involve very real costs for preparers that will ultimately fall on the pension fund itself. We are concerned about the impact of the proposed look through requirements in relation to risk disclosures on pooled investment vehicles. We consider such disclosures to be of limited relevance to pension scheme accounts, which are not publicly available and are generally not used by scheme members as a basis for making investment decisions.

9. Our comments on the proposed investment risk disclosures in the SORP are, therefore, made subject to the reservation that we consider the requirements of FRS 102 section 34.43 in relation to investment risk disclosures to be unduly burdensome.

10. In this context, the SORP should not seek to 'gold plate' the requirements of FRS 102: disclosures over and beyond those required by FRS 102 should be a matter for the judgment of the trustees, as paragraph 3.12.22 explains in the case of annuity valuation.

11. We do not agree that the basis for the approach to be used in determining the extent of the risk disclosures of a pooled investment vehicle should depend on the trustees' intentions in holding the investment. The purpose of an investment has no effect on the actual risks that the investor is exposed to simply by holding that investment. It needs to be made clearer that, whilst the disclosures may vary, the assessment of risks for pooled investments should be the same, as one reading of the current SORP is that there could be inconsistency across the sector in the risks attributed to identical assets. The trustees may in practice have different levels and detail of information about different investments from fund managers depending on the nature of those investments. For example they are likely to have full look through for a FTSE 100 fund but may not for a hedge fund.

12. Further, the approach itself should reflect the nature of the fund. For example, balanced funds are designed to balance out the risk of any one asset class so as to provide less volatility. If applied to balanced funds, the drill down approach would present the risk of each asset class individually rather than recognising that the overall fund balances out many of those risks so that analysis at unit level is sufficient. However, if the fund does not achieve the intended balance, then the gross exposure arising from the individual components would need to be recognised.

13. Only where it is not possible for trustees to obtain details of the underlying assets – for example in some types of hedge fund of funds – should it be permissible for risk disclosures to be made at the pooled vehicle level. In this case the disclosures should describe the structure of and risks associated with the pooled investment fund itself.

Fair value hierarchy

14. We suggest that the proposed distinction of investments between category c(i) and c(ii) set out in paragraphs 3.12.8 to 3.12.10 be optional rather than a requirement, depending on whether the trustees consider that a split between categories would be useful to members of the scheme.

15. We recommend that paragraphs 3.12.5 and 3.12.6 be revised to make it clearer that reclassification between categories (a) and (b) would be expected to arise from a change in liquidity in the market, ie, a fundamental or significant change. We should not expect reclassification from one year to the next simply because of the timing of the year end or most recent transaction. In this context, we recommend that the SORP give guidance on the classification of weekly priced funds.

Financial statement presentation

16. We welcome the clarification of requirements and illustrative example including comparative figures for hybrid schemes in Appendix 1. However, it may be helpful to provide additional examples, to avoid inappropriate boilerplate presentations or the assumption that other formats are not allowed. Whilst this may be more demanding for preparers of accounts, it will result in better information for scheme members.

Auto-enrolment

17. We agree with the approach taken by the SORP. However, we note that some schemes currently only account for contribution income after the member’s opt-out date has passed, even if the cash has been remitted to the scheme by the employer. Before the opt-out date has passed the scheme effectively accounts for the cash received as income in advance because the employees are not members of the Scheme at this point. We consider that this is an acceptable alternative treatment, and so should not be prevented by the SORP prescribing only the approach of accounting for contribution income when received from the employer.

Legislative disclosure requirements

18. We agree with PRAG’s view that the legislative disclosure requirements in relation to investment classification as set out in the Audited Accounts Regulations should be updated to come into line with FRS 102 and the draft SORP. However, rather than simply updating the legislation, it is preferable for the detail to be removed from the legislation, which would then be future-proofed by cross-referring the legislation to the SORP.

Concentration of investments

19. We consider that the concentration of investments note provides useful additional information on risk which is not superseded by the proposed new investment risk disclosures. We therefore support retaining the requirement for disclosure of investments other than UK Government securities in which more than 5% of the total value of the net assets of the scheme is invested, but we do not think it is necessary to adopt the ‘look through’ approach in relation to pooled investment vehicles.

Other issues

Accounting for repurchase and reverse repurchase agreements and stock lending

20. We consider that the proposed accounting treatment in paragraphs 3.18 and 3.19 is reasonable. However, these kinds of transaction are likely to be increasingly common in the future with a corresponding increase in concerns around the completeness of reported transactions. More guidance is likely to be needed when the SORP is next updated.

21. There is no mention of collateral arrangements in paragraphs 3.19.1 or 3.19.2. We consider that information about such arrangements should be provided as being at least as useful and relevant to users as an analysis by asset class of the securities out on loan, as this collateral effectively replaces the assets on loan in cases of default.