



Beware: new SORP!

The Statement of Recommended Practice, Financial Reports of Pension Schemes (“the SORP”) was revised in May 2007 and is effective for all scheme years commencing on or after 6 April 2007. Early adoption is recommended and as such many schemes are currently going through the process of applying the new recommendations for the first time.

This helpsheet summarises the key changes arising from the new SORP to the Fund Account, Net Assets Statement and Notes to the Accounts, as well as some hints on best practice for both the accounts and the Annual Report.



Helpsheet No. 8 Beware: New SORP!

“Ash Shaw are specialists in pensions so they have the knowledge and know what to look for.”

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Fund Account

There are very few changes to the face of the Fund Account, although the detailed disclosures have experienced more of a facelift - see the section Notes to the Accounts below for more detail.

The changes to the Fund Account itself are simply that the account captions have changed from contributions receivable to contributions and from benefits payable to benefits.

Net Assets Statement

The face of the Net Assets Statement has seen a few more changes and there are significant changes to the underlying detail, particularly for investments.

On the Net Assets Statement itself, there are presentational changes:

- The ‘investments’ caption is now called ‘investment assets’;
- If there are any, then ‘investment liabilities’ should be shown as a separate line on the Net Assets Statement;
- Current assets and current liabilities should be shown as separate line items on the Net Assets Statement each with their own corresponding note to provide further detail - previously these were disclosed as one figure on the Net Assets Statement - ‘net current assets / (liabilities)’;
- For defined contribution schemes, the SORP has removed the need to split the Net Assets Statement between those assets and liabilities designated to members and those not designated. Further detail on money purchase assets is included below in ‘Notes to the Accounts’; and
- the explanation that the accounts do not take account of liabilities to pay pensions and other benefits after the scheme year end, which is usually included in the Basis of Preparation note, should be given more prominence and so is being moved to the foot of the Net Assets Statement.

The most significant change which affects the figures disclosed in the Net Assets Statement is the move to value investments, including derivative contracts, on a fair value basis. In simple terms this will mean that where there is an active market, the bid price is the most appropriate market price to use when valuing investment assets. For derivative contracts, the recommendation to value on the basis of associated economic exposure has been replaced by a fair value basis.

These changes and the impact on presentation and disclosure are covered in greater detail below, in ‘Notes to the Accounts’.



Helpsheet No. 8 Beware: New SORP!

Notes to the Accounts

The Notes to the Accounts will need to be considered in detail and are taken in turn below, starting with the Basis of Preparation and Accounting Policies, then running through the usual notes which support the captions in the Fund Account and Net Assets Statement.

Also, as a general point, the practice of referring to the Fund Account, Net Assets Statement and Notes collectively as the 'Financial Statements' has been changed to 'Accounts'.

1. Basis of Preparation

As noted above, the paragraph which deals with the explanation that the accounts do not take account of liabilities to pay pensions and other benefits after the scheme year end, has been removed from the Basis of Preparation note and placed at the foot of the Net Assets Statement, for both defined benefit and defined contribution schemes.

If the provisions of the new SORP are being adopted early, then a note should be inserted here to explain that this is the case.

2. Accounting Policies

Considerations for first year of the new SORP

Since the new SORP is suggesting some changes to accounting policies, e.g. fair value accounting for investments, consideration must be given to the comparative figures and the question – to restate or not to restate?

On this subject, the SORP sets out transitional provisions with regards changes in accounting policies arising on implementation of the revised SORP. In summary, the SORP states that comparative figures do not need to be restated in the year of transition:

- For a change in accounting policy with respect to the valuation of investment, **if the difference is immaterial**, with reference to FRS18; and
- Where additional information is disclosed for the first time in respect of transaction costs and the comparative information is not available. However, the scheme should disclose this fact.

Where comparatives are not restated, the existing (i.e. old) accounting policies should be applied to the comparatives and disclosure should be made of the basis on which the comparatives are disclosed and the main adjustments which would be necessary to make the information comply with the new requirements.

Where presentational changes have been made, the comparative amounts should be adjusted.

You may conclude that it is in fact easier and indeed better practice, to restate the prior year balances.

When implementing a change in accounting policy, the notes should give details of the change including a brief explanation of why the new policy is thought more appropriate, the effect of a prior period adjustment on the results of the previous period and an indication of the effect of the change in policy on the results for the current period.



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“Our relationship is very good. What is important is that they are professional and friendly, they have the right balance and are enjoyable people to work with.”

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Practical tip – before deciding whether to adopt early, consider if the information you will need is available. Remember that in order to restate the 2007 investment balance, for example, you will also need the 2006 bid prices to correctly adjust the change in market value figure in the Fund Account!

If the thought of accounting for a change in accounting policy leaves you cold, just [ask Ash Shaw](#) – we’re happy to help.

Contributions

The basis of accounting for contributions remains unchanged but the descriptions of the types of contributions should be updated to ensure that they are consistent with the terminology used in the contributions note. Ensure also that the accounting policy is explained for all major categories of contributions.

Investments

The investments accounting policy note should disclose the new basis of valuation. As noted above, if comparatives are not being restated, both the old and new basis of accounting will need to be disclosed.

3. Contributions Note

The key changes in the contributions note recognise the varying methods of funding scheme contributions and so seek to clarify the related descriptions and disclosures:

Terminology

- Contributions paid to augment specific members’ benefits should be disclosed as ‘Employers’ augmentation contributions’ rather than the historic practice of calling them additional or special contributions;
- Contributions paid by the employer as a single payment or for a limited period to improve the funding of the scheme should be disclosed as ‘Employers’ deficit funding contributions’ instead of additional or special contributions. If the employer’s deficit funding is not paid as a separately identifiable amount but instead is included in the contribution rates based on wages and salaries, the notes to the accounts should explain that employer normal contributions include deficit funding payments, and the amount should be quantified and disclosed in the notes. If the amount cannot easily be quantified, the notes and the Trustees’ Report should explain the rates paid in respect of deficit funding and current service contribution payments. In any event, the notes should explain for how long deficit funding contributions are payable and the amounts payable where these relate to past service benefit accrual; and
- ‘other contributions’ which may be paid, for example to contribute towards the administrative costs or life assurance premiums, should be accounted for in accordance with the agreed arrangements.



Helpsheet No. 8 Beware: New SORP!

Section 75 debts

Contributions payable in respect of Section 75 debt are payable when an employer ceases to be a participating employer in a scheme and the scheme actuary determines there is a past service deficit for members who are or were employees of the employer.

The Section 75 debt should be accounted for when paid or when determined by the scheme actuary, whichever is earliest. If the Section 75 debt is met by way of, for example, a guarantee, it should not be recognised unless or until an asset arises from the guarantee. As there is no statutory timescale within which a Section 75 debt must be determined, this should be disclosed in the notes to the accounts and an estimate of the debt should be included or a statement that the debt cannot be estimated with the reasons why.

4. Investment Income Note - annuity income

Income from annuity policies which is initially paid to the trustees in order to fund the pension paid by the scheme to the pensioner, should be included in investment income and the pensions paid to the pensioners included in pension payments. There should be no netting off of these amounts. Under the previous SORP, these amounts could be netted off, with disclosure of the value of annuity income if this was material.

5. Investments Note

Basis of valuation

The key change for investments is the move to fair value accounting. These changes have arisen in order to bring the SORP into line with recently issued Financial Reporting Standards, FRS 25 (IAS 32): Financial instruments disclosure and presentation, and parts of FRS 26 (IAS 39): Financial instruments: recognition and measurement.

So for quoted securities, investments should be included at the closing price – these may be the last traded price or bid price depending on the convention of the stock exchange or other market on which they are quoted, rather than last traded or mid. Pooled investment vehicles should be included at the closing bid price if both bid and offer prices are published, or if single priced then at the closing single price.



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“It’s easy doing business with them they are on the ball with ideas to make things happen and are very thorough.”

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Derivatives

The previous SORP provided guidance for accounting for futures and options but this has been widened in the latest revision to cover all derivative contracts. The SORP provides an overview of the accounting and disclosure requirements, but for more detailed guidance refer to the PRAG publication “Accounting for Derivatives in Pension Schemes”.

Key points to note are:

- derivative contracts should be disclosed separately under investments and further analysis should be given of the contracts by their main types e.g. futures, options, swaps, forward foreign currency contracts, and further analysed between exchange traded and over the counter;
- derivative investments with positive values should be included in the Net Asset Statement as assets and those with negative values should be included in the Net Asset Statement as liabilities. These balances should not be offset unless there is a legal right of offset;
- derivatives should be included in the net assets statement at fair value – the SORP sets out detailed guidance on the relevant valuation bases for the various types of contract;
- the accounting policy notes should include a description of the basis of valuation for derivatives;
- disclosure should be made of the key details of the contracts in place at the end of the scheme year, such as the types of contracts, the period covered, the counterparties to the contracts, the nominal values or gross exposures, the values at the year end and whether they are assets or liabilities;
- the amount and nature of any collateral held or pledged at the year end should be disclosed, as should the amounts of the initial and variation margin;
- the notes should contain sufficient information to aid the understanding of derivative products and the objectives and policies for holding such contracts;
- for schemes with derivative investments, the note which analyses investment movements will have new column headings - “purchases at cost and derivative payments” and “sales proceeds and derivative receipts”, as opposed to simply “purchases at cost” and “sales proceeds”; and
- if material, any income from derivatives will be separately analysed in the investment income note.

Investment Transaction Costs

The Exposure Draft of the SORP indicated that investment transaction costs would be separately included in investment management expenses in the fund account, rather than being netted against sale proceeds of investment transactions or included in purchase cost. Transaction costs include fees, commissions and duties. The final SORP states that, in fact, investment transaction costs should be added to purchase costs and netted against sales proceeds, as appropriate. However, the total amount of direct transaction costs on all investment types, including property, derivatives contracts and the costs associated with aborted investments, should be disclosed in the notes to the accounts under the investment movement summary.

This does not apply to indirect transactions costs such as bid-offer spread costs and costs charged within pooled investment vehicles. However, in such cases the notes to the accounts should explain the existence of these bid-offer spread costs.



Helpsheet No. 8 Beware: New SORP!

Other disclosures in the Annual Report

Going concern

The actuarial statement and actuarial valuation are the primary sources of information regarding the ability of a defined benefit (DB) scheme to meet the benefit promises. The Accounts do not provide any relevant information in this context. For a defined contribution (DC) scheme, the concept of solvency does not apply because the obligations of the scheme to pay benefits depend on the funds available at the time.

Therefore the going concern concept doesn't play a fundamental role in scheme accounting and as such the basis of preparation doesn't need to mention the concept of going concern unless the Trustees or employer have taken the decision to wind up the scheme.

Even in the case of a significantly underfunded DB scheme or where the trustees are aware that the sponsoring companies are experiencing financial difficulties, it should continue to be treated as a going concern unless a decision has been made to wind up the scheme or it has entered the PPF assessment period.

Once a scheme is in the process of being wound up, the Trustees' Report should refer to the annual actuarial report prepared under section 224 of the Pensions Act 2004, estimating the solvency of the scheme.

If the Accounts are prepared on a scheme cessation basis, this should be explained in the basis of preparation note together with the reasons why and the impact, if any, on the bases of valuing the scheme's assets and liabilities should be disclosed in the notes to the accounts. In such cases, the bases of valuation of assets should be re-examined to ensure that the methods used are consistent with the intended method and timescales for wind up.

The SORP provides detailed guidance for consideration for schemes in winding up, and similar situations.

Pension Protection Fund (PPF)

A scheme will enter a PPF assessment period if an employer experiences an insolvency event and when certain other criteria are met. The likelihood is that the scheme will then enter the PPF. At this point, the scheme is treated as being wound up immediately.

When a scheme enters the PPF assessment period, accounts will need to be prepared for the purposes of a Section 143 valuation. The accounts should be prepared on a cessation basis and the valuation of assets and liabilities should be consistent with the likely potential timescales and method of entry into the PPF. Trustees may then choose to use the Section 143 effective valuation date as a revised statutory accounting reference date and the anniversary for future statutory accounts.



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“If you’re proactive, you don’t have to wait for circumstances or other people to create perspective expanding experiences. You can consciously create your own.”

Stephen R.
Covey

Contingent assets

Contingent assets include arrangements put in place with the employer which provide certainty that the employer can make further deficit funding contributions to the scheme in certain circumstances by making the assets available via a secure arrangement, for example through letters of credit, guarantees and escrow accounts. Details of these arrangements should be disclosed in the Trustees Report.

Contingent assets should not be recognised in the accounts until realisation of the gain is virtually certain. But a contingent asset *should* be disclosed in a note to the accounts when an inflow of economic benefit is probable. Disclosure should be made of the contingent asset at the net asset date and an estimate of its financial effect.

However note that where a contingent asset is recognised by the PPF for levy purposes this does not necessarily mean that the asset should be included in the scheme’s accounts. Guarantees in respect of future funding by the employer, as opposed to past funding, should not be disclosed as a contingent assets as these relate to future events.

Money purchase assets

A new distinction has been made for money purchase assets depending on where the ‘designation’ of assets takes place i.e. at the investment managers or the administrators:

- where the individual member’s contributions are invested separately (rather than in a common fund) the assets are ‘**designated**’ as being solely for the benefit of the names members;
- where money purchase investments are held on a pooled basis by the investment manager (i.e. the manager cannot identify investments by member) and the administrator keeps records of the allocation of investments by the member the investments are ‘**allocated**’ to members.

On the face of the net assets statement for a DC scheme the SORP has removed the need to split the net assets statement to those assets and liabilities designated to members and those not designated. However, this detail should still be disclosed in the Notes, as described below. Therefore this key information which forces the reconciliation of members’ units on a regular basis, and the recognition and monitoring of Trustees’ units, is losing prominence.

The notes to the financial statements should disclose investments designated to members, investments allocated to members and investments not designated or allocated to members i.e. held for the general purpose of the scheme. The SORP then goes on to say, rather contradictorily, that these categories should be grouped together and described as investments allocated to members and investments not allocated to members.

For non-investment current assets and liabilities, the explicit note disclosure of the make-up of current assets/liabilities between allocated and not allocated to members has been removed. However we suggest that, for clarity, this is an area where additional disclosure would be useful.



Helpsheet No. 8 Beware: New SORP!

Actuarial Information

The disclosure and inclusion of actuarial information is an area which combines the requirements of the Disclosure Regulations and best practice.

PRAG encourages the inclusion of the latest Summary Funding Statement, or extracts thereof, in the Trustees' Report. Where extracts are included this should include the values attributed to the technical provisions and the actuary's estimate of the solvency of the scheme.

The Disclosure Regulations require that the Annual Report for a DB scheme should include a copy of the latest certificate by the actuary of the adequacy of the rates of contributions for the purposes of meeting the minimum funding requirement (prepared under section 57(1)(b) of the Pensions Act 1995) or statutory funding objective (prepared under section 227 of the Pensions Act 2004), as appropriate.

For schemes where the MFR valuation is still relevant, the Regulation 30 statement should also be included in the Annual Report. Once the minimum funding regulations are no longer relevant to a scheme, the requirement to include the Regulation 30 statement falls away but PRAG encourages the inclusion of the actuarial certification of the technical provisions (prepared under section 225 of the Pensions Act 2004) in place of the Regulation 30 statement.

Statement of Trustees' Responsibilities

The wording used for the Statement of Trustees' Responsibilities should reflect the latest available wording issued by the Auditing Practices Board and set out in Practice Note 15 "The audit of occupational pension schemes in the United Kingdom".

This may need to be modified in the event of early adoption of the new SORP to ensure that early adoption is disclosed.

Monitoring versus procuring

A key change in the latest wording is in the section which refers to the Trustees' responsibilities in respect of contributions. Previously this paragraph said that the Trustees "are responsible... for procuring that contributions are made to the Scheme in accordance with the Schedule of Contributions / Payment Schedule". This implied that the Trustees would be responsible for any shortfall in contribution payments and so has now been revised to reflect the reality – that the Trustees "are responsible..... for monitoring whether contributions are made to the Scheme by the employer in accordance with the to reflect that the Schedule of Contributions / Payment Schedule". It also goes on to explain the requirement for Trustees to report any breaches of the Schedule. For a full copy of the revised wording of the Statement of Trustees' Responsibilities just [Ask Ash Shaw](#).

Good Governance

It is best practice in the Annual Report to provide an overview of how the scheme is managed and how the trustees demonstrate good governance. This may include details of any specific sub-committees and their activities, the Trustees' training plan and how they meet their training needs.