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PENSION SCHEME ACCOUNTING DISCLOSURES TIME FOR ACTION!

The Financial Reporting Council has issued revised financial reporting standard FRS102 which is mandatory in the UK and will apply to companies and pension schemes for financial years ending after 1 January 2015.

The Pensions Research Accountants Group (PRAG) has issued a revised pensions Statement of Recommended Practice (SORP) resulting in new disclosure requirements for both defined benefit and defined contribution scheme investment assets (including AVC assets).

The key changes are:

- Investment valuation hierarchy
- Investment risk disclosures
- Annuities valued
- Analysis of transaction costs.

Valuation Hierarchy

There is a new requirement to analyse investments according to the following four-tiered valuation hierarchy which is broadly based on liquidity.

Trustees will need to obtain opening balances from their investment manager. For example, for schemes with a financial year ending 31 March 2015 it will be necessary to obtain this information at 1 April 2014. This may prove challenging where trustees invest in funds with discretionary mandates, multiple assets or in funds which invest in other funds.

However for the majority of pooled funds this information should be available from the investment manager and aggregated across managers/ funds. Action should be taken in advance of the financial year end to establish opening balances.

PRAG is currently consulting on the interpretation of some practical aspects of the valuation hierarchy and we expect this to be completed by the end of February 2015. They apply to both defined benefit and defined contribution schemes.

Investment Risk Disclosures

Trustees will be required to explain the nature and the extent of investment risks, quantify the risk exposures, explain how they arise and set out their policies for risk management. The risks set out by FRS102 are as follows:

- Credit (counterparty) risk
- Interest rate risk – the risk that the fair value or cash flows will fluctuate because of a change in market interest rates
- Currency risk – the risk that the fair value of cash flows will fluctuate because of changes in foreign exchange rates
- Other Price risk.

For each type of credit and market risk arising from financial instruments, a scheme is required to disclose:

- the exposures to risk and how they arise
- its objectives, policies and processes for managing the risk and the methods used to measure the risk, and
- any changes from the previous period.

Although the risk disclosures are narrative rather than quantitative, they will be specific for each scheme. The SORP provides some guidance on typical disclosures which could include:

- How the risks arise in the context of the scheme's investment strategy. For example, foreign exchange risk arises where the trustees have chosen to diversify the investment portfolio into securities priced in foreign currencies. Credit risk will arise in bond portfolios which could be part of a liability driven investment strategy.
- The investment strategy is set taking into account wider risks. For defined benefit schemes these wider risks will relate to the employer covenant, actuarial liabilities and funding. For defined contribution schemes these wider risks will relate to cost of annuity purchase, level of contributions and member investment choices. Trustees may find it useful to put the investment risks required to be disclosed by FRS 102 into the wider context of other scheme risks.
- For defined contribution schemes investment risk at a scheme level may not be directly relevant to individual member investment risks. Trustees may therefore wish to consider making risk disclosures by reference to member investment funds, or the more significant member funds, such as the lifestyle or default fund.
- Disclosures relating to the objectives, policies and processes for managing the risks and the methods used to measure the risks should explain how the trustees set their investment strategy, how this is translated into investment guidelines and limits for investment managers and an explanation of the trustees approach to monitoring investment risks through management information. For example, where the Statement of Investment Principles (SIP) sets out the asset allocation for the scheme, it may be useful to explain the investment risk management process in the context of the SIP, how investment assets are allocated in accordance with the SIP and how they are monitored for compliance with the SIP.

Annuities valued

The revised SORP requires that annuities that match liabilities need to be valued on a scheme funding basis. Trustees will need to make reasonable efforts to determine whether their records of annuities are up to date, although we await guidance on how 'reasonable efforts' will be determined. Trustees will need to ask their actuary to provide a valuation and update this annually.

Transaction costs

There is a requirement to analyse the type of direct transaction costs by significant asset class as the FRC require disclosures in relation to transaction costs to be more transparent. However this will not affect investments in pooled funds.

Actuarial liabilities

The SORP requires defined benefit pension schemes to disclose information alongside the financial statements on the actuarial position (based on the most recent valuation), the significant assumptions and method used to calculate the valuation.

Our experienced investment team will ensure that your conversion to the new UK SORP runs smoothly, improves communication between key stakeholders and minimises costs of transition and ongoing compliance.

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Helping you make it happen

We can support you through the implementation process for the new disclosure requirements and to ensure it runs smoothly by helping you to:

- Ensure your administrators and asset managers are aware of the new requirements and their responsibilities
- Obtain valuation hierarchy information for opening balances well ahead of the scheme year end from your investment managers
- Aggregate data across managers if applicable
- Prepare draft disclosures relating to investment objectives, policies and processes
- Liaise with your scheme auditors to ensure all disclosure statements are in accordance with the revised SORP.

If you would like to discuss this please contact your usual Broadstone consultant or:

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