

CIPFA response to the Institute of Chartered Accountants of Scotland discussion paper on the accounting and disclosures of member organisations which belong to a multi-employer plan

30 November 2010



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30 November 2010

David Wood
Executive Director of Technical Policy
ICAS
CA House, 21 Haymarket Yards
EDINBURGH
EH12 5BH

Dear David

Discussion paper on the accounting and disclosures of member organisations which belong to a multi-employer plan

CIPFA is pleased to offer its comments on the ICAS discussion paper on the accounting and disclosures of member organisations which belong to a multi-employer plan.

General Observations

The discussion paper raises some interesting questions regarding the depth and quality of the disclosures of employers participating in multi-employer plans where they are unable to identify the corresponding share of the underlying assets and liabilities in the scheme and who account for it as if it were a DC scheme.

We agree that where an employer has financial commitments to a pension scheme that are not fully expressed under the current the FRS17/IAS19 disclosure requirements, there is always the potential for the financial relationship between the employer and the pension scheme to be miscommunicated or misunderstood. However we believe that the current reporting framework is sufficient to allow employers to provide the type of disclosures discussed in the paper and that promulgation of good practice by the accounting Institutes rather than amended standards or regulation could be used to raise the quality of pension-related disclosures. CIPFA has recently used this approach in connection with the financial reports of public sector pension schemes ("Narrative Reporting in Public Sector Pensions").

Specific comments on the questions for respondents are attached in Annex A.

I hope that you find these comments a useful contribution to the discussion on accounting and disclosures of member organisations which belong to a multi-employer plan. If you have any questions regarding any of our comments, please contact Nigel Keogh, at nigel.keogh@cipfa.org.

Yours sincerely



Una Foy
Assistant Director, CIPFA
3 Robert Street, London WC2N 6RL

Annex A

1. Should there be a concern that organisations participating in multi-employer plans, where there is an overall funding deficit, could potentially be weaker than their statement of financial position suggests by not showing the deficit on the balance sheet? How should this be addressed?

Where an employer has financial commitments to a pension scheme that are not fully expressed under the current the FRS17/IAS19 disclosure requirements, there is always the potential for the financial relationship between the employer and the pension scheme to be miscommunicated or misunderstood.

In the examples given, the fact that an employer is a participant in a pension scheme which operates a "last man standing" provision is significant and has the potential (albeit remote) to have a material bearing on the organisations financial position.

It is also significant if the employer is a participant in pension scheme which is carrying a funding deficit. The ability of the employer to service other liabilities (such as loan financing) may be affected by the need to service the pensions deficit. The pensions position therefore may be germane to the view of the organisations financial health taken by creditors or potential investors. It may also impact upon the organisation's ability to secure loan finance.

It is therefore important that the financial statements of the organisation convey sufficient information such that its financial interaction with any pension scheme is clear to the user of the financial statements.

2. Is it possible for organisations participating in multi-employer plans to do more to obtain the necessary information to allow them to account for their contributions to the scheme as a DB scheme – whether or not this is under UK GAAP or IFRS?

Under FRS17/IAS19 organisations participating in multi-employer plans where the employer is unable to identify its share of the underlying assets and liabilities in the scheme account as if it were a DC scheme.

However the example of the Local Government Pension Scheme (LGPS) demonstrates that it is possible for employers within complex multi-employer DB schemes to provide more than the basic DC disclosure. In the LGPS, the underlying assets and liabilities can be attributed to each employer and therefore participant employers are able to provide full FRS17/IAS19 disclosure.

In theory therefore it should be possible for some organisations participating in multi-employer plans to adopt a similar policy. In most, if not all cases, the pension scheme administrator will be able to identify:

- Active pension scheme members
- Deferred scheme members (by reference their employer at the point of exit)
- Pensioner members (by reference to their employer at the point of retirement)

This would allow an actuary to build up a picture of the liabilities associated with any given employer. When expressed as a proportion of the total scheme liability, this can then be used to determine the notional proportion of assets attributable to that employer, and consequently any share of deficit or surplus.

There are of course exceptions. Complex business combinations where the attribution of employees, past or present, to a particular reporting entity is not straightforward would perhaps struggle to follow the methodology set out above. This in turn would give rise to concerns as to whether the necessary source data upon which to base a valuation of assets and liabilities can be produced on a consistent and reliable basis.

A further point to note is that even if a pension scheme were able to employ the methodology set out above to build up a picture of the assets and liabilities associated with any given employer, there would be costs associated with obtaining the data and turning it into a disclosure form that met FRS17/IAS19 standards. This is considered further below.

a. Is the “consistent and reasonable” basis (UK GAAP) or the “with sufficient reliability” basis (IFRS) the right method to test how member employers’ account for their pensions in multi-employer plans?

Yes – the principles of consistency and reliability are fundamental to the conceptual framework of both UK and international reporting standards. There is no persuasive argument set down in this paper to justify setting aside these principles.

b. Should their auditors and/or actuaries be playing a bigger part in ensuring their client is making all reasonable attempts at obtaining the required information? Is cost an inhibitor in obtaining the information? If so, should there be a cost/benefit appraisal exercise?

Each reporting entity is responsible for applying and following the appropriate accounting standards when preparing its financial statements. If it is the employer’s assertion that it is unable to identify its share of the underlying assets and liabilities in the scheme on a consistent and reasonable basis, this should be tested through the audit process. Furthermore we do not believe that it is the role of the actuary to determine whether the employers’ choice of accounting treatment is correct or not.

As noted above, the cost of compliance is a major factor to be considered. In the LGPS, the average cost of providing employers with information to comply with FRS17/IAS19 disclosures is around £500 per annum. However this has only been achieved by actuaries maximising the economies of scale that large numbers of participatory employers presents; years of experience in streamlining processes; and significant investment in systems and personnel. The comparative data in the private sector, exemplified by schemes with fewer employers, can cost up to ten times this figure.

There is also the cost of additional accounts preparation and external audit time to consider, as well as any costs that might fall upon the scheme administrator in supplying data to the actuary to facilitate the necessary calculations. The costs of compliance therefore need to be weighed carefully against the benefits that might be derived from enhanced disclosure.

3. Should a lesser level of accuracy be accepted in providing estimates for the share of pension assets and liabilities on the grounds that the inclusion of best estimate deficits (or surpluses) in the member organisations' financial statements, or the disclosures of those deficits (or surpluses), is better than simply ignoring their existence?

The amount of effort required to provide any estimate of assets and liabilities per employer (other than on a purely superficial level) would equate to much of the work necessary to meet the FRS17/IAS19 DB disclosure requirements in full.

Therefore the middle ground between the full FRS17/IAS19 disclosure requirement and the approach taken by organisations participating in multi-employer plans where the employer is unable to identify its share of the underlying assets and liabilities in the scheme and who account for it as if it were a DC scheme, may be better addressed by enhanced narrative description surrounding the latter type of disclosure.

4. If this is not considered to be achievable, should there be more focused and individual wording used by organisations in their disclosures to inform the reader of the financial statements as to precisely why it was not possible to obtain this information? Is it desirable and/or necessary to have "boiler-plate" disclosure in these instances to maintain a level of consistency in the pensions reporting between member organisations of the same multi-employer plan?

As noted above, enhanced narrative description that expands upon the current requirement for organisations participating in multi-employer plans where the employer is unable to identify its share of the underlying assets and liabilities in the scheme may offer an alternative where employers are unable for practical or financial reasons to adopt the full FRS17/IAS19 DB disclosure.

This might include (in addition to the existing requirements of FRS17/IAS19):

- Disclosure of the reasons why full FRS17/IAS19 disclosure is not possible
- Any details of last-man standing arrangements within the scheme or disclosure of any other pensions liabilities that might fall on the employer (that are not directly related to the employer)
- A summary of the key financial assumptions underpinning the scheme and the sensitivity of the scheme to changes in these assumptions

For the purposes of maintaining consistency between member organisations in the same scheme, one should expect to see the same level of disclosure in each. However the precise content of the disclosures might vary dependent upon each organisations' exposure to the scheme.

It should be noted that the current disclosure requirements of FRS17/IAS19 do not preclude this type of disclosure.

5. In these situations should the “umbrella bodies” provide the member organisations with a core of common numerical information on the scheme for use in their financial statements with the member organisation supplementing this with their own information where applicable? Would this help in providing a consistency of reporting?

The primary source of data for disclosure will come from the pension scheme administrator.

6. Is there unnecessary confusion caused with the reporting of different valuation bases used and is the “scheme specific” basis the best one to use for reporting purposes? Would the Pension Protection Fund (PPF) or buy-out basis be more appropriate?

Whilst there may be different bases for valuing pension scheme liabilities, each serves a specific purpose and reflects differing levels of accepted risk within that valuation. The different results that these various approaches produce are not inherently contradictory and are capable of being explained as being the result of different valuation assumptions.

7. Is it acceptable for a SORP to include a scheme “self-certification” regarding a scheme and its assets and liabilities and the position of its employer organisations? Should these “umbrella bodies” have to demonstrate what steps they are taking to try and address the issue? Should the SORP provide this detail?

As noted at 2b above, each reporting entity is responsible for applying and following the appropriate accounting standards when preparing its financial statements. Whilst the pension scheme administrator might advise an employer on what information can be provided with regard to the scheme, it is not the responsibility of the administrator to determine how an employer should account for the scheme. Therefore it is for the member organisations to pursue the matter with the administrator if deemed necessary.

The content of SORPs is a matter for the SORP making bodies to determine and consult on, and subject to the approval processes of the ASB. We would hesitate to preclude mention of scheme circumstances and likely accounting consequences. However, we agree that the wording used in the Further and Higher Education SORP at paragraphs 200 and 202 might be seen as setting out accounting policies as a matter of fact without due consideration of subsequent developments, overriding the requirement to consider each scheme on the basis of circumstances at paragraph 199. Without further information on the facts of the schemes, we cannot comment on whether such an apparently permanent designation is appropriate, but this is perhaps something which should be considered when the SORP is next reviewed.

8. Are member organisations considering the contingent liability position in FRS 12 under UK GAAP? Should there be a move to amend UK GAAP to make the link to potential contingent liabilities more explicit? Should remoteness be a factor in disclosing this?

When an entity faces potential liabilities that are not addressed elsewhere in the financial statements, the requirement to consider the disclosure of a contingent liability arises. The example of a “last-man standing” arrangement is one where an organisation might consider such a disclosure as it bears similar characteristics to a joint and several liability (the example given in FRS12). However we believe that the existing provisions of UKGAAP (or IFRS) are already sufficient to warrant such a disclosure.

9. How far should the accounting and/or disclosures go under both UK GAAP and IFRS with regard to “last man standing” schemes? Should they be enhanced/reduced accordingly to reflect the risk of the scheme based on the funding levels? If a scheme is in deficit, should this automatically lead a contingent liability or would this be deemed as too remote?

As noted above, the example of a “last-man standing” arrangement is one where an organisation might consider such a disclosure as it bears similar characteristics to a joint and several liability. This, taken together with the existing requirement for a member organisation in a multi-employer scheme to disclose “any available information about the existence of the surplus or deficit in the scheme and the implications of that surplus or deficit for the employer”, should be sufficient to give the reader of the financial statements sufficient understanding of the employer’s financial relationship with its pension scheme.

10. Should the FRC/FRRP issue guidance (through the Accounting Standards Board, Auditing Practices Board or the Board for Actuarial Standards) on the need for quality disclosure and compliance with FRS17/IAS19 disclosure requirements and/or focus on these areas in their compliance work? Should the proposed revision to PN22 include an enhanced guidance appendix for the auditors of multi-employer plans?

As noted above, we believe that the current disclosure requirements are sufficient to allow employers to provide the type of disclosures described at Question 4. Each reporting entity is responsible for applying and following the appropriate accounting standards when preparing its financial statements and for providing the appropriate level of disclosure. If it is the employer’s assertion that it is unable to identify its share of the underlying assets and liabilities in the scheme on a consistent and reasonable basis, this should be tested through the audit process, as should whether the level of disclosure is sufficient to provide a clear picture of the employer’s financial interaction with its pension scheme. There may also be a role here for accountancy bodies to promulgate examples of good practice in disclosure as a means of demonstrating how the existing standards might be interpreted.