

# **Exposure Draft**

## **The Pensions Research Accountants Group**

Statement of Recommended Practice:

Financial Reports of Pension Schemes

**Issued on 16 April 2014**

# **ADDRESS FOR COMMENTS AND INTRODUCTION**

The Pensions Research Accountants Group would welcome comments on this Exposure Draft which should reach us by 16 July 2014.

Comments should be sent by email to:

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All replies will be regarded as on the public record unless confidentiality is requested by the commentator.

## **1) Introduction**

The Pensions Research Accountants Group ('PRAG') in conjunction with its SORP Working Party ('SWP') is pleased to publish this Exposure Draft which sets out a revised Statement of Recommended Practice: Financial Reports of Pension Schemes ('Draft SORP') intended to replace the current SORP ('2007 SORP').

Interested parties are urged to take the opportunity to consider and comment on this by the deadline of 16 July 2014. PRAG is extremely grateful for the time and effort spent in the review of the 2007 SORP and the production of the Draft SORP by the SWP.

## **2) Reasons for the revision**

In 2012 and 2013 the Financial Reporting Council (FRC) revised financial reporting standards for the UK. The revision fundamentally reformed financial reporting replacing almost all extant financial reporting standards and specifically addresses financial reporting by pension schemes.

In addition, since the 2007 SORP was published, regulations and the pensions industry has changed with pension investment arrangements becoming increasingly complex, the introduction of auto-enrolment and increasing numbers of pension schemes entering the Pension Protection Fund.

## **3) Format of the Draft SORP**

FRS 102 has fundamentally restructured accounting standards in the UK. PRAG has therefore taken the opportunity to clarify the source of accounting and disclosure requirements in the Draft SORP by including the original requirements from FRS 102 where appropriate and referencing other required disclosures to sources. PRAG has sought to make it clear where the Draft SORP is recommending disclosure in addition to what is required by standards or law.

In addition to the above, a summary of the main changes to the structure and approach to the Draft SORP compared to the 2007 SORP is set out below:

- Trustees' Report – the reference to separate reports for Investments, Compliance and so on has been removed to clarify that there is one Trustees' Report which will include commentary on these areas.
- Certification of the calculation of the technical provisions – this recommended disclosure has been removed as FRS 102 requires a separate report on actuarial liabilities.
- Example Accounts – these are given in Appendix 1 for a hybrid scheme thus covering both DB, DC and hybrid arrangements in one example, compared to the 2007 SORP which has separate examples for each type of scheme.

- Contents of Annual Report – to help clarify the statutory content requirements of the Annual Report the Draft SORP has separate appendices for the UK and Republic of Ireland disclosure requirements. Suggested voluntary disclosures in relation to the Trustees' Report set out in Appendix 1 of the 2007 SORP have been removed from these appendices to provide clarity on the statutory disclosure requirements.
- Application of accounting standards – the last appendix of the 2007 SORP which comments on how individual accounting standards apply to pension schemes has been removed as FRS 102 is the sole accounting standard to which the Draft SORP has to refer. All significant aspects of FRS 102 as they relate to pension schemes have been included in the main body of the Draft SORP.

The changes compared to the 2007 SORP are significant and required the revised Draft SORP to be built up from original drafting and therefore a track changes version comparing current to revised is not available.

#### **4) Approach adopted**

PRAG has generally sought not to extend the Draft SORP's recommendations beyond required disclosures or current practices except where appropriate and proportionate. For example, in the interests of consistent reporting, the Draft SORP extends the disclosures required by FRS 102 in respect of financial instrument fair value determination and risks to cover all scheme investments including investment properties.

#### **5) Summary of changes**

A full appreciation of the recommendations contained in the Draft SORP can be obtained only by reading the entire document. It is not possible to summarise all the changes between the Draft SORP and the 2007 SORP in a few paragraphs, or to rank changes in order of importance, as what is important to one reader may be irrelevant to another. In addition, the fundamental revision of reporting standards described above means that every reference to accounting standards throughout the 2007 SORP has had to be amended. Allowing for these factors, significant changes and additional clarifications made by the Draft SORP include the following.

- FRS 102 requires annuity policies to be valued at the amount of the related obligation. The exemption available under the Audited Accounts Regulations and 2007 SORP to value annuity policies at NIL is therefore no longer available. PRAG notes that this change will require many schemes to incur additional costs in obtaining valuations for annuities previously reported at NIL. However, annuities held in the name of the trustees form part of the overall assets of a pension scheme and do not secure the pensions which they fund. For example, if a scheme enters the Pension Protection Fund (PPF), annuity income is redirected to the PPF who take over payment of pensions, which may be restricted to PPF limits. Therefore it seems appropriate for scheme financial statements to recognise annuities on a 'gross' basis since the current 'net' approach is not supported by the

substance of the arrangement. The Draft SORP notes that if the value of the annuity is not considered significant to the Statement of Net Assets and the costs of obtaining a valuation outweigh the benefits then the current practice can continue.

- FRS 102 sets out a fair value hierarchy for valuing financial instruments and requires new disclosures on the approach to determining fair value of financial instruments. In the interests of consistency the Draft SORP extends these disclosures to all scheme investments which includes investment property. The SORP also recommends that the disclosure of investments valued using a valuation technique is analysed between those valued using market observable data and those valued using non-observable data. PRAG believes this will provide a useful distinction. PRAG notes that the fair value hierarchy required by FRS 102 is not consistent with the fair value hierarchy under IFRS and this may require providers of investment accounting information to provide two different analyses of investment valuations. PRAG will raise the fair value hierarchy issue with the FRC, when it is renewing FRS 102.
- FRS 102 requires new disclosures on investment risks arising on financial instruments. In the interests of consistency the Draft SORP extends these disclosures to all scheme investments which includes investment property. By recommending this approach, the Draft SORP places these new disclosure requirements in the context of a pension scheme's investment strategy. PRAG notes that investment risks are only one aspect of the overall risks for trustees and members of pension schemes. However, in the interests of limiting disclosures to the requirements except where appropriate and proportionate, PRAG considers it is reasonable to limit risk disclosures to investment risk. PRAG also notes that a particular area of challenge for pension schemes is the application of risk disclosures to pooled investment vehicles. This has created the most complex additional content of the Draft SORP. PRAG has sought to interpret FRS 102's disclosure requirements with the aim of achieving an approach that is both pragmatic and consistent with trustees' intentions for investing in pooled investment vehicles.
- Scheme investments in subsidiaries, associates and joint ventures are required to be reported at fair value in the Statement of Net Assets. The Draft SORP recommends that where a scheme has investments in subsidiaries a summary of the underlying net assets are disclosed. FRS 102 does not require the production of consolidated financial statements for pension schemes, but a scheme may do so if it holds shares in subsidiaries which are not held exclusively for resale.
- The content of the Draft SORP in relation to guidance on accounting for DC arrangements has been reduced as PRAG's view was that accounting for these arrangements is now well established in the mainstream of pension scheme accounting and the detailed and lengthy guidance in the 2007 SORP could be shortened and simplified.
- Auto-enrolment is being introduced in the UK. Pension schemes which are the employer's designated auto-enrolment scheme will have to deal with the extended period employers have for the remittance of the first contribution for auto-enrolled employees and with employees who opt out. PRAG has taken a pragmatic approach to accounting for the first contribution due for auto-enrolled employees and are recommending opt-out payments made by the scheme are reported as an item of expenditure in the Fund Account.

- PRAG questioned the value of the disclosures required by the Audited Accounts Regulations in relation to types of investment (for example equity, fixed interest public sector, fixed interest other and index linked securities analysed between quoted and unquoted and UK and overseas) and disclosure of pooled arrangements between property/other and unit trusts/managed funds. These disclosures were introduced in 1986 at the time of the introduction of the first SORP and at the time the SORP and Regulations were consistent. Now, some 30 years on, whilst the SORP and pension investments have moved on the legal disclosure requirements have not and are now outdated. PRAG and the FRC are liaising with the DWP over possible changes to legislation to remove these requirements.

The above changes will require new investment disclosures and the possible removal of existing statutory disclosure requirements. PRAG and the Investment Managers Association (IMA) have set up a joint working party to consider the information requirements arising from the Draft SORP.

## 6) Particular issues on which comments are invited

PRAG welcomes comments on any aspect of the Draft SORP and it would be helpful if respondents could suggest comments with reasons, and where applicable, preferred alternatives. The provision of background information would also be useful. When making comments respondents should bear in mind that the Draft SORP cannot override the requirements of FRS 102 which can only be amended by the FRC. Therefore whilst observations on FRS 102 are of interest to PRAG and the FRC, they are not directly relevant to the consultation on the Draft SORP and respondents are encouraged to frame their responses accordingly.

PRAG is interested in respondents' views on the practical issues schemes will face in dealing with new investment disclosures and views on associated costs or cost savings where PRAG is seeking to reduce existing requirements.

Respondents' views are especially sought on the following matters:

- 1) **Annuities** - FRS 102 requires annuities to be reported at the amount of the related obligation. What practical issues do you see arising from this requirement? The Draft SORP envisages the annuity value will be based on the trustee perspective of the related obligation and therefore most likely determined by the Scheme Actuary. Do you agree with this approach? (3.12.18 to 3.12.22).
- 2) **Investment risk disclosures** – has the Draft SORP taken the right approach to risk disclosures? (Section 3.16). In particular is the approach to pooled investment vehicles and the look through and asset class approaches considered appropriate? (3.16.1 to 3.16.15). Is the approach to direct credit risk for pooled investment vehicles, which recommends disclosing an analysis of types of pooled vehicles held, appropriate? (3.16.10 – 3.16.13). Are there alternative approaches that could be considered?
- 3) **Fair value hierarchy** – is the distinction of investments valued using a valuation approach (Category C investments) between those using market observable data ( C (i)) and non-observable data ( C(ii)) considered helpful? (3.12.8 to 3.12.10).

- 4) **Financial statement presentation** – Do the example financial statements provide sufficient practical guidance on the application of the Draft SORPs’ new disclosures? Is the alternative combined presentation of investment risk and derivative notes to the example financial statements helpful? Is having a choice of examples helpful? Are there better alternative approaches?
- 5) **Auto-enrolment** – do you agree with the approach taken by the Draft SORP in relation to accounting for the first contribution arising from employees who are auto-enrolled? (3.8.2)
- 6) **Legislative disclosure requirements** – do you agree with PRAG’s view that the legislative disclosure requirements in relation to investment classifications as set out in the Audited Accounts Regulations are updated to come into line with FRS 102 and the Draft SORP? (Appendix 7)
- 7) **Concentration of investments** – in addition to the detailed investment classification disclosures referred to above, the Audited Accounts Regulations also require the disclosure of any investment (other than UK Government securities) in which more than 5% of the total value of the net assets of the scheme is invested. Do you think this disclosure is necessary in light of the risk disclosures required by FRS 102 (section 3.15) and the separate requirement to disclose employer related investments (section 3.32)? If you do think it is required should it apply to investments in pooled investment vehicles at the unit level or should investments held indirectly through pooled investment vehicles be taken into account (the “look through” approach)?

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(Revised xxxx 2014)

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## **Preface**

Under the Financial Reporting Council's SORP Policy and Code of Practice SORP making bodies are required to monitor and update the SORPs for which they are responsible on a regular basis. The recommendations in the SORP Financial Reports of Pension Schemes (Revised May 2007) were arrived at after consideration of the Statements of Standard Accounting Practice (SSAPs) and Financial Reporting Standards (FRSs) and applicable law and regulations in force in the United Kingdom and the Republic of Ireland as at 6 April 2007.

Since the last SORP was published accounting standards, regulations and the pension industry have changed: accounting standards have moved to converge with International Financial Reporting Standards (IFRS), regulations have been partly updated, auto-enrolment is currently being introduced, pension investment arrangements are becoming more complex and the number of schemes entering the Pension Protection Fund has increased. The SORP Financial Reports of Pension Schemes (Revised [xx] 2014) has been updated to take account of these developments.

The FRC has revised the financial reporting framework in the UK for unlisted entities through the introduction of FRS 102 – The Financial Reporting Standard applicable in the UK and Republic of Ireland. This standard is based on IFRS for Small and Medium Sized Entities and it replaces all the previous SSAPs, FRSs and UITFs. Importantly this new standard specifically addresses the financial statements for pension schemes by setting out the required content of pension scheme financial statements, the basis of valuing pension scheme assets and treatment of actuarial liabilities. It requires new disclosures in relation to fair value determination, investment risks and a separate report alongside the financial statement for actuarial liabilities. FRS 102 applies for accounting periods commencing on or after 1 January 2015.

In light of FRS 102's new investment disclosure requirements and the increasing complexity of pension investment portfolios, PRAG's view is that the detailed investment disclosures required to be made in pension scheme financial statements by the Audited Accounts Regulations, which have remained unchanged since 1986, need to be reviewed and ideally withdrawn and replaced with the requirement to comply with FRS 102. This will realign investment disclosures to a more risk based disclosure regime which will afford more flexibility as investments used by pension schemes continue to evolve. At the time of issuing this Exposure Draft discussions with the DWP continue.

In developing the revised SORP, PRAG has regard to the FRC's objectives for SORPs to recommend particular accounting treatments and disclosures, with the aim of narrowing areas of difference and variety between comparable entities. PRAG has sought not to extend the reporting and disclosure requirements beyond those required by FRS 102 or existing best practices. Regard must be paid to applicable accounting standards, laws and regulations since SORPs cannot override these requirements.

Appendices 3 and 4 set out the legal disclosure requirements for the UK and Republic of Ireland respectively in respect of the annual reports for pension schemes and appendices 5

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and 6 provide further information on the legal frameworks in the UK and Republic of Ireland.

Neither PRAG nor the members of any working party or committee thereof can accept any responsibility or liability whatsoever (whether in respect of negligence or otherwise) to any pension scheme trustee, member or third party, wherever situated, as a result of anything contained in, or omitted from the SORP, nor for the consequences of reliance or otherwise on the provisions of the SORP.

## **FRC's Statement on the draft SORP**

In accordance with the FRC's Policy and Code of Practice on the development of SORPs the FRC carried out a limited scope review of the proposed SORP focussing on those aspects relevant to the financial statements. We note that, in accordance with FRS 102, *The Financial Reporting Standard applicable in the UK and Republic of Ireland*, the financial statements of a retirement benefit plan include a statement of net assets available for benefits (or Fund Account). This statement does not include the actuarial present value of promised retirement benefits, which shall be disclosed in a report alongside the financial statements.

# 1 Introduction

## 1.1 Background

1.1.1 In 2012 and 2013 the Financial Reporting Council (FRC) issued revised financial reporting standards for application in the United Kingdom and Republic of Ireland. The revision fundamentally reforms financial reporting, replacing almost all extant standards from 1 January 2015 with three Financial Reporting Standards:

- FRS 100 Application of Financial Reporting Requirements;
- FRS 101 Reduced Disclosure Framework; and
- FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland.

1.1.2 The FRC made these fundamental changes recognising that the introduction of International Financial Reporting Standards for listed groups in 2002 (with application from 2005) called into question the need for two sets of financial reporting standards. Evidence from consultation supported a move towards an international-based framework for financial reporting, but one that was proportionate to the needs of preparers and users. FRS 102 is based on the IFRS for Small and Medium Sized Entities with some tailoring for the UK and Republic of Ireland.

1.1.3 The introduction to FRS 100 states that the FRC's, "overriding objective in setting accounting standards is to enable users of accounts to receive high-quality understandable financial reporting proportionate to the size and complexity of the entity and users' information needs".

1.1.4 The Financial Reporting Standard for Smaller Entities (FRSSE) is being retained for eligible entities for the time being. However, as before, this standard is not available to pension schemes.

## 1.2 SORPs

1.2.1 The new accounting framework recognises statements of recommend practice and FRS 100 states that the purpose of SORPs is to:

**'Recommend particular accounting treatments and disclosures with the aim of narrowing areas of difference and variety between comparable entities. Compliance with a SORP that has been generally accepted by an industry or sector leads to enhanced comparability between the financial statements of entities in that industry or sector. Comparability is further enhanced if users are made aware of the extent to which an entity complies with a SORP, and the reasons for any departures. The effect of a departure from a SORP need not be quantified, except in those rare cases where such quantification is necessary for the entity's financial statements to give a true and fair view'. (FRS 100:7)**

1.2.2 The objective of the SORP set out in section 3 of this document is to apply the requirements of FRS 100 as described above, to financial reporting for pension schemes in the UK and Republic of Ireland. In doing so the SORP has regard to the applicable accounting standard, FRS 102, which sets out specific requirements for financial

reporting for pension schemes for the first time in UK and Irish accounting standards. These requirements are set out in FRS102 section 34 'Specialised Activities' and cover:

- the form and content of pension scheme financial statements;
- the basis of determining the fair value of scheme investments;
- disclosures, mainly in relation to investment fair value determination and investment risks; and
- treatment of actuarial liabilities, which are to be reported in a separate report alongside the financial statements.

1.2.3 In addition, the financial statements of pension schemes have to comply with the whole of FRS 102.

1.2.4 Whilst financial statement preparers should pay particular attention to the specific requirements for pension schemes in Section 34, regard should also be given to the other sections. The pension SORP covers FRS 102's specific requirements for pension schemes and the other requirements which are expected to apply to most pension schemes. Whilst pension schemes are included in FRS 102's definition of financial institutions they are exempted from the additional disclosure requirements for financial institutions.

1.2.5 The pension SORP is set out in section 3 of this document. In addition this document also explains the Annual Report in which it has been assumed the financial statements will be placed. This additional commentary is set out in section 2 and Appendices 1 to 4 of this document and does not form part of the SORP.

### 1.3 **Abbreviations**

1.3.1 This document refers to a number of different sources. Common abbreviations used are:

- FRS 100 – Financial Reporting Standard 100 Application of Financial Reporting Requirements;
- FRS 102 – Financial Reporting Standard 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland;
- Disclosure Regulations – The Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013;
- Irish Disclosure Regulations – The Occupational Pension Schemes (Disclosure of Information) Regulations, 2006 (as amended);
- Audited Accounts Regulations – The Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996, as amended;
- The 1995 Act – The Pensions Act 1995;
- The 2004 Act – The Pensions Act 2004;
- The Irish 1990 Act – The Pensions Act (1990);

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- Scheme Funding Regulations – The Occupational Pension Schemes (Scheme Funding) Regulations 2005;
- Investment Regulations – The Occupational Pension Schemes (Investment Regulations) 2005;
- Practice Note 15 – Practice Note 15 – the Audit of Occupational Pension Schemes in the UK (revised); and
- Irish Practice Note 15 – Practice Note 15 The Audit of Occupational Pension Scheme in the Republic of Ireland.

Extracts from the above sources are generally set out in bold text in this document.

## 2 **The Annual Report**

### 2.1 **Requirement to prepare an annual report**

2.1.1 The United Kingdom Disclosure Regulations require trustees to prepare an Annual Report within seven months of the end of the scheme year and to make this report available to members (Republic of Ireland Disclosure regulations require the trustees to prepare an annual report within nine months of the end of the scheme year and make it available to members and other groups within certain time limits). The Disclosure Regulations also set out the required minimum contents of the Annual Report:

- The audited financial statements;
- The auditors' reports;
- Actuarial certificate; and
- Information on the scheme in relation to scheme management, membership and investments.

### 2.2 **Objectives**

2.2.1 There are broadly two types of party that have an interest in the Annual Report of a pension scheme:

- internal parties being those participating in and managing the scheme such as the trustees, members and prospective members, pensioners, spouses and beneficiaries, and participating employers; and
- external parties involved with the scheme such as the regulatory and governmental bodies and agencies (including Her Majesty's Revenue and Customs, the Pensions Regulator and the Pension Protection Fund in the United Kingdom and the Pensions Board and Revenue Commissioners in Ireland), actuaries, auditors, trade unions and other employee representative groups, bankers, lawyers and other professional advisers.

2.2.2 As well as complying with relevant legislation the general objective of the pension scheme's Annual Report is to provide information that is relevant to these interested parties:

- trustees - the trustees, who are responsible for the Annual Report, use the Annual Report to demonstrate how they have discharged their duties and as a means of satisfying themselves that they have properly met their responsibilities;
- members and prospective members, deferred pensioners, pensioners, spouses and beneficiaries - this group typically requires information about the security of their pensions or pension promise, investment performance and information about the progress of the scheme towards meeting its potential liabilities and obligations towards them. Research has also shown that this group needs a regular reminder of some basic information about the scheme;

- participating employers - employers typically require information about the trustees' stewardship of the scheme, the development of the scheme and the security of assets;
- regulators - regulators require to be satisfied about compliance with laws, regulations and regulatory guidance; and
- professional advisers - professional advisers require clear and reliable information about the transactions of the scheme, including any unusual transactions, and about the current position, activities and policies of the scheme.

## 2.3 **Plain English**

2.3.1 The Annual Report should, as far as possible, be written in plain English so that it is clear to the reader why particular disclosures are being made and what they mean. However, it is impractical to avoid established pensions and accounting terminology entirely. For the financial statements in particular, there is an implicit assumption that users of financial statements have a reasonable knowledge of business and economic activities and a willingness to study the information presented with reasonable diligence. The use of established terminology does not detract from understanding, provided that the terminology itself is set in an appropriate context and explained in user-friendly terms.

2.3.2 The overall structure of the report should also be made clear to the reader, with appropriate use made of headings and sub-headings. For longer Annual Reports, a contents page may be helpful.

## 2.4 **Content of the Annual Report**

2.4.1 The content of the Annual Report is largely based on legislative, audit and financial reporting requirements and comprises:

- Trustees' Report;
- Financial statements;
- Auditors' report on financial statements (in the Republic of Ireland the auditor's report will also include a separate opinion on contributions);
- Auditors' statement on contributions (not in the Republic of Ireland);
- Valuation report on liabilities (Defined Contribution scheme requirement for Republic of Ireland only);
- Report on actuarial liabilities (forming part of the Trustees' Report); and
- Actuarial certifications.

2.4.2 Each of these elements is described below. Detailed information on legal disclosure requirements for the Annual Report is set out in detail in Appendix 3 for UK pension schemes and Appendix 4 for schemes in the Republic of Ireland.

## 2.5 **Trustees' Report**

2.5.1 The purpose of the Trustees' Report is to demonstrate accountability of the trustees to the members, employers, regulators and other persons involved in the scheme. The Trustees'

Report is a key component of the Annual Report. It sets the context in which the rest of the report is read and therefore has a significant effect on the overall message conveyed to the readers of the Annual Report. It should therefore be:

- written in a clear and simple style to be readily understandable by members and other readers of the Annual Report;
- succinct whilst not excluding matters that are likely to be significant to the readers; and
- fair and impartial in the choice of matters for discussion and in the comments made.

2.5.2 The Trustees' Report can be structured to cover scheme management, investment matters, compliance matters and actuarial liabilities.

***Scheme management***

2.5.3 The report should include such information as is needed to explain how the scheme is managed; its financial development during the scheme year and other significant developments in relation to the employer, the scheme constitution or benefits, pension increases and scheme membership during the period. It will include details of the trustees and how they are appointed and details of scheme advisers. If there have been changes to the trustees in the period from the date of the annual report to date of its approval by the trustees, it is recommended these should also be included.

***Investment matters***

2.5.4 The objectives of the investment commentary are to outline and explain the trustees' policies on investments and the strategy for achieving the policies. This may be particularly useful to the readers of the financial statements where there is a complex investment strategy, which may involve alternative investments including derivative contracts. The investment commentary should also review investment performance against that background and compare the investment return with any benchmark adopted. All the material in the investment commentary should focus on the circumstances and requirements of the scheme itself, with commentary on general economic and market conditions restricted to what is necessary for an understanding of the scheme's own situation. The report should include a note of the trustees' policy for the custody of investments.

- 2.5.5 The investment advisor or manager(s) may assist in the preparation of the investment commentary. In some cases the trustees may indeed wish to include a report by the investment manager(s) within the investment commentary. Nevertheless, the investment commentary remains the responsibility of the trustees.
- 2.5.6 Where a scheme's investments are managed by more than one investment manager, details of the investment strategy and investment performance of the scheme in aggregate should be disclosed and not just for each manager individually.
- 2.5.7 Irish Disclosure regulations require the investment report to include the latest Statement of Investment Policy Principles.
- 2.5.8 FRS 102 requires pension scheme financial statements to make disclosures in relation to investment risks. Trustees may wish to cross refer the Trustees' Report to the financial statements to avoid duplication.

***Compliance matters***

- 2.5.9 The purpose of the compliance commentary is to disclose information which is required to be disclosed in order to comply with the law or information which is disclosed voluntarily. It typically deals with matters of administrative routine and therefore may not require a prominent position in the Trustees' Report.

## **2.6 Statement of trustees' responsibilities**

- 2.6.1 Practice Note 15 requires the trustees to make a statement about their key responsibilities in relation to the preparation of financial statements, monitoring of contributions, keeping of books and records, and prevention and detection of fraud and maintaining appropriate internal controls (in the Republic of Ireland the guidance in the Irish Practice Note 15 should be adopted).

## **2.7 Report on actuarial liabilities**

- 2.7.1 FRS 102 requires a separate report alongside the financial statements on actuarial liabilities. This report contains the latest available valuation of actuarial liabilities and the assumptions and methodology used to calculate them. This will normally be based on the latest available scheme funding valuation and the information contained in the related Summary Funding Statement and Statement of Funding Principles in the United Kingdom and the Actuarial Valuation prepared under Section 56 of the Irish 1990 Act in the Republic of Ireland. The SORP also recommends that the report disclose the amount of the scheme net assets at the date of the actuarial valuation.
- 2.7.2 The actuarial valuation and the preparation of annual financial statements are discrete exercises. They serve two different purposes. The financial statements are essentially a matter of record of past performance, while the actuarial valuation is a forward-looking exercise, the aim of which is usually to assess funding levels and to recommend contribution rates. The timings of the exercises are different. The actuarial valuation is not required to be carried out annually but rather at least every three years and the effective date of the valuation will not necessarily coincide with the accounting date. The actuarial view of the timing and incidence of scheme liabilities is shaped by the assessment of probabilities of future outcomes using actuarial techniques.

## 2.8 Actuarial certificates

- 2.8.1 In the United Kingdom the latest available certificate of the adequacy of the contribution rate is required to be included in the Annual Report under the Disclosure Regulations. The certification of the Schedule of Contributions certifies that the contribution rates are adequate for the purpose of securing that the statutory funding objective can be expected to be met. The certificate is prepared in a format that in the United Kingdom is prescribed by regulations.
- 2.8.2 In the Republic of Ireland, the Irish Disclosure Regulations require the annual report to include the annual Actuarial statement, the Actuarial Funding Certificate and on and after 1 June 2012 the Funding Standard Reserve Certificate (with the same effective date as the Actuarial Funding Certificate) prepared under section 42 of the Irish 1990 Act.
- 2.8.3 The Actuarial Statement and Actuarial Funding Certificate states if the scheme satisfied the funding standard provided for in Section 44 (1) of the Irish 1990 Act, while the Funding Standard Reserve Certificate states if the scheme satisfies the funding standard reserve under Section 44(2) of the Irish 1990 Act. If the funding standard/reserve is not satisfied a proposal must be submitted to the Pensions Board which details how the scheme will satisfy the funding standard/reserve within the required deadlines.

## 2.9 Auditors' reports

- 2.9.1 The Disclosure Regulations in the United Kingdom require the following statements by the scheme auditors (in the case of both defined benefit and defined contribution schemes) to be included in the Annual Report:
- a report by the auditors about the payment of contributions to the scheme; and
  - an auditors' opinion on the financial statements.
- 2.9.2 A pension scheme audit is an examination of the scheme's financial statements and accounting records designed to enable the auditors to form an independent opinion on the financial statements. For the UK the auditors also report in a separate statement on whether the contributions payable to the scheme have in all material respects been paid at least in accordance with the Schedule of Contributions or Payment Schedule, as appropriate. The auditors' report and statement on contributions, which set out the auditors' opinions on these matters, also normally explain the auditors' responsibilities and the basis of those opinions. In the Republic of Ireland the auditors report is required to include:
- an auditors opinion on the financial statements; and
  - a separate opinion on contributions covering whether contributions were received in accordance with the scheme rules and recommendations of the actuary and within the timetable for remittance and investment of contributions provided for in the Pensions Act 1990 (as amended) within 30 days of the scheme year end.
- 2.9.3 Auditors are required by International Standards on Auditing (UK and Ireland) 700 to distinguish between their responsibilities and those of the trustees by including in their report a statement that the financial statements are the responsibility of the trustees, a reference to the description of those responsibilities as set out either in the Trustees' Report or elsewhere in the Annual Report, and a statement that the auditors' responsibility is to express an opinion on the financial statements. If the Annual Report

does not include an adequate description of the relevant responsibilities of the trustees, auditors are required to include a description of those responsibilities in their audit report.

## 2.10 **The financial statements**

2.10.1 The United Kingdom Audited Accounts Regulations and Irish Disclosure Regulations require trustees to obtain audited financial statements within seven months (nine months for the Republic of Ireland) of the scheme year-end which show a true and fair view of:

- the financial transactions of the scheme during the scheme year;
- the amount and disposition of the assets at the end of the scheme year; and
- the liabilities of the scheme, other than the liabilities to pay pensions and benefits after the end of the scheme year.

2.10.2 Under Republic of Ireland legislation when Additional Voluntary Contributions have been separately invested on a defined contribution basis they can be excluded from the net assets of the scheme and disclosed separately in the notes to the financial statements. However, to comply with FRS 102 they should be included in the net assets of the scheme where significant to the Statement of Net Assets (see 3.25.8).

2.10.3 The pension scheme financial statements are therefore prepared in accordance with applicable UK/Irish accounting standards in order to show a true and fair view. The current applicable standard is FRS 102 which states that the objective of financial statements is:

**To provide information about the financial position, performance and cashflows of an entity that is useful for economic decision making by a broad range of users who are not in a position to demand reports tailored to meet their particular information needs (FRS 102:2.2). Financial statements also show the results of the stewardship of management – the accountability of management for resources entrusted to it. (FRS 102:2.3)**

2.10.4 FRS 102 sets out the format and content of pension scheme financial statements. They comprise:

- Fund Account – reporting dealings with members and returns from investments;
- Statement of Net Assets available to meet benefits – reporting the pension scheme net assets at fair value; and
- Notes to the Fund Account and Statement of Net Assets available to meet benefits.

2.10.5 FRS 102 does not require the actuarial liabilities to be included in the financial statements. It does require them to be included in a report alongside the financial statements. FRS 102 also exempts pension schemes from the requirement to include a statement of cashflows in the financial statements. (FRS 102:7.1A). For these reasons PRAG believes the main objective for pension scheme financial statements is to report the results of stewardship of management of the scheme's resources by the trustees.

## 2.11 **Other disclosures in the annual report**

2.11.1 PRAG recommends that the registration number of the scheme with the Pensions Regulator (in the United Kingdom) or The Pensions Board (in the Republic of Ireland) should be disclosed prominently, for example on the front cover of the Annual Report.

## 3 Statement of recommended accounting practice

### 3.1 Scope and purpose

#### *Financial reporting framework*

- 3.1.1 FRS 100 sets out the financial reporting framework in the UK and Ireland and has the following objective and scope:

**The objective of this Financial Reporting Standard (FRS) is to set out the applicable financial reporting framework for entities preparing financial statements in accordance with legislation, regulations or accounting standards applicable in the United Kingdom and Republic of Ireland.(FRS 100:1)**

**This FRS applies to financial statements that are intended to give a true and fair view of the assets, liabilities, financial position and profit or loss for a period. (FRS 100:2)**

- 3.1.2 The United Kingdom Audited Accounts Regulations and the Republic of Ireland Irish 1990 Act require the trustees to obtain financial statements which show a true and fair view. Therefore FRS 100 applies to pension scheme financial statements which are prepared in accordance with these legislative requirements. It also applies in situations where other requirements require the preparation of pension scheme financial statements which show a true and fair view under accounting standards applicable in the UK and the Republic of Ireland.

- 3.1.3 Under FRS 100.4 (b) pension scheme financial statements may be prepared either in accordance with FRS 102 or EU-adopted International Financial Reporting Standards (IFRS). If a pension scheme applies EU-adopted IFRS then this SORP does not apply since SORPs are not recognised under IFRS. Instead the pension scheme will prepare its financial statements in accordance with International Accounting Standard 26 – Accounting and Reporting by Retirement Benefit Plans and other EU adopted IFRS as appropriate.

#### *Scope*

- 3.1.4 The scope of this Statement therefore includes pension schemes preparing financial statements under FRS 102 including *inter alia*:

- defined benefit schemes;
- defined contribution schemes;
- schemes which are fully insured;
- ear-marked schemes (where trustees choose to prepare financial statements, see paragraph 3.1.6 below);
- financial statements prepared for the purpose of actuarial valuations (where no Trustees' Annual Report is required);

- Common Investment Funds (in which only pension schemes participate);
- funded unapproved retirement benefit schemes/funded employer-financed retirement benefit schemes (FURBS) (UK only);
- schemes in winding up;
- schemes constituted overseas;
- trust-based stakeholder pension schemes (UK only); and
- schemes in the Pension Protection Fund assessment period.

3.1.5 The recommendations of this Statement do not apply to:

- schemes which are unfunded, where benefits are paid directly by the employer and no provision is made for future liabilities by setting aside assets under trusts;
- free standing AVC schemes (except in the Republic of Ireland);
- stakeholder schemes which are not trust based;
- personal pensions which are not trust based;
- personal pension schemes in which employees of a particular employer participate on a grouped basis (sometimes referred to as group personal pension schemes) where investments are earmarked for individual employees. These are merely arrangements for collecting contributions and not occupational pension schemes;
- Personal Retirement Savings Accounts (Republic of Ireland only); and
- Local authority pension schemes which are required to prepare their financial statements in accordance with the Code of Practice on Local Authority Accounting which is largely based on IFRS.

3.1.6 The Audited Accounts Regulations in the United Kingdom and the Irish Disclosure Regulations provide an exemption in defined circumstances for money purchase schemes holding ear-marked insurance policies from the requirements to prepare financial statements. These are referred to as “ear-marked” pension schemes and are defined as “an occupational pension scheme which is a money purchase scheme under which all the benefits are secured by one or more policies of insurance or annuity contracts and such policies or contracts are specifically allocated to the provision of benefits for individual members”.

3.1.7 In the Republic of Ireland all small schemes (less than 100 active and deferred members) are exempt and allowed to prepare alternative Annual Reports, see Appendix 6.

### *Application of the SORP*

- 3.1.8 The SORP is applied to pension scheme financial statements by FRS 100 and FRS 102 as follows:

**If an entity's financial statements are prepared in accordance with the FRSSE or FRS 102, SORPs will apply in the circumstances set out in those standards (FRS 100: 5).**

- 3.1.9 FRS 102 does not state explicitly that the pension SORP applies, but it does state that in making judgements on what accounting policies to apply management shall, where an entity's financial statements are within the scope of a Statement of Recommended Practice (SORP), refer to and consider the applicability of requirements and guidance in the SORP (FRS 102: 10.5 (6)).

## **3.2 Effective date**

- 3.2.1 The recommendations of this SORP are applicable for all scheme years commencing on or after 1 January 2015 or earlier if a scheme adopts FRS102 early.

## **3.3 Transitional provisions**

- 3.3.1 Transition from reporting under previous UK/Irish GAAP to FRS 102 is required to be carried out in accordance with the requirements of section 35 of FRS 102. These requirements require the first set of financial statements that are prepared in accordance with FRS 102 to be prepared on the basis that FRS 102 always applied to the current and previous accounting periods. There is therefore no need to account for changes in asset recognition or valuation arising on transition to FRS 102 as a prior year adjustment. Full comparatives in accordance with FRS 102's disclosure requirements are required for the comparative period.

- 3.3.2 FRS 102 requires the following disclosures in relation to the transition:

**An entity shall explain how the transition from its previous financial reporting framework to this FRS affected its reported financial position and financial performance. (FRS 102:35:12). To comply with paragraph 35.12, an entity's first financial statements prepared using this FRS shall include:**

- (a) **a description of the nature of each change in accounting policy;**
- (b) **reconciliations of its equity determined in accordance with its previous financial reporting framework to its equity determined in accordance with this FRS for both of the following dates:**
  - (i) **the date of transition to this FRS; and**
  - (ii) **the end of the latest period presented in the entity's most recent annual financial statements determined in accordance with its previous financial reporting framework; and**
- (c) **a reconciliation of the profit or loss determined in accordance with its previous financial reporting framework for the latest period in the entity's most recent annual financial statements to its profit or loss**

**determined in accordance with this FRS for the same period. (FRS 102:35.13)**

3.3.3 This SORP recommends that the disclosures required by FRS 102 above are satisfied by disclosing a reconciliation between the scheme net assets at the transition date and at the end of the comparative period and the net increase/decrease in the fund during the comparative period as previously stated under UK/Irish GAAP and as stated under FRS 102. The transition date is the opening date of the comparative period.

3.3.4 The main change to accounting policies for pension schemes arising from the revised SORP relates to the requirement under FRS 102 to report annuity policies at the amount of the related obligation. The main additional disclosures arising under the revised SORP relate to FRS 102's requirements for pension schemes to disclose information relating to the determination of fair values and risk disclosures relating to financial instruments. Comparative disclosures should be provided on adoption of these new disclosures.

### 3.4 **Terminology**

3.4.1 This statement is intended to be applied to schemes in the United Kingdom and the Republic of Ireland, as well as to other relevant overseas schemes if their financial statements are intended to give a true and fair view. However, for simplicity, it adopts terms such as 'UK investments' and 'sterling' rather than using phrases such as 'investments in assets domiciled at home' and 'local currency'. For the meaning of terms used in the statement, reference should be made to 'Pensions Terminology - A Glossary for Pension Schemes' published by the Pensions Management Institute and PRAG.

### 3.5 **Form and content of pension scheme financial statements**

3.5.1 FRS 102 requires the following in relation to the content of pension scheme financial statements:

**The financial statements of a retirement benefit plan shall contain as part of the financial statements:**

- a) **a statement of changes in net assets available for benefits (which can also be called a Fund Account);**
- b) **a statement of net assets (available for benefits); and**
- c) **notes, comprising a summary of significant accounting policies and other explanatory information. (FRS 102:34.35)**

3.5.2 In accordance with FRS 102 this SORP recommends that pension scheme financial statements should comprise:

- **Fund Account** which discloses the magnitude and character of financial additions to, withdrawals from, and changes in value of the fund during the accounting year, segregated between dealings with members, returns on investments and taxation which reconciles the net assets of the scheme at the beginning of the scheme year with those at the end of the year;

- **Statement of Net Assets** available for benefits which discloses the amounts and disposition of the net assets of the scheme at the end of the scheme year available to meet benefits; and
- **Notes to the financial statements** which includes information on the basis of presentation of the financial statements and the accounting policies used plus further detail on items in the primary statements.

3.5.3 The financial statements should contain such additional information as is necessary to show a true and fair view of the financial transactions of the scheme for the scheme year and of the amounts and disposition of its net assets at the end of the scheme year. In particular, material unusual or non-routine transactions or balances should be given sufficient prominence on the face of the primary statements to draw readers' attention to their non-routine nature (for example material group transfers or scheme mergers).

3.5.4 Appendix 1 provides an illustration of a suggested presentation of pension scheme financial statements incorporating the main content required by FRS 102 and this SORP for a hybrid pension scheme, which covers both defined benefit and defined contribution arrangements. This example is not comprehensive and does not therefore illustrate every disclosure requirement set out in the SORP and FRS 102.

### **3.6 Accounting principles, policies and presentation**

3.6.1 FRS 102 sets out accounting concepts and principles that underpin the preparation of financial statements (FRS 102:2). This section of the SORP sets out a summary of the more significant of these for pension schemes.

#### ***Accruals***

3.6.2 FRS 102 requires that an entity should prepare its financial statements on the accruals basis of accounting (FRS 102:2.36).

3.6.3 The accruals basis of accounting requires that the non-cash effects of transactions and other events are reflected, as far as is possible, in the financial statements for the accounting period in which they occur, and not, for example, in the period in which any cash involved is received or paid. In rare circumstances, it may not be possible to reflect such effects in the period in which they occur because the income or expenditure may not yet be capable of reliable measurement. Only in these very exceptional circumstances, recognition of the income or expenditure may be deferred until reliable measurement is possible. The accruals concept is also the key to determining when to recognise assets and liabilities in a scheme's Statement of Net Assets. The accrual basis should be applied consistently from one accounting period to the next.

3.6.4 Guidance on individual items for which accrual policies may need to be developed is given in this SORP. In very rare cases where it is not possible to reflect the non-cash effects of transactions and other events in the financial statements for the period in which they occur because they cannot be reliably measured, the accounting policies note should make clear what accounting policy has been adopted for such items, and give brief reasons justifying the adoption of the policy. The policies adopted in applying the accruals concept to significant categories of income and expenditure, such as contributions, investment income, transfer values and benefits should be disclosed.

*Offsetting financial assets and liabilities*

- 3.6.5 Financial assets and liabilities should not be offset unless there is a legally enforceable right to set-off the assets and liabilities and the scheme intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously (FRS 102:11.38A). This means that where there is no legal right of offset, as will be the case in most instances, the total asset value and the total liabilities should be disclosed separately on the face of the Statement of Net Assets. Suggestions of how this may be achieved are shown in Appendix 1.

*Substance of transactions*

- 3.6.6 Under FRS 102 assets and liabilities are defined as follows:
- An asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.**
- A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits. (FRS 102:2.15)**
- 3.6.7 An asset or liability as defined by FRS 102 should be recognised in the Statement of Net Assets if the following conditions are met:
- (a) **it is probable that any future economic benefit associated with the item will flow to or from the entity; and**
  - (b) **the item has a cost or value that can be measured reliably. (FRS 102: 2.7)**
- 3.6.8 **The failure to recognise an item that satisfies those criteria is not rectified by disclosure of the accounting policies used or by notes or explanatory material. (FRS 102:2.8)**
- 3.6.9 **The concept of probability is used in the first recognition criterion to refer to the degree of uncertainty that the future economic benefits associated with the item will flow to or from the entity. Assessments of the degree of uncertainty attaching to the flow of future economic benefits are made on the basis of the evidence relating to conditions at the end of the reporting period available when the financial statements are prepared. Those assessments are made individually for individually significant items, and for a group for a large population of individually insignificant items. (FRS 102:2.29)**
- 3.6.10 **The second criterion for the recognition of an item is that it possesses a cost or value that can be measured with reliability. In many cases, the cost or value of an item is known. In other cases it must be estimated. The use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability. When a reasonable estimate cannot be made, the item is not recognised in the financial statements. (FRS 102:2.30).**
- 3.6.11 An asset or liability as defined by FRS 102 above should be recognised in the Statement of Net Assets where it meets the recognition requirements as set out by FRS 102.

*Consistency*

- 3.6.12 It is a fundamental accounting concept that there is consistency of accounting treatment within each accounting period and from one period to the next. FRS 102 only allows a change in accounting policy for the following reasons:
- a) **it is required by an FRS or FRC Abstract; or**
  - b) **results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance or cash flows (FRS 102: 10.8)**
- 3.6.13 **Where a change arises in relation to an FRS or FRC Abstract the change is accounted for in accordance with the transitional provisions of the amendment. Where the change is voluntary it is applied retrospectively to comparative information for prior periods to the earliest date for which it is practicable, as if the new policy had always been applied (FRS 102:10.11-12).**
- 3.6.14 When changes are made they should be disclosed, along with a brief description of why the new accounting policy is thought more appropriate and, if practicable, the effect of a prior period adjustment on the figures for the preceding and current period should be disclosed. If it is not practicable to give these disclosures, that fact, together with the reasons, should be stated.
- 3.6.15 Where there is a change in estimation technique, a description of the change and, where practicable, the effect on the current figures, should be disclosed. More detail on the required disclosures are set out in paragraphs 10.13 to 10.18 of FRS 102.

*Comparative amounts*

- 3.6.16 FRS 102 requires comparative information in respect of the comparative period for all amounts presented in the current period's financial statements (FRS 102:3.14). This SORP recommends that comparative information need not be provided for items included in the investment reconciliation table as described in section 3.14 of this SORP.
- 3.6.17 **FRS 102 requires an entity to retain the presentation and classification of items in the financial statements from one period to the next unless there is a change in accounting standards, a change in the entity's operations or a review of its financial statements such that another presentation or classification would be more appropriate (FRS 102:3.11). Where change in presentation or classification occurs the scheme should disclose, where practicable:**
- a) **the nature of the reclassification;**
  - b) **the amount of each item or class of items that is reclassified; and**
  - c) **the reason for the reclassification. (FRS 102:3.12)**
- 3.6.18 **If it is impractical to reclassify comparative amounts, an entity shall disclose why reclassification was not practicable. (FRS 102:3.13)**
- 3.6.19 **The accounting period will usually be one year in duration. If this is not the case for both the current and corresponding periods, this fact should be clearly stated.**

**Details of and reasons for the change in the length of accounting period should be disclosed (FRS 102:3.10).**

- 3.6.20 For UK pension schemes the Audited Accounts Regulations require the statutory accounting period to be no shorter than six months and no longer than eighteen months. For Irish pension schemes, financial statements can be prepared for a period up to 23 months with the permission of the Pensions Board.

***Accounting policies***

- 3.6.21 FRS 102 requires the disclosure of significant accounting policies in relation to the measurement bases used in preparing the financial statements and other accounting policies that are relevant to the understanding of the financial statements, including any significant judgements. The explanations should be clear, fair and as brief as possible.
- 3.6.22 The following are examples of areas where it may be appropriate to disclose the accounting policies adopted:
- a) significant categories of income and expenditure, such as contributions and AVCs, investment income, investment expenses, transfer values and benefits;
  - b) the approach taken to determine fair value of investment assets;
  - c) the basis of foreign currency translation;
  - d) the accounting treatment of derivative contracts; and
  - e) the bases adopted for accounting for investments in subsidiary and associated undertakings.
- 3.6.23 FRS 102 also requires disclosure of significant assumptions and other key sources of estimation uncertainty that have a significant risk of causing a material adjustment to the carrying amounts of the scheme's assets and liabilities within the next financial year. Generally disclosure of the approach to determining fair value for investment assets and liabilities will satisfy this requirement. Consideration should be given to whether any non-investment assets or liabilities are subject to significant estimation uncertainty and where this is the case the notes should disclose the nature of the uncertainties and the carrying amount of the asset or liability at the end of the reporting period (FRS 102:8.7).

***Notes to the financial statements***

- 3.6.24 FRS 102 sets out certain requirements in relation to the notes that accompany the financial statements.
- 3.6.25 The notes shall:
- a) **present information about the basis of preparation of the financial statements and the specific accounting policies used;**
  - b) **disclose the information required by this FRS that is not presented elsewhere in the financial statements; and**
  - c) **provide information that is not presented elsewhere in the financial statements but is relevant to an understanding of them. (FRS 102:8.2)**

- 3.6.26 FRS 102 notes that an entity will normally present the notes in the following order:
- a) **a statement that the financial statements have been prepared in compliance with the FRS;**
  - b) **a summary of significant accounting policies applied;**
  - c) **supporting information for items presented in the financial statements, in the sequence in which each statement and each line item is presented; and**
  - d) **any other disclosures. (FRS 102:8.4)**
- 3.6.27 Striking the right balance between including additional detail on the face of the primary statements and relegating this detail to the notes will be a matter of judgement in the circumstances of the particular scheme.
- 3.6.28 The terms “surplus” or “deficit” should generally be avoided in describing the difference between inflows and outflows, as their use may mislead the reader into believing that the financial statements, in some way, reflect an improvement or deterioration in the actuarial position during the period.
- 3.6.29 Typical examples of the application of FRS 102’s requirements in relation to notes to the financial statements in the context of pension schemes are given in Appendix 1. The notes illustrated in the appendix deal with providing additional analysis of items in the primary statements. They do not cover all the disclosures recommended by this SORP or required by FRS 102.

***Compliance with FRS 102 and the SORP***

- 3.6.30 A statement should be included (preferably in a ‘basis of preparation’ note to the financial statements) of whether or not the financial statements have been prepared in accordance with FRS 102 and the SORP. In the rare circumstances of a departure from FRS 102 (FRS 102:3:4) the following disclosures should be made:
- a) **that management has concluded that the financial statements present fairly the entity’s financial position;**
  - b) **that it has complied with the FRS except that it has departed from a particular requirement to achieve a fair presentation; and**
  - c) **the nature of the departure, including the treatment that the FRS would require, the reason why that treatment would be so misleading in the circumstances that it would conflict with the objective of financial statements, and the treatment adopted. (FRS 102:3.5)**
- 3.6.31 Where the financial statements depart from the SORP FRS 100 states:
- When a SORP applies, the entity should state in its financial statements the title of the SORP and whether its financial statements have been prepared in accordance with the SORP’s provisions that are currently in effect. In the event of a departure from those provisions, the entity should give a brief description of how the financial statements depart from the recommended practice set out in the SORP, which shall include:**

- a) **for any treatment that is not in accordance with the SORP, the reasons why the treatment adopted is judged more appropriate to the entity's particular circumstances; and**
- b) **brief details of any disclosures recommended by the SORP that have not been provided, and the reasons why they have not been provided. (FRS 100:6)**

3.6.32 The Audited Accounts Regulations and the Irish Disclosure Regulations also require the financial statements to include a statement as to whether they have been prepared in accordance with the SORP and if not an indication of where there are any material departures from those guidelines.

### **3.7 Fund Account – content and format**

3.7.1 FRS 102 requires the financial statements of a pension scheme to contain a statement of changes in net assets available for benefits which may also be called a Fund Account (FRS 102 34.35(a)). FRS 102 requires the presentation of the following items, for both defined benefit and defined contribution, in the Fund Account (FRS 102:34.37):

- (a) **employer contributions;**
- (b) **employee contributions;**
- (c) **investment income such as interest and dividends;**
- (d) **other income;**
- (e) **benefits paid or payable (analysed, for example, as retirement, death and disability benefits, and lump sum payments);**
- (f) **administrative expenses;**
- (g) **other expenses;**
- (h) **taxes on income;**
- (i) **profits and losses on disposal of investments and changes in value of investments; and**
- (j) **transfers from and to other plans.**

3.7.2 In relation to the above, this SORP recommends the following disclosures, with bold items on the face of the Fund Account and items in italics disclosed separately in the notes to the financial statements where material.

#### **Employer contributions**

*normal*

*augmentation*

*deficit funding*

*S75 debts (UK only)*

*other*

**Employee contributions**

*normal*

*additional voluntary*

**Transfers in**

*group transfers in from other schemes and scheme mergers*

*individual transfers in from other schemes*

**Other income**

*claims on term insurance policies*

*any other category of income which does not naturally fall into the above classification, suitably described and analysed where material*

**Benefits paid or payable**

*pensions*

*commutation of pensions and lump sum retirement benefits*

*purchase of annuities*

*lump sum death benefits*

*taxation where lifetime or annual allowances are exceeded*

**Payments to and on account of leavers**

*refunds of contributions in respect of non-vested leavers*

*refunds of contributions in respect of opt-outs*

*purchase of annuities*

*group transfers out to other schemes*

*individual transfers out to other schemes*

**Other payments**

*premiums on term insurance policies*

*any other category of expenditure which does not naturally fall into the above classification, suitably described and analysed where material*

**Administrative expenses** borne by the scheme, *with suitable analysis where material*

**Net additions/(withdrawals) from dealings with members**, representing the net amount of the income or expenditure represented by the items above

**Investment income**

*dividends from equities*

*income from bonds*

*income from pooled investment vehicles*

*net rents from properties (any material netting-off should be separately disclosed)*

*interest on cash deposits*

*income from derivatives (for example, net swap receipts/payments)*

*annuity income*

*other (for example from stock lending or underwriting)*

**Change in market value of investments** (comprising profits and losses on disposal of investments and changes in value of investments)

**Taxation**

*pension levy (Republic of Ireland only)*

**Investment management expenses** borne by the scheme, *with suitable analysis where material*

**Net returns on investments**, representing the net sum of the above items

*resulting in a net total of*

**The net amount of the increase or decrease in the fund**

*to which is added the*

### **Opening net assets of the scheme**

*to give*

### **Closing net assets of the scheme.**

## **3.8 Fund Account – accounting policies and disclosures**

### ***Employee normal contributions***

- 3.8.1 Employee contributions, including AVCs, should be accounted for by the trustees when they are deducted from pay by the employer, except for employee contributions arising from the first contribution due where the employee has been auto-enrolled by the employer (applicable in the UK only, see paragraph 3.8.2 below). The payroll itself should be treated on a cash basis, for example where a scheme has a year-end on 5 April and salaries are paid on the 30th of each month in arrears, then contributions deducted on 30th March should be accrued, but not 5/30 of April contributions.
- 3.8.2 Under auto-enrolment employers' auto-enrol eligible employees into the pension scheme. The employees can then opt out of the scheme if they wish within one month of being auto-enrolled. The employer has to remit the first month's contributions deducted from a member who is auto-enrolled within 19 days of the second month following the month in which deductions are made. If an employee opts out before contributions are remitted to the scheme the employer returns the contributions to the member. This SORP recommends that such contributions are not reported by the scheme. If the employee opts out after the employer remits contributions to the scheme, then the scheme refunds the contributions to the employer who returns the contributions to the member. In this case the contributions are reported by the scheme and the refund of contributions for the opt out by the scheme to the employer is separately reported. In summary, this SORP recommends that contributions arising in the first month a member is auto-enrolled are recognised when received by the scheme. Thereafter they are recognised in accordance with paragraph 3.8.1 above.

### ***Employer normal contributions***

- 3.8.3 Employer normal contributions are the ongoing contributions paid into the scheme by the employers, in accordance with the Schedule of Contributions or Payment Schedule in force during the year in the UK and in accordance with the Trust Deeds and Rules and the Actuary's recommendations detailing the Actuarial Valuation or Funding Proposal (as applicable) in the Republic of Ireland. These contributions normally relate to the accrual of benefits for current service. If employer normal contributions are based on rates of salaries or wages, they should be accounted for on the same basis as employee contributions as set out in paragraphs 3.8.1 to 3.8.2 above. If they are expressed as fixed amounts they should be accounted for in the period to which they relate.
- 3.8.4 Some schemes include employer deficit funding in the contribution rates based on salaries or wages, in which case they should be accounted for on the same basis as employee contributions as set out in paragraphs 3.8.1 to 3.8.2 above. Where this is the case the notes to the financial statements should explain that employer normal contributions include deficit funding payments and the amount should be quantified and disclosed in the notes. Where this information cannot be easily extracted from systems without disproportionate cost, this fact should be explained in the notes to the financial statements

and the Trustees' Report should explain the rates paid in respect of deficit contributions and current service contribution payments. (For deficit contributions paid for a limited period or as a single payment see paragraphs 3.8.7 to 3.8.10.)

- 3.8.5 Under salary sacrifice arrangements employees sacrifice salary in exchange for the employer making contributions to the pension scheme on behalf of employees. Employer contributions made under a salary sacrifice arrangement are received by the scheme as employer normal contributions and should be reported as such in accordance with the description of contributions set out in the schedule of contributions. This SORP recommends that a note is included in the financial statements to explain that salary sacrifice arrangements are in place.

***Employer augmentation contributions***

- 3.8.6 Employer augmentation contributions are contributions payable to provide new benefits or to augment benefits for specified members. These should be accounted for either in accordance with the agreement under which they are being paid, or in the absence of an agreement, on a receipts basis.

***Employer deficit funding contributions***

- 3.8.7 Employer deficit funding contributions are contributions payable, for example, for a limited period or as a single payment, to improve the funding of a defined benefit scheme, often arising from a scheme funding recovery plan. These contributions normally relate to past service benefit accruals. These deficit funding contributions should be recognised as assets on the due dates on which they are payable in accordance with the Schedule of Contributions in the United Kingdom or the Actuarial Valuation/Funding Proposal in the Republic of Ireland, or on receipt if earlier than the due dates in the schedule with the agreement of the employer and trustees. This SORP recommends that the notes to the financial statements explain for how long deficit funding contributions are payable and the amounts payable. For multi-employer schemes this information can be provided on an aggregated basis at scheme level.
- 3.8.8 The trustees and employer may agree a recovery plan that is based on deficit funding contributions that are receivable by the scheme when certain triggers are met, for example the payment of a dividend by the employer or the profitability of the employer. Such arrangements and associated triggers are normally set out in the Schedule of Contributions/actuarial valuation/funding proposal and the related deficit funding contributions should be accounted for when they become due under the Schedule of Contributions. This SORP recommends that the nature of these arrangements, including a reference to triggers and the amounts involved, should be disclosed in the notes to the financial statements.
- 3.8.9 Where a contribution is paid to a scheme through the transfer of non-cash assets, a fair value at the date of receipt should be attributed to the assets. The contribution should only be recognised if the non-cash consideration meets the asset recognition criteria set out in FRS 102 (see paragraph 3.6.6 and 3.6.10).
- 3.8.10 Deficit funding contributions that are expressed as a percentage of pay should be accounted for as described in paragraph 3.8.4 above.

***S75 debt contributions***

- 3.8.11 In the United Kingdom contributions payable in respect of S75 debts are contributions payable when an employer ceases to be a participating employer in a scheme and the scheme actuary determines there is a past service deficit on a prescribed basis for members who are or were employees of an employer. The employer ceases to be a participating employer when for example they leave an employer corporate group, or they have no active members in the scheme. A S75 debt becomes due from this time and should be accounted for when a reasonable estimate of the amount due can be determined. In assessing this estimate the Trustees consider the amount determined by the scheme actuary and agreements with the employer as to how the S75 debt is to be treated. If the S75 debt is met by way of, for example, a guarantee it should not be recognised unless or until an asset arises from the guarantee. For contingent assets see section 3.34. As there is no statutory timescale within which a S75 debt must be determined, where a reasonable estimate cannot be made, for example because the S75 debt has not been determined by the actuary, this SORP recommends this is disclosed in the notes to the financial statements and a statement that the debt cannot be estimated with the reasons why.
- 3.8.12 If the S75 debt arises on the insolvency of an employer the estimated recoverable amount under the debt, if any, should be accounted for based on the trustees' estimate taking into account latest available information from the Insolvency Practitioner.

***Other contributions***

- 3.8.13 Contributions receivable under Financial Support Directions or Contribution Notices issued by the Pensions Regulator should be accounted for in accordance with the terms of the Direction or Notice as appropriate, taking into account the trustee expectations of likelihood of receiving the relevant contribution amounts from the employer.
- 3.8.14 Employers' other contributions may be paid for example to contribute towards the administration cost, life assurance costs of the scheme or the Pension Protection Fund annual levy. These contributions should be accounted for in accordance with the agreed arrangements.
- 3.8.15 Additional contribution categories can be added where appropriate.

***Recognition of benefits and payments to leavers***

- 3.8.16 Under United Kingdom and Republic of Ireland regulations and FRS 102 the Statement of Net Assets is not required to include liabilities to pay pensions and benefits after the end of the scheme year. The objective is to ensure that all benefits that fall due for payment in the accounting period are recognised in the financial statements.
- 3.8.17 The following paragraphs give guidance on the recommended treatment of these benefit transactions in the most common circumstances. The membership statistics reported in the Trustees' Report as at the scheme year-end should be consistent with the accruals treatment adopted in the financial statements for accounting for benefits.
- 3.8.18 Where a member has a *choice* about the form of their benefit, the liability to pay the benefit does not arise before the choice is made. For example:
- if a member, on leaving before normal retirement date, has the choice of either a refund of his contributions or a deferred pension, and has left employment before the end of the accounting period but as at the accounting date has not made his choice,

then the scheme remains liable for the member's deferred pension, payable at a future date; this liability is not included in the financial statements. The member would be shown as a deferred member in the membership statistics;

- if a member on retirement is entitled to either a full pension or a lump sum plus a reduced pension, and has retired before the end of the accounting period but as at the accounting date has not made his choice, then there is no liability at the accounting date to pay any lump sum potentially payable and hence no liability should be recognised. The member should normally be shown as a deferred member in the membership statistics; and
- where significant potential liabilities exist at the scheme year-end, pending members' decisions, disclosure should be made of the potential effect on the financial statements.

3.8.19 Where the member has no choice (for example is only entitled to a refund, or single cash sum on retirement), accounting entries should be made based on the date of leaving or retirement, which is when the liability to pay the benefit arises.

3.8.20 The date on which a liability to pay a benefit arises is therefore defined under normal circumstances as the later of the date of leaving/retirement/death and the date on which any option is communicated to the trustees.

***Taxation where lifetime or annual allowances are exceeded***

3.8.21 Where a member's benefit entitlement exceeds the United Kingdom Inland Revenue tax limits (Lifetime Allowance or the Annual Allowance) or in the Republic of Ireland, Revenue Commissioners limits, the member is liable for taxation. This tax can be settled by the member or trustees may agree to settle the tax on behalf of the member in exchange for a reduction in benefit entitlement. In this scenario this SORP recommends that the payment of tax on behalf of the member is reported separately in the notes to the financial statements.

***Transfers***

3.8.22 Transfers in and out are accounted for when the related member liability transfers between schemes.

3.8.23 For individual transfers this is normally when the transfer is paid. The receiving scheme will not, under normal circumstances, be liable for any pension benefits in respect of the transferring member until assets (whether in cash, investments or any other form of asset) have actually been received. The transferring scheme normally retains liability for the member's pension benefits until payment of the transfer value has been successfully made, regardless of instructions from the member requesting a transfer value to be paid. Under these circumstances, no liability for the transfer value arises in either scheme until payment is actually made and hence the recommended basis of accounting for transfers is on the basis of amounts paid and / or received.

3.8.24 In the case of group transfers or scheme mergers it is common for the legal agreement between the schemes to set a date of transfer for scheme member liabilities and scheme assets. This is the effective date of the transfer and should be the date at which the transfer is accounted for in scheme financial statements. In practice the scheme assets may not be registered in the name of the receiving/merged scheme for some time. None

the less they become the assets of the receiving/merged scheme from the date of the legal agreement and should be accounted for as such.

Where, however, the trustees of the receiving scheme have agreed to accept liability in advance of the receipt of funds, the liability to pay the transfer value exists from the date of the agreement and should be accrued in the transferring scheme and the scheme assets remain in the transferring scheme. The transfer should therefore be accrued in accordance with the terms of the agreement.

- 3.8.25 This SORP recommends disclosure of the method by which group transfers have been effected, where these have been other than by a cash payment, for example by the transfer of ownership of investment assets.
- 3.8.26 If the basis adopted for accruals of group transfers is different from that used in the report on membership statistics included in the Trustees' Report, this SORP recommends that the difference, if material, should be disclosed either in the financial statements or the Trustees' Report.

***Expenses***

- 3.8.27 Unless immaterial, expenses (such as the fees of actuaries, auditors, PPF levy and administrators) should be accrued to ensure expenses for the full accounting period are accounted for in the Fund Account. For significant projects done on a consultancy basis, if the amounts involved are material, it could prove necessary to accrue on the basis of the proportion of work completed by the scheme year-end.

***Investment income***

- 3.8.28 FRS 102 requires the following disclosure in relation to investment income:  
**An entity shall disclose the following items of income, expense, gains or losses:**
- a) **income, expense, net gains or net losses, including changes in the fair value, recognised on financial assets measured at fair value through profit and loss; and**
  - b) **total interest income and total interest expense (calculated using the effective interest method) for financial assets or liabilities that are not measured at fair value through profit and loss. (FRS 102: 11.48)**
- 3.8.29 Since FRS 102 requires pension schemes to report fair value through the Fund Account approach (a) above applies to pension schemes. Approach (b) does not apply and therefore pension schemes do not use the effective interest method when reporting interest income on bond securities.
- 3.8.30 This SORP recommends:
- dividends from securities should be accrued when the securities are quoted ex-dividend, or dividend declared for unquoted securities;
  - income on bond securities should be accounted for on an accruals basis. Interest purchased and sold on investment transactions should be reported through income on bond securities in the Fund Account;

- rents should be accrued as earned in accordance with the terms of the lease;
- interest on cash deposits and bonds should be accrued on a daily basis;
- investment income arising within pooled investment vehicles which is rolled up in the investment fund and reflected in the value of the units is not separately reported in the scheme's financial statements. Where income is distributed and immediately reinvested to purchase more units it should be reported as investment income and the purchase of units included as an investment purchase in the investment reconciliation table;
- distributions by special purpose vehicles (SPVs) established for scheme funding arrangements (see paragraph 3.12.25) will comprise an element of income and capital. If the split of income and capital elements of the distribution is readily obtainable the distribution will be accounted for in part within investment income and in part within sale proceeds of investments. However, if the split between income and capital is not available this SORP recommends receipts are reported as either investment income or sale proceeds with a note disclosing the approach adopted;
- income arising from annuity policies held by the trustees of a scheme may be paid to the trustees in order to fund the pension paid by the scheme to the pensioner(s) or it may be paid directly to the pensioner by the annuity provider. In both these circumstances the receipts arising from the annuity policies should be included in the financial statements and the pensions paid to the pensioners included in pension payments. There should be no netting off of these amounts. The receipts from the annuity provider can be apportioned to sale proceeds and investment income or reported all within investment income. Disclosure of the approach taken should be included in the financial statements; and
- derivatives – where the nature of the cash flow is income the net cash flow is reported as investment income. Where the nature of the cash flow is related to an asset or liability the net cash flow is reported within change in market value. Cashflows are analysed at contract level. It is not necessary to allocate cashflows arising from a contract between income and capital unless information is available to do so and trustees consider it appropriate in the circumstances.

### *Taxation*

3.8.31 FRS 102 requires the following disclosure in relation to taxation:

**An entity shall disclose information that enables users of its financial statements to evaluate the nature and financial effect of the current and deferred tax consequences of recognised transactions and other events. (FRS 102: 29.25).**

- 3.8.32 Pension schemes registered with HMRC in the United Kingdom and the Revenue Commissioners in the Republic of Ireland are exempt from income tax and capital gains tax. This SORP therefore recommends the notes to the financial statements disclose the tax status of the scheme to explain it is exempt from taxation except for certain withholding taxes (see below).
- 3.8.33 If a scheme is an unapproved scheme it shall comply with the accounting and disclosures set out in FRS 102 Section 29 'Income Tax' in relation to income tax and capital gains tax.
- 3.8.34 Tax on investment income should be accounted for in accordance with FRS102 29.19, and the terms "withholding tax" and "tax credit" in this paragraph carry the same meaning as in FRS 102. Recoverable withholding tax on investment income should normally be accrued on the same basis as the net income. There may be a significant time lag between the receipt of an overseas dividend net of taxation and receipt of the withholding tax refund. However, only if there is significant uncertainty as to eventual receipt should the tax be deducted from the amount accrued. Accrued investment income should not include tax credits. Any withholding tax that is irrecoverable should be shown separately as a tax charge.
- 3.8.35 In the Republic of Ireland the government has introduced a financial levy on the assets of private pension funds. This pensions levy is normally reported within taxation with a suitable note disclosure to explain its nature. The pensions levy should be recognised in the Fund Account as it falls due.

***Investment transaction costs***

- 3.8.36 Transaction costs are incremental costs that are directly attributable to the acquisition or disposal of a financial asset or liability. An incremental cost is one that would not have been incurred if the scheme had not acquired or disposed of the investment (FRS 102 Glossary).
- 3.8.37 Transaction costs include fees and commissions paid to agents, advisers, brokers and dealers, levies by regulatory agencies and securities exchanges, and transfer taxes and duties. Direct transaction costs do not include debt premiums or discounts, financing costs, any difference between the quoted bid and offer prices or internal administration or holding costs.
- 3.8.38 FRS 102 sets out approaches for initial recognition of financial assets and investment properties.
- 3.8.39 For a financial asset it states that an entity shall measure it at fair value, which is normally the transaction price (including transaction costs except in the initial measurement of financial assets and liabilities that are measured at fair value through profit and loss). (FRS 102: 12.7)
- 3.8.40 FRS 102 sets out a different approach for initial measurement of investment properties. An entity shall measure investment property at its cost at initial recognition. The cost of a purchased investment property comprises its purchase price and any directly attributable expenditure such as legal and brokerage fees, property transfer taxes and other transaction costs. (FRS 102: 16.5)
- 3.8.41 This SORP recommends that transaction costs arising on all investment purchases and sales are charged to the Fund Account within 'Change in market value' by adding to purchase costs and netting against sale proceeds, as appropriate for all investment types.

This recommendation achieves consistency between asset classes and ensures all transaction costs are charged to the Fund Account.

- 3.8.42 This SORP recommends that the total amount of 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 financial statements under the investments reconciliation table. Direct transaction costs should be analysed for each significant asset class disclosed in the investment reconciliation table. The analysis should include disclosure of the amount of each type of direct transaction cost. Explanations should be given to enable users of the financial statements to understand the nature of transaction costs and how they arise for different types of investment.
- 3.8.43 Indirect costs such as bid-offer spread costs and costs charged within pooled investment vehicles do not need to be disclosed. However the notes to the financial statements should explain the existence of these bid-offer spread costs.

### 3.9 **Statement of net assets – content and format**

- 3.9.1 FRS 102 requires the following content for a pension scheme Statement of Net Assets:

**The financial statements of a retirement benefit plan, whether defined contribution or defined benefit, shall present the following in the statement of net assets available for benefits:**

- (a) **assets at the end of the period suitably classified; and**
- (b) **liabilities other than the actuarial present value of promised retirement benefits. (FRS 102: 34.38)**

- 3.9.2 FRS 102 does not provide guidance on what a suitable classification of assets may be. Therefore this SORP recommends that a suitable classification for scheme assets and liabilities (other than the actuarial present value of promised retirement benefits) on the face of the net asset statement is as follows:

#### **Investment assets**

- Equities
- Bonds
- Property
- Pooled investment vehicles
- Derivatives
- Insurance policies
- Other investments
- AVC investments
- Cash
- Other investment balances

#### **Investment liabilities**

- Derivatives
- Other investment balances

#### **Current assets**

## **Current liabilities**

## **Total net assets**

- 3.9.3 Further items in relation to scheme assets and liabilities can be included on the face of the Statement of Net Assets if significant to the scheme's affairs.

## **3.10 Statement of net assets - disclosures**

### *FRS 102 financial instrument disclosures*

- 3.10.1 FRS 102 requires the following disclosures in relation to financial instruments:

**A retirement benefit plan shall disclose information that enables users of its financial statements to evaluate the significance of financial instruments for its financial position and performance. (FRS 102: 34.40)**

**A retirement benefit plan shall disclose a disaggregation of the statement of net assets available for benefits by class of financial instrument. A class is a grouping of financial instruments that is appropriate to the nature of the information disclosed and that takes into account the characteristics of those financial instruments. (FRS 102: 34.41)**

- 3.10.2 FRS 102 defines financial instruments as: A contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity (FRS 102: Glossary). FRS 102 also provides definitions of financial assets and liabilities. These are very widely drawn and most scheme investment assets and liabilities would therefore be considered to be financial instruments, the main exception being investment properties. FRS 102 also requires disclosure of fair value determination (see paragraphs 3.13.1 to 3.13.5) by class of financial instrument.
- 3.10.3 This SORP's recommendations for the disclosure of scheme investments by category on the face of the net asset statement is normally expected to meet FRS 102's requirements for disclosure of financial instruments by class.

### *FRS 102 investment properties disclosures*

- 3.10.4 FRS 102 requires the following to be disclosed in relation to investment property valuations:
- a) **the methods and significant assumptions applied in determining the fair value of investment property;**
  - b) **the extent to which the fair value of investment property (as measured or disclosed in the financial statements) is based on a valuation by an independent valuer who holds a recognised and relevant professional qualification and has recent experience in the location and class of the investment property being valued. If there has been no such valuation, that fact shall be disclosed;**
  - c) **the existence and amounts of restrictions on the realisability of investment property or the remittance of income and proceeds of disposal; and**

**d) contractual obligations to purchase, construct or develop investment property or for repairs, maintenance or enhancements. (FRS 102: 16.10)**

3.10.5 In relation to investment properties this SORP recommends that the notes to the financial statements should disclose the name, or employing firm, and qualification of the valuer and should disclose, where relevant, that the valuer is an employee of the scheme or participating employer(s). The date(s) and basis (or bases) of valuation should also be disclosed. Disclosure should also be made of the basis of any fair value adjustments to latest available valuations at the reporting date.

***Audited Accounts Regulations disclosures***

3.10.6 The Audited Accounts Regulations require the disclosure of any investment (other than UK Government securities) which represents more than 5 percent of the total value of net assets of the scheme.

3.10.7 The Audited Accounts Regulations also require a number of detailed disclosures. These are set out in Appendix 7 together with related explanatory notes. *NOTE: PRAG is liaising with the DWP with the objective of removing the prescriptive disclosures of investments required by the Audited Accounts Regulations.*

***Derivatives***

3.10.8 This SORP recommends the following disclosures in relation to derivatives:

- An explanation should be given of the objectives and policies for holding derivatives;
- the accounting policies should include a description of the basis of valuation for derivatives;
- derivative contracts are disclosed separately under investments. Derivative investments with positive values should be included in the Statement of Net Assets as assets, and those with negative values should be separately included in the Statement of Net Assets as liabilities. These balances should not be offset unless there is a legal right of offset, as explained in paragraph 3.6.5;
- derivatives should be disclosed according to their type. The most commonly used are futures, swaps, options and forward foreign exchange contracts. Derivatives contracts should be further analysed between exchange traded and over the counter contracts;
- the key details of the contracts in place at the end of the financial year are disclosed. This could include the types of contracts, an indication of the period covered by the contracts, the counterparties to the contracts, the nominal values or gross exposures of the contracts, the values of the contracts at the year end and whether they are assets or liabilities. The key contract details may be aggregated for example by the terms of the contract;
- the amount and nature of any collateral held or that has been pledged at the year end should be disclosed;

- amounts payable to or receivable from brokers and counterparties should be recorded as separate items, within cash deposits and other balances in the Statement of Net Assets. Amounts due to and from brokers should not be offset unless there is a legal right of offset, as explained in paragraph 3.6.5; and
- the investment reconciliation table should show the movements on derivative investments during the year (see Appendix 1 and section 3.14). This can be further analysed by derivative type if this is considered helpful.

3.10.9 Disclosures relating to derivatives may be presented as a separate note or included within the risk disclosures required by FRS 102 (see paragraph 3.15.1 to 3.15.11). It is not necessary to provide detailed comparatives for the key contract disclosures recommended above. An example of this is set out in Appendix 1.

***Insurance policies - disclosures***

3.10.10 The United Kingdom Audited Accounts Regulations require the disclosure of an insurance policy's main characteristics where it exceeds 5% of total net assets value. This SORP recommends these characteristics could include:

- type(s) of insurance contract for example, with profits; unitised with profits contracts and annuity and deferred annuity contracts, including buy-ins;
- name(s) of insurance company(ies) involved;
- the method of valuation and date(s) of valuation;
- whether valued by the insurance company and, if not, name of valuer(s), qualification and whether the valuer is an employee of the scheme or of the participating employer; and
- in the Republic of Ireland where Section 53B policies (otherwise known as sovereign annuities), have been purchased, the notes to the financial statements shall include a statement of the value of the pension obligations of the scheme which are matched by these policies, and if there is any reduction in payments under any section 53B policies held by the scheme these notes must include a statement detailing the particulars of that reduction.

3.10.11 These disclosures are not required for investment unit linked insurance policies which are covered by financial instrument disclosures.

***Other investment disclosures***

3.10.12 In addition to the above this SORP recommends the following disclosures are made to provide appropriate information on investments:

- for pooled investment vehicles, disclosure should be made of the type of fund, such as equity, bond, property, hedge funds, diversified growth funds, private equity funds, infrastructure funds and other;

- other investments should be disclosed by type of investments, for example; longevity swaps (where they are not classified as a derivative), special purpose vehicles and other;
- balances due and payable arising under repurchase agreements and reverse repurchase agreements and amount of securities sold which are subject to repurchase contracts (see 3.18);
- stock lending arrangements in place and total value of securities on loan and an analysis by asset class of securities on loan (see 3.19); and
- assets held to provide defined contribution benefits for individual members should be clearly distinguished from those that are not.

3.10.13 If the scheme holds material categories of other investments not covered by the above, disclosure should be made taking into account the nature and size of the investment.

***Current assets and liabilities***

3.10.14 In relation to current assets and liabilities this SORP recommends the following disclosures.

- current assets – disclosure of contributions due from employer, cash balances (not forming part of investment assets) and other current assets; and
- current liabilities – disclosure of unpaid benefits and other current liabilities.

### **3.11 Explanatory comments on investments**

***Investment trust companies***

3.11.1 This SORP recommends that holdings in investment trust companies (ITCs) are classified as an equity if the holding is part of a wider equity portfolio or as a pooled investment vehicle if it is held to obtain exposure to the underlying investments.

***Pooled investment vehicles***

3.11.2 Pooled investment vehicles include the various forms of pooled investments such as unit trusts, unitised or unit linked insurance policies, open-ended investment trusts and open ended investment companies, shares in limited liability partnerships and limited partnerships.

***Insurance policies***

3.11.3 The typical insurance policies used by pension schemes are unit linked policies, annuities and with-profits policies. Unit linked policies are reported within pooled investment vehicles. Annuity policies are reported as scheme assets where the policy is in the name of the trustees and can comprise either policies relating to individual members or to bulk annuities covering groups of members (buy-ins). Annuities (including deferred annuity contracts), with-profits contracts and unitised with-profits contracts should be disclosed in the Statement of Net Assets under ‘insurance policies’.

### *Derivatives*

3.11.4 Derivatives are financial instruments that derive their value from the price or rate of some underlying item. Underlying items include equities, bonds, commodities, interest rates, exchange rates, and stock market indices. There are many types of derivatives including futures, options, forward foreign currency contracts and swaps. Derivatives can be exchange traded or traded over the counter. The most commonly used derivatives in pension schemes are described below:

- Futures contracts are exchange traded contracts to sell or buy a standard quantity of a specific asset at a pre-determined future date, at a price agreed now. There are many types of futures contracts including equity, bond and interest rate futures.
- Forward foreign exchange contracts are over the counter contracts whereby two parties agree to exchange two currencies on a specified future date at an agreed rate of exchange. Forward foreign exchange contracts are over the counter so the size of the deal, the settlement date and price are all negotiable between the two counterparties.
- Options are contracts that give the purchaser the right, but not the obligation, to buy (call option) or sell (put option), from/to the seller of the option, a specified quantity of a particular product at a specified price. Conversely options which are written give the seller the obligation to buy or sell a specified quantity of a particular product at a specified price, should the buyer decide to exercise that option. Options can be exchange traded or over the counter. The cost of the option is known as the premium. The price of the underlying security at which the option can be exercised is known as the strike price.
- Swaps are normally over the counter contracts where the parties to the contract agree to exchange cash flows, the amount of which is determined by reference to an underlying asset, index, instrument or notional amount. An interest rate swap, for example, is an exchange of interest rates on a specified amount of notional capital. One party pays to the other a fixed rate of interest on the notional capital amount and receives in return the floating rate of interest on the same notional amount (fixed 'leg' for floating 'leg').

3.11.5 Further guidance on derivatives is available from PRAG's publication "Accounting for Derivatives in Pension Schemes". Also see section 3.17 of this SORP. Longevity swaps may also be disclosed as derivatives (see paragraph 3.11.10).

### *Special purpose vehicles*

3.11.6 A typical special purpose vehicle (SPV) arrangement is where the employer places business assets into a ring-fenced structure, which acts as collateral for an investment made by the pension scheme into the arrangement. The pension scheme will then receive future cashflows from the SPV. The cashflow can be structured in a number of different ways, the most straightforward being a fixed regular amount. Alternatively they may be more complex, typically varying depending on the funding level of the scheme and in terms of timing, with some arrangements using a 'bullet payment' at the end of the term of the investment.

- 3.11.7 PRAG has issued guidance on accounting and valuing special purpose vehicles. This guidance is available from PRAG via the members' section of the PRAG website.

*Longevity swaps*

- 3.11.8 A longevity swap is normally an arrangement whereby regular payments are made by a scheme based on mortality assumptions fixed at the outset to an investment bank or insurer and, in return, the bank or insurer pays out amounts based on actual mortality rates of the pensioner population being hedged. There are therefore fixed and floating legs and settlement is normally on a net basis.
- 3.11.9 There are typically two types of swap: bespoke swaps and index-swaps. Bespoke longevity swaps provide a hedge against the longevity of actual members of the pension scheme whereas index based swaps move in line with general developments in longevity.
- 3.11.10 Longevity swaps may be classified as derivatives where they use market based longevity information to determine cashflows. If they use scheme specific longevity information they are technically not regarded as derivatives for accounting purposes and are reported under 'other investments'. This does not alter the approach to valuing the arrangements (see paragraph 3.12.24).

*Repurchase agreements and reverse repurchase agreements*

- 3.11.11 A repurchase agreement (repo) is an agreement under which one party receives cash in exchange for securities delivered as collateral, later "repurchasing" the securities within a specified time at a specified price (normally at a higher price to include interest). A reverse repurchase agreement (reverse repo) is an agreement under which one party disburses cash to receive ("buy") securities, later "reselling" the securities at a specified time at a specified price (normally at a higher price to include interest income). The economic nature of both repo transactions is a financing activity, a secured lending or borrowing.

## 3.12 Valuation of assets and liabilities

- 3.12.1 FRS102 contains specific guidance on the approach to determining fair value of pension scheme investment assets. FRS 102: 28.15(b) requires scheme assets to be measured at fair value in accordance with guidance in FRS 102 paragraphs 11.27 to 11.32 with the exception of annuity insurance policies (see 3.12.11).
- 3.12.2 FRS 102 defines fair value as: 'the amount for which an asset could be exchanged, a liability settled ... between knowledgeable, willing parties in an arm's length transaction.' (FRS 102: Glossary).

*Fair value hierarchy*

- 3.12.3 FRS 102 requires the use of the following hierarchy to estimate the fair value of investments:

Category (a) - **The best evidence of fair value is a quoted price for an identical asset in an active market. Quoted in an active market in this context means quoted prices are readily and regularly available and those prices represent actual and regularly occurring market transactions on an arm's length basis. The quoted price is usually the current bid price.**

Category (b) - **When quoted prices are unavailable, the price of a recent transaction for an identical asset provides evidence of fair value as long as there has not been a significant change in economic circumstances or a significant lapse of time since the transaction took place. If the entity can demonstrate that the last transaction price is not a good estimate of fair value (eg because it reflects the amount that an entity would receive or pay in a forced transaction, involuntary liquidation or distress sale), that price is adjusted.**

Category (c) - **If the market for the asset is not active and recent transactions of an identical asset on their own are not a good estimate of fair value, an entity estimates the fair value by using a valuation technique. The objective of using a valuation technique is to estimate what the transaction price would have been on the measurement date in an arm's length exchange motivated by normal business considerations. (FRS 102: 11.27)**

3.12.4 FRS 102 defines active market as a market in which all the following conditions exist:

**(a) the items traded in the market are homogeneous;**

**(b) willing buyers and sellers can normally be found at any time; and**

**(c) prices are available to the public. (FRS 102: Glossary)**

*Category (a) – further guidance*

3.12.5 Assets that would typically fall in category (a) include actively traded exchange traded securities, such as equities and certain derivatives where official prices are available from the relevant securities exchange at the reporting date, and pooled investment vehicles which are priced and traded daily. If a market is closed due to normal business hours at the time the fair value is determined this does not cause an otherwise active market to be regarded as inactive. If a daily price is not available at the reporting date (which is a normal business day) then the investment would be valued under category (b) or (c) below.

3.12.6 The prices used to value category (a) assets may be official close, settlement price, last traded, bid/offer depending on the market convention. For example: actively traded equities fair value will be based on bid prices, official close or last trade depending on the convention of the stock exchange where the equities are listed. For exchange traded derivative contracts fair value will be based on settlement prices or adjusted settlement prices. Pooled investment vehicles such as unitised funds should be included at the closing bid price if both bid and offer prices are published or, if single priced, at the closing single price.

*Category (b) – further guidance*

3.12.7 Category (b) assets would include exchange traded securities which are relatively illiquid, that is, there were no traded prices available on the reporting date and pooled investment vehicles that are priced weekly or monthly. There is no guidance in FRS 102 as to what constitutes a 'recent transaction' nor what may constitute 'significant change in economic

circumstances or a significant lapse of time since the transaction took place'. Therefore judgement will be required when considering the use of prices for assets which are other than at the reporting date. If adjustments are required, or the last available price is considered to be inappropriate, then a valuation technique will be used to value the asset and it will be classified in category (c).

*Category (c) – further guidance*

- 3.12.8 Category (c) as defined by FRS 102 includes a wide range of investments which use valuation techniques to determine fair value. This SORP recommends that investments whose value is determined by valuation techniques that rely significantly on assumptions and non-observable market data are disclosed separately to those whose value is determined by valuation techniques that use observable market data.
- 3.12.9 Fair value based on a valuation technique using observable market data will generally include evaluated pricing techniques using inputs such as quoted prices for similar instruments, interest rates, yield curves or credit spreads. This could include bonds, OTC derivatives and investment properties. This category is referred to as c (i).
- 3.12.10 Fair value based on a valuation technique that relies significantly on non-observable market data will include values not primarily derived from observable market data. This could include private equity, insurance contracts, special purpose vehicles and investment properties where there are few transactions for the type of property. This category is referred to as c (ii).

*Valuation techniques*

- 3.12.11 FRS 102 comments as follows on valuation techniques:

**Valuation techniques include using recent arm's length market transactions for an identical asset between knowledgeable, willing parties, if available, reference to the current fair value of another asset that is substantially the same as the asset being measured, discounted cash flow analysis and option pricing models.**

**If there is a valuation technique commonly used by market participants to price the asset and that technique has been demonstrated to provide reliable estimates of prices obtained in actual market transactions, the entity uses that technique. (FRS 102: 11.28)**

**The objective of using a valuation technique is to establish what the transaction price would have been on the measurement date in an arm's length exchange motivated by normal business considerations. Fair value is estimated on the basis of the results of a valuation technique that makes maximum use of market inputs, and relies as little as possible on entity-determined inputs. A valuation technique would be expected to arrive at a reliable estimate of the fair value if:**

- (a) **it reasonably reflects how the market could be expected to price the asset;**  
**and**

- (b) **the inputs to the valuation technique reasonably represent market expectations and measures of the risk return factors inherent in the asset. (FRS 102: 11.29)**

3.12.12 This SORP sets out the typical approach to applying valuation techniques to investments in category (c) below.

***Bonds***

3.12.13 Bonds, which do not trade frequently, including short-term instruments, are priced based on evaluated prices provided by pricing vendors. Such prices are normally on a “clean” basis (the value of the bond less the accrued interest) and may be determined by factors which include, but are not limited to, market quotations, yields, maturities, call features, ratings, institutional size trading in similar groups of securities and developments related to specific securities. However, in some global markets, evaluated prices are on a “dirty” basis (the value of the bond that includes the accrued interest) and there will not be any separate interest accruals on these securities.

***Unquoted securities***

3.12.14 Unquoted securities should be included at a fair value estimated by the trustees, based on the advice of an investment manager or other appropriate professional adviser. Where such investments are material, the trustees should adopt an appropriate basis of valuation, such as the valuation guidelines of the International Private Equity and Venture Capital Valuation (IPEV) Guidelines, and apply the basis consistently. The valuation basis should be disclosed in a note to the financial statements.

***Over the counter derivatives***

3.12.15 Fair values for over the counter derivatives are determined using valuation techniques which depend on the type of derivative, for example:

- options – option-pricing models;
- swaps – current value of future cashflows arising from the swap taking into account the time value of money calculated using discounted cash flow models and using market data at the reporting date; and
- forward foreign exchange – fair value is determined as the gain or loss that would arise from closing out the contract at the reporting date by entering into an equal and opposite contract at that date.

***Pooled investment vehicles***

3.12.16 Private equity, infrastructure and other relatively illiquid pooled investment arrangements are normally reported at the net asset value (NAV) of the fund. The NAV should be determined by the pool manager by applying fair value principles to the underlying investments of the pooled arrangement. There may be circumstances where the NAV is not appropriate as a measure of fair value, for example if the trustees have decided to sell the pooled arrangement in a secondary market. There may be a discount or premium to

NAV in a secondary market depending on the circumstances of the pooled arrangement. Therefore if there is a commitment to dispose of the pooled arrangement consideration should be given to adjusting NAV to reflect the level of discount or premium to NAV at the reporting date.

***Insurance policies – unit linked***

- 3.12.17 Unit linked or unitised insurance policies value fluctuates directly in relation to the fair value of the asset class or classes that constitute the investments underlying the insurance policies. These policies should be valued on the same basis as pooled investment vehicles.

***Insurance policies - annuities***

- 3.12.18 FRS 102 requires annuities, which FRS 102 defines as an insurance policy that exactly matches the amount and timing of some or all of the benefits payable under the plan, to be valued as follows:

**the fair value of the asset is deemed to be the present value of the related obligation (FRS 102: 28.15 (b)).**

- 3.12.19 The present value of the related obligation will depend on the basis of the valuation of the scheme liabilities. A pension scheme has several bases for determining actuarial liabilities, for example scheme funding or buy-out. This SORP recommends that the basis adopted by the trustees for pension scheme financial statements reflects the circumstances and purpose of the annuity arrangements. For example, if the intention is to hold the annuities in the scheme for the long term then the scheme funding valuation basis would seem most appropriate. If the annuity has been purchased with a view to moving to a buy-out then the trustees may consider the buy-out basis more appropriate. See Appendix 4 for additional Irish disclosure requirements for Section 53B insurance policies.
- 3.12.20 The basis adopted should be disclosed in the financial statements. If the basis adopted is not consistent with the scheme funding valuation this should be noted in the financial statements so the scheme actuary can consider any adjustments necessary to the scheme's reported net assets for the purposes of the scheme funding valuation.
- 3.12.21 FRS 102 also requires the employer to value annuities for the purposes of employer accounting for employee benefits. Since the value of the scheme liabilities for the purposes of employer financial statement reporting will be based on high quality corporate bonds (FRS 102: 28.17) it is expected the employer financial statements will have a different value for annuities compared to pension scheme financial statements.
- 3.12.22 If an annuity value determined in accordance with FRS102 is not considered significant in relation to the Statement of Net Assets of the pension scheme then consideration should be given as to whether the costs of obtaining a value outweigh the benefits of including a value in the Statement of Net Assets. Where the costs are considered to outweigh the benefits then the annuity is not valued in the Statement of Net Assets and a note to this effect is included in the financial statements. When considering significance the total value of all annuities should be taken into account.

***Insurance policies – with-profits***

- 3.12.23 With-profit insurance policies should be reported at an estimate of their fair value which will normally be the on-going value of the policy based on the cumulative reversionary bonuses declared and the current terminal bonus. If there is a commitment to redeem the policy then surrender value should be used. Under FRS 102, which requires fair value to be determined on an ‘exit’ value rather than an ‘entry value’ the use of an actuarial value or premium value is not appropriate.

***Longevity swaps***

- 3.12.24 The fair value of the longevity swap should be based on the expected future cash flows arising under the swap discounted using market interest rates. The cashflows are discounted using market-based interest rates, taking into account credit risk and liquidity premium appropriate for the circumstances. Projected variable cashflows also need to take into account current market views of longevity.

***Special purpose vehicles (SPVs)***

- 3.12.25 SPVs are typically highly illiquid and are not transferrable, whilst some give the employer pre-emption rights such that disposal to a third party is highly unlikely to occur. Notwithstanding the illiquid nature of these arrangements and a lack of an active market a fair value can be determined using valuation techniques.
- 3.12.26 The valuation technique will be based on the expected future cash receipts and the discount rate used to bring these expected cashflows to a present value.
- 3.12.27 The future cashflows may depend on the circumstances at the time they are received; for example the future funding level of the scheme. In such cases stochastic modelling will often be used to assess the future likely cashflows.
- 3.12.28 The discount rate used will depend on a number of factors, for example the security of the arrangement; the credit worthiness of the employer and related collateral in the arrangement; the illiquidity of the arrangement and the current yield on any market-traded securities which have features similar to the SPV.
- 3.12.29 When modelling the value of an SPV some particular aspects that may need to be considered, depending on the nature of the arrangement, are:
- future assumed investment returns;
  - the trustee’s future investment strategy;
  - the employer’s approach to funding future deficit contributions;
  - determination of the future actuarial valuation discount rate;
  - development of the scheme’s actuarial liabilities; and
  - conditional criteria that may switch off cashflow from the SPV, for example, funding triggers.

- 3.12.30 Consideration of the above should be from the perspective of a third party willing buyer or seller at arms-length rather than from the trustee perspective.
- 3.12.31 These arrangements are highly illiquid and in some cases the arrangements cannot be sold on to third parties. This SORP recommends that if an SPV is highly illiquid this is disclosed in the scheme financial statements.

***Investment properties***

- 3.12.32 This SORP recommends that properties should be valued in accordance with the Royal Institution of Chartered Surveyors' Valuation Standards. The Valuation Standards UK PS 1.1, Valuation for Financial Statements, (which also applies in the Republic of Ireland) provides that the basis of valuation shall be that:
- a) properties in the occupation of the pension scheme should be valued at existing use value;
  - b) all other properties, other than specialised properties should be valued at market value; and
  - c) specialised properties should be valued at depreciated replacement cost.
- 3.12.33 There is no distinction between bid and mid values in the case of property.
- 3.12.34 Properties are reported at fair value at the scheme year end. The valuation of properties may involve additional expense in professional fees and the valuation approach is therefore a matter of judgement for the trustees, subject to any specific requirements in the scheme documentation. Where property comprises a significant proportion of total investments, it is recommended that property valuations should be carried out by independent valuers at the same frequency as actuarial valuations of the fund, but in any case not less frequently than triennially. In other cases, properties may be included on the basis either of an annual valuation by an internal or external valuer or, where the proportion of property assets within total investments justifies a less frequent valuation, on a rolling basis over one to three years by an internal or external valuer. More frequent valuations may be necessary in the case of properties in the course of development, redevelopment or refurbishment.
- 3.12.35 Where the valuation of investment properties is not at the reporting date, for example where the rolling valuation approach described above is adopted, consideration should be given to the need for a fair value adjustment to the latest valuation to the reporting date using appropriate market information such as property indices.

### **3.13 Disclosure of fair value determination**

- 3.13.1 FRS 102 requires the following disclosure in relation to fair value determination:
- For financial instruments held at fair value in the statement of net assets available for benefits, a retirement benefit plan shall disclose for each class of financial instrument, an analysis of the level in the fair value hierarchy (as set out in paragraph 11.27) into which the fair value measurements are categorised. (FRS 102: 34.42)**
- 3.13.2 This SORP recommends that the above disclosure is made, by class of investment disclosed on the face of the Statement of Net Assets. Further analysis can be provided if

desired. FRS 102's disclosure requirements in relation to fair value determination only relate to financial instruments. This SORP recommends all investments reported at fair value in the Statement of Net Assets are included in the disclosure including for example investment properties to achieve consistent disclosures for all scheme investments. Disclosure should include an analysis of Category (c) investments between c (i) and c (ii) as set out in paragraphs 3.12.8 – 3.12.10

- 3.13.3 Where a valuation technique is used FRS 102 also requires disclosure of the following:

**When a valuation technique is used, the entity shall disclose the assumptions applied in determining fair value for each class of financial assets or financial liabilities (FRS 102: 11.43)**

- 3.13.4 It will generally be sufficient to refer to the accepted valuation methodologies and use of market information to satisfy this requirement. For example in the case of private equity investments referring to the use of the International Venture Capital Association's guidelines to carry out the valuation would be sufficient. However, for certain types of investments such as SPVs where the assumptions used are specific to the scheme additional disclosure may be appropriate.

- 3.13.5 The disclosures made in relation to investment assets valued using a valuation technique should have regard to the significance of the investment asset in relation to the overall investment portfolio and the disclosures should be proportionate to the investment asset's value in relation to the overall value of the investment portfolio.

### 3.14 **Investment reconciliation table**

- 3.14.1 The United Kingdom Audited Accounts Regulations require disclosure of the total amount of the purchases and the total amount of the sales of investments during the scheme year to which the financial statements relate. FRS 102 also requires a reconciliation of carrying value of investment properties at the beginning and end of the accounting period.

- 3.14.2 This SORP recommends that the disclosure of sales and purchases of investments and of the changes in value during the period should provide a reconciliation between the opening and closing value of investments, analysed by asset class as disclosed on the face of the Statement of Net Assets as a minimum. Cash and other investment balances such as broker balances are not required to be included in this reconciliation.

Where there are derivative receipts and payments these amounts should be described as 'purchases at cost and derivative payments' and 'sales proceeds and derivative receipts'.

- 3.14.3 Where purchase cost or sales proceeds include accrued income, for example on bond securities, these should be excluded from investment purchases and sales and reported through investment income in the Fund Account.

### 3.15 **Investment risk disclosures**

- 3.15.1 FRS 102 requires certain disclosures in relation to risks arising from financial instruments:

**A retirement benefit plan shall disclose information that enables users of its financial statements to evaluate the nature and extent of credit risk and market risk arising from financial instruments to which the retirement benefit plan is exposed at the end of the reporting period. (FRS 102: 34.43)**

- 3.15.2 FRS 102 defines credit risk as: **the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. (FRS 102:Glossary)**
- 3.15.3 FRS 102 defines market risk as: **the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: currency risk, interest rate risk and other price risk.**
- **Interest rate risk – the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.**
  - **Currency risk – the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.**
  - **Other price risk – the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices (other than those arising from interest rate risk or currency risk), whether those changes are caused by factors specific to the financial instrument or its issuer, or factors affecting all similar financial instruments traded in the market. (FRS 102: Glossary)**
- 3.15.4 **For each type of credit and market risk arising from financial instruments, a retirement benefit plan shall disclose:**
- a) **the exposures to risk and how they arise;**
  - b) **its objectives, policies and processes for managing the risk and the methods used to measure the risk; and**
  - c) **any changes in (a) or (b) from the previous period. (FRS 102: 34.44)**
- 3.15.5 FRS 102 requires these risk disclosures for financial instruments only which would exclude other investments such as investment properties. This SORP recommends that the risk disclosures required by FRS 102 are applied to all investments reported at fair value in the Statement of Net Assets including for example investment properties.
- 3.15.6 These disclosures are required for both defined benefit and defined contribution scheme investment assets (including AVC assets), subject to materiality.
- 3.15.7 In order to satisfy FRS 102's requirement to provide information to enable an evaluation of a scheme's exposure to the nature and extent of credit and market risk at the year end this SORP recommends pension schemes disclose for significant risk exposures, the value of investment assets and liabilities subject to each of the above risks at the reporting date (and for the comparative reporting date) or suitable alternative information. Typical disclosures could include:
- **Credit risk** – this would include investments such as bond securities, over the counter derivatives, balances with counterparties such as unsettled trades and balances with banks;
  - **Currency risk** – value of investment assets denominated in foreign currencies analysed by major currencies at the year-end. Foreign currency hedging arrangements should be taken into account when making these disclosures. The

impact of the hedging arrangements can be reported on a gross or net basis. In other words total gross currency exposures may be given, together with a quantification of how these exposures are modified and how they are changed by the hedges, or the currency exposures may be reported net of the hedges;

- **Interest rate risk** – the value of financial instruments subject to interest rate risk at the year-end. These would typically be bond securities, derivatives whose value is impacted by interest rates, such as interest rate swaps and other investments valued using a valuation technique where interest rates are a major input; and
- **Other price risk** – value of financial instruments subject to other price risk would normally comprise quoted equities, bonds and private equity.

3.15.8 The notes to the financial statements should explain 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.

3.15.9 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.

3.15.10 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.

3.15.11 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) (or the Statement of Investment Policy Principles in the Republic of Ireland) 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.

*Credit risk – additional disclosures*

3.15.12 FRS 102 also requires additional disclosures in relation to credit risk:

**The amount that best represents its maximum exposure to credit risk at the end of the reporting period. This disclosure is not required for financial instruments whose carrying amount best represents the maximum exposure to credit risk. (FRS 102: 34.45)**

- 3.15.13 Since pension schemes report investments at fair value this disclosure is not required.
- 3.15.14 **A description of collateral held as security and of other credit enhancements, and the extent to which these mitigate credit risk. (FRS 102: 34.45)**
- 3.15.15 The amount and nature of collateral held at the reporting date, stated at fair value, should be included in the notes to the financial statements, with an indication of the class of investment included in the Statement of Net Assets to which it relates. Typical arrangements with collateral are over the counter derivatives, repurchase arrangements (repos) and stocklending.
- 3.15.16 **The amount by which any related credit derivatives or similar instruments mitigate that maximum exposure to credit risk. (FRS 102: 34.45)**
- 3.15.17 This SORP requires additional disclosures relating to derivatives in paragraph 3.10.8. If derivatives are held to mitigate credit risk relating to other financial instruments it would normally be appropriate to include this information with the disclosures required for derivatives.
- 3.15.18 **Information about the credit quality of financial assets that are neither past due nor impaired. (FRS 102: 34.45).**
- 3.15.19 This requires the disclosure of the credit quality of bond portfolios and other financial assets subject to credit risk. This SORP recommends as a minimum that pension schemes disclose investment grade, non-investment grade and unrated financial assets. There is no industry standard definition of investment and non-investment grade. Therefore trustees should agree with the provider of credit quality information the basis of this classification and apply it consistently across investments and from one year to the next.
- 3.15.20 Where a scheme has had to take possession of collateral during the year FRS 102 requires the following disclosures:
- When a retirement benefit plan obtains financial or non-financial assets during the period by taking possession of collateral it holds as security or calling on other credit enhancements (such as guarantees), and such assets meet the recognition criteria in other sections, a retirement benefit plan shall disclose:**
- a) the nature and carrying amount of the assets obtained; and
  - b) when the assets are not readily convertible into cash, its policies for disposing of such assets or for retaining them. (FRS 102: 34.46)

### 3.16 **Investment risk disclosures for pooled investment vehicles**

#### *Direct and indirect risks*

- 3.16.1 Where a pension scheme invests in a pooled investment vehicle it obtains direct exposure to the credit and market risks arising from the pooled investment vehicle and indirect exposure to the credit and market risks arising from the underlying investments of the pooled investment vehicle.

#### *Look through vs asset class approach*

- 3.16.2 Trustees may invest in pooled arrangements to obtain exposure to the underlying investments of the pooled arrangements or they may invest in the pooled arrangement as an asset class in its own right in order to achieve a strategic asset allocation. They will

therefore manage the associated investment risks either at the underlying investment or unit/share of fund level depending on the purpose of investing in the pooled arrangement. For example, a typical strategic asset allocation could be:

	%
Equities	40
Bonds	40
Hedge funds	20

- 3.16.3 If the equity and bond allocations are achieved through investing in pooled arrangements the trustees will manage and monitor the investment risks by reference to the underlying investments of the pooled arrangement. For example they will choose which fund to invest in based on the underlying equity allocations to markets and currency, and the underlying bonds by reference to type, currency and credit quality. On the other hand hedge funds are regarded as an asset class in their own right. The trustees do not typically choose which hedge fund to invest in based on the hedge fund's underlying investments. They typically choose hedge funds based on type of mandate, examples of which would be absolute return, unconstrained, or long only and performance is typically measured on an absolute return basis rather than against a particular market benchmark.
- 3.16.4 Where trustees invest in a pooled investment vehicle to obtain exposure to the underlying investments this SORP recommends a "look through" approach to disclosure of the indirect market and credit risks. Trustees will liaise with the pooled investment manager to obtain appropriate information to provide these disclosures at the reporting date. For some opaque arrangements such as hedge fund of funds or defined contribution white label investment funds the information may not be readily available in which case reasonable estimates should be made where possible. Where estimates have had to be made this should be disclosed.
- 3.16.5 Where trustees invest in the pooled arrangement as an asset class in its own right the look through approach can be used. However, it may be impractical to obtain the information required or trustees may consider it not appropriate because they do not monitor investment risk at the underlying investment level. In this case it is recommended that risk disclosures are considered at the unit of investment level. This may be units in a fund or a share of a fund such as an interest in a partnership. In this case the trustees make enquiries to the pooled fund manager to determine if the unit of investment is subject to change in value arising from market and credit risks and which types of market risk. The whole value of the pooled fund is then disclosed in the relevant risk analysis with an explanation of the trustee approach to investing in the pooled arrangement as an asset class in its own right.

***Direct market risks***

- 3.16.6 Pension schemes can have direct market risk arising from their holdings in pooled investment vehicles, for example currency risk arises if the interest in the pooled vehicle, for example units, is priced in a currency other than sterling.

*Indirect market risks*

3.16.7 Indirect market risk arises if the underlying investments of the pooled vehicle are exposed to currency, interest rate or other price risks.

3.16.8 For example a pension scheme that invests in overseas securities via a pooled arrangement whose units are priced in sterling has no direct foreign exchange risk. However, the underlying portfolio does have foreign exchange risks to which the scheme is exposed. Therefore on a look-through basis the disclosures required by FRS 102 in relation to foreign exchange risks as set out in 3.15 above are made in respect of the underlying investments. For example, if the value of the pooled fund was £1,000 and the pooled fund manager advised the trustees that the currency exposure of underlying investments of the pooled fund was 50% US\$, 30% Euros, 10% Yen and 10% other, the foreign exchange risk disclosure in respect of the pooled fund would be:

	£	
US\$		500
Euro		300
Yen		100
Other		<u>100</u>
		<u>1,000</u>

3.16.9 If trustees invest in the pooled fund as an asset class in its own right, trustees make enquiries to determine if there are underlying market risks and the total value of the pooled fund is included in the appropriate risk disclosure analysis.

*Direct credit risk*

3.16.10 Pension schemes generally have a direct credit risk to pooled investment arrangements where they are dependent on the pooled arrangement to deliver the cash flows which support the pooled arrangement's fair value and units or shares in the pooled arrangement can only be transacted with the pool manager. This credit risk arises because the scheme is exposed to potential losses as a result of the pool or pool manager failing to discharge their obligations to the scheme. If a pension scheme's interest in a pooled arrangement can be traded in the open market then the scheme generally does not have direct credit risk to the pooled arrangement.

3.16.11 The nature of direct credit risk of pooled investment vehicles will generally depend on the nature of the pooled arrangement which can typically comprise unit-linked insurance policies, authorised and unauthorised unit trusts, shares in open ended investment companies and shares in partnerships. Each type of arrangement has different regulatory and legal structures and the underlying investments of the pool will have differing degrees of protection from insolvency of the pool manager. Trustees will manage and monitor the direct credit risk of pooled arrangements by considering the nature of the arrangement, the legal structure and regulatory environment. Typically pooled arrangements are not credit rated. Therefore this SORP recommends the financial statements disclose the type of pooled arrangement by value and the trustees approach to managing and monitoring the associated direct credit risk.

- 3.16.12 Some pooled arrangements invest in other pooled arrangements, for example hedge fund of funds or insured unit-linked investment platforms which invest in other funds using reinsurance agreements.
- 3.16.13 Trustees consider the impact of these arrangements in relation to the scheme's exposure to failure by the sub-funds or reinsurers who may have different regulatory or insolvency protections compared to the pooled investment made directly by the scheme.

***Indirect credit risk***

- 3.16.14 If the underlying investments in the pooled arrangement have credit risk for example bonds, then the pension scheme is indirectly exposed to these credit risks. This SORP recommends that where the look through approach is adopted the value of the pooled fund subject to such indirect credit risk and the credit quality between investment grade, non-investment grade and unrated of the underlying assets of the pooled fund are disclosed. However, this SORP does not recommend the additional credit disclosures set out in paragraphs 3.15.10 to 3.15.18 above are made for pooled investment vehicles since the tactical management of credit risk within the pool arrangement is not the direct responsibility of the trustees.
- 3.16.15 If the pooled investment vehicle is held as an asset class in its own right the trustee makes enquiries to the investment manager as to whether there is underlying credit risk. If there is, the whole of the value of the pooled investment vehicle is disclosed in the indirect credit risk analysis.
- 3.16.16 An example of risk disclosures is given in the illustrative pension scheme financial statements included as Appendix 1 to this document.

### **3.17 Accounting for derivatives**

- 3.17.1 Derivatives can be used as part of the trustees' investment strategy for many different purposes including managing economic exposure to markets; to enhance investment returns; and to manage pension liability risk. For example:
- a) futures and options in equities and bonds can provide trustees with the opportunity to reallocate risk and exposures within a portfolio;
  - b) forward foreign currency contracts may be used to hedge against foreign currency movements or to create an absolute return; and
  - c) inflation swaps may be used as part of an investment strategy to match pension liabilities.
- 3.17.2 This SORP summarises the main characteristics and accounting treatment of derivatives. Further guidance on "Accounting for Derivatives in Pension Schemes" is available from PRAG.

***Purchase cost***

- 3.17.3 If a derivative has a purchase price, for example the premium paid when buying an option, this is the cost of the investment. If the derivative does not have an initial purchase price but does require a deposit to be made with a broker, for example an initial margin deposit under a futures contract, the cost of the investment is nil. The initial margin deposit is a cash balance returnable from the broker and is recognised as an asset.

***Accounting***

- 3.17.4 The day-to-day accounting entries in relation to derivatives need to deal with two separate aspects of the transaction: the changes in the fair value of the contract and the amounts due to or from the brokers or counterparties to the contract.
- 3.17.5 The fair value of an open derivative contract is shown in the Statement of Net Assets and the change in market value is shown in the Fund Account.
- 3.17.6 Changes in the fair value of open derivative contracts often have a cash movement associated with them. For example, futures contracts have variation margin receipts and payments, whilst swap and option contracts have collateral receipts and payments. These cash movements are typically intended to reduce credit risk between the contracting parties and do not represent realised gains and losses. Accordingly margin and cash collateral receipts and payments are accounted for within cash and amounts due to and from brokers, within investment assets and liabilities.
- 3.17.7 Changes in fair value of the derivative contract are unrealised gains and losses until the contract is closed out, at which time gains and losses become realised and are normally mainly represented by the accumulated variation margin/collateral holding. On close out of a derivative contract the market value of the contract at that date is reduced to nil. Any outstanding amount is then settled with the broker.
- 3.17.8 Some types of derivative contracts have cash flows that should be reported when they are due. For example, interest rate swaps typically have regular cash receipts or payments representing the difference between rates of interest that have been swapped.
- 3.17.9 The nature of the derivative contract needs to be understood so that accounting for change in market value, cash flows associated with change in market value and other cash flows arising under the contract are accounted for appropriately.
- 3.17.10 For example, on futures contracts collateral is paid to the exchange in the form of the initial margin. This is the amount required to be paid by the scheme to the exchange on the opening of a new futures contract. Initial margin will be an amount per 'lot' ('lots' being the units in which futures are bought and sold) and will be set by the market as a percentage of the contract value. Interest is received by the pension scheme on this margin deposit amount. At the end of each day and on close out of a contract, each outstanding contract will be valued and, to the extent that value differs from the previous day's value, the scheme will be required to pay additional margin amounts or will receive the return of some of the margin monies held. These movements are referred to as variation margin. Interest on the margin monies on futures contracts may be payable or receivable by the scheme.

### 3.18 **Accounting for repurchase agreements and reverse repurchase agreements**

- 3.18.1 When a pension scheme enters a repo transaction, the scheme continues recognising and valuing the securities that are delivered out as collateral, and disclosing them in the notes to the financial statements. This is because the scheme retains substantially all the risks and rewards of the ownership of the securities. The cash received is recognised as an asset, the obligation to pay it back is recognised as a payable amount. Where possible and material, the interest is accrued and included in the payable amount to recognise the higher price when “buying back” the securities.
- 3.18.2 When a pension scheme enters a reverse repo transaction, the scheme does not recognise the securities received as collateral in its financial statements as the scheme does not have the economic benefits. The scheme does however recognise the cash delivered to the counterparty as a receivable in the financial statements. Where possible and material, the interest is accrued and included in the receivable amount to recognise the higher price due to be received when “reselling” the securities. The securities received as collateral are disclosed in the financial statements.

### 3.19 **Accounting for stock lending**

- 3.19.1 Where the scheme’s investment custodian is authorised to release stock to a third party under a stock lending arrangement this SORP recommends that this be disclosed (even if no stock lending activity has taken place in the year).
- 3.19.2 Any securities loaned at the scheme year-end are included in the Statement of Net Assets to reflect the scheme’s continuing economic interest in those securities. The total value of securities out on loan at the year-end is disclosed in a note to the financial statements together with an analysis by asset class of the securities out on loan.

### 3.20 **Sole investor pooled arrangements**

A pension scheme may be the sole investor in a pooled arrangement, for example, liability driven investment funds typically set up as a Qualifying Investment Fund (QIF).

- 3.20.1 FRS 102 does contain consolidation requirements in relation to Special Purpose Entities (FRS 102: 9.10) and it is arguably the case that sole investor funds would fall to be consolidated under these requirements. However, FRS 102 requires investments held exclusively with a view to subsequent resale to be reported at fair value and not consolidated. FRS 102 defines “held exclusively with a view to subsequent resale” in its Glossary and this definition includes interests held as part of an investment portfolio, which is in turn defined in FRS 102’s Glossary as:

**“an interest is held as part of an investment portfolio if its value to the investor is through fair value as part of a directly or indirectly held basket of investments rather than as media through which the investor carries out business. A basket of investments is indirectly held if an investment fund holds a single investment in a second investment fund which, in turn, holds a basket of investment (FRS 102: Glossary).**

- 3.20.2 Where this is the case this SORP recommends that the scheme’s investment should continue to be reported as an interest in a pooled arrangement with disclosure as follows:
- an explanation that the scheme is the sole investor in the pooled arrangement; and

- a summary of the pooled arrangement's assets and liabilities at the reporting date.

3.20.3 The investment risk disclosures required by FRS102 should be made using the look through approach for sole investor pooled arrangements.

### **3.21 Common investment funds**

3.21.1 Some groups of companies retain separate pension schemes for different group companies or sub-groups but maintain a common investment fund (CIF) for the assets of all the group schemes, each scheme's interest being represented by a share of the common investment fund, typically expressed in terms of investment units. The question arises whether it is sufficient for the individual scheme's Annual Report to give details of the units held in the CIF but no information on the underlying assets. There are two reasons why information on the underlying assets should be provided:

- it is helpful to disclose to the reader of the financial statements the underlying exposure of the scheme to the main asset classes; and
- the CIF is likely to be a related party because it will have trustees who are also trustees of the participating schemes.

3.21.2 For these reasons, this SORP recommends that, where schemes participate in a CIF and each scheme's interest is represented by units or shares in that fund, the individual scheme's financial statements should state the percentage of units or share of the CIF owned by the scheme at the beginning and the end of the scheme year and either:

- include the financial statements of the CIF itself within the Annual Report; or
- provide equivalent details of the CIF's portfolio and income and state the scheme's proportionate share thereof.

3.21.3 The scheme's investment report should include appropriate details of CIF investments and investment performance.

3.21.4 The CIF's financial statements will show a true and fair view under UK/Irish GAAP and will therefore be prepared in accordance with FRS 102. The CIF will value its investments at fair value in accordance with FRS 102's fair value hierarchy. The CIF is not a pension scheme and it could be argued that the risk disclosures required by FRS 102 do not apply. However, this SORP recommends that CIF financial statements are prepared in accordance with FRS 102 as if pension disclosure requirements apply and therefore contain the risk disclosures in relation to financial instruments that would be disclosed as if it were a pension scheme.

3.21.5 This SORP further recommends that where the CIF financial statements are included in the scheme's Annual Report then the scheme financial statements can cross refer to the fair value and risk disclosures in the CIF financial statements and need not include risk and fair value disclosures in its financial statements. If the scheme financial statements include equivalent details of the CIF's portfolio then they should also include the risk and fair value disclosures.

## 3.22 **Subsidiaries, associates and joint ventures**

3.22.1 If a pension scheme has subsidiaries, joint ventures or associates it needs to consider its approach to these in its financial statements. FRS 102 has the following requirements that need to be taken into account:

- pension schemes are not required to prepare consolidated financial statements under FRS 102 (FRS 102: 9.2 and 9.3) but may choose to do so;
- investments in subsidiaries, associates and joint ventures are reported in the scheme's Statement of Net Assets at their fair values (FRS: 102: 34.36); and
- a subsidiary shall be excluded from consolidation and included at fair value where investment in the subsidiary is held exclusively with a view to subsequent resale (FRS 102: 9.9 (b) and FRS 102:9.9B).

3.22.2 Consequently, where a subsidiary is held as part of the scheme's investment portfolio it will be reported at fair value in the scheme's Statement of Net Assets and if the scheme chooses to prepare consolidated financial statements in the consolidated Statement of Net Assets.

Where a subsidiary is not held exclusively with a view to resale, for example a trading subsidiary, it will be reported in the scheme's Statement of Net Assets at fair value, and if the scheme chooses to prepare consolidated financial statements it will consolidate the subsidiary, and comply with the requirements of Section 9 of FRS 102 in relation to consolidated financial statements. However, it is expected that the majority of pension scheme group structures will be investment related and will therefore be excluded by FRS 102 from preparing consolidated financial statements.

Where a pension scheme holds investments in a subsidiary this SORP recommends that a summary of the underlying net assets are disclosed, or if there are a number of subsidiaries, the aggregate net assets of the subsidiaries is disclosed.

3.22.3 FRS 102 requires the following disclosures:

- **whether the financial statements are consolidated or non-consolidated;**
- **if the financial statements are non-consolidated the basis under FRS 102: 9.3 by which the scheme is exempt from preparing consolidated financial statements.** This will normally be 9.3 (g) as the statutory framework for pension scheme financial reporting does not require consolidation; and
- **if the financial statements are non-consolidated, a description of the methods used to account for the investments in subsidiaries, joint ventures and associates (FRS 102: 9.27)**

3.22.4 For consolidated subsidiaries where there is goodwill, for example in trading subsidiaries, differences may arise between the parent and consolidated Statement of Net Assets because under FRS 102 goodwill cannot be revalued and has to be amortised whereas shares in subsidiaries at fair value will include revalued goodwill. If the net asset values on a consolidated and non-consolidated basis are significantly different and the scheme chooses to prepared consolidated financial statements it will also have to prepare a parent Statement of Net Assets.

### **3.23 Annuity contracts**

#### ***Buy-ins***

3.23.1 Trustees may decide as a matter of investment policy or of administrative efficiency to purchase annuity policies which are specifically allocated to the provision of benefits for, and which provide all the benefits payable under the scheme to, or in respect of, particular members. These annuity policies are usually in the name of the trustees, and remain assets of the scheme. These transactions are generally referred to as ‘buy-ins’. This is because the trustees are not legally discharged of the corresponding liabilities.

3.23.2 The United Kingdom Audited Accounts Regulations state that such policies “must be included in the net assets statement and there must be a note of the existence of such policies but that entry need not include their market value or an estimate”. As set out in paragraph 3.12.18 above, FRS 102 requires these policies to be valued annually at the amount of the related obligation which is the liability to provide the pension of the members covered by the annuity contract.

3.23.3 Members whose benefits are funded by the purchase of such annuity policies remain members of the scheme and should be included in the scheme’s membership statistics.

#### ***Buy-outs***

3.23.4 Trustees may purchase insurance policies in the name of individual beneficiaries, or may assign existing policies in the trustees’ name into the names of individual beneficiaries. These transactions are generally referred to as ‘buy-outs’. The trustees’ intention is generally to secure the benefits to those beneficiaries and to secure a legal discharge for the trustees of the corresponding liabilities. The policies in these circumstances are not, or cease to be, assets of the scheme and cannot be included in the scheme’s Statement of Net Assets. The purchase cost of such policies (or the disposal on assignment to members of such policies previously valued in the scheme’s Statement of Net Assets) should be accounted for as the “purchase of annuities” in the Fund Account.

3.23.5 The costs should be disclosed under the “Benefits Payable” caption for immediate annuities and under the “Payments to and on behalf of leavers” caption for deferred annuities. Members whose benefits have been secured in this way should be treated in the scheme’s membership statistics as having exited the scheme.

3.23.6 In the Republic of Ireland, buy-out policies include Section 53B (sovereign annuity) policies and on the purchase of these policies, the financial statements must include in the notes a statement of the value of the pension obligations of the scheme which are matched by Section 53B policies and, where there has been any reduction in payments under any Section 53B policies held by the scheme, a statement detailing particulars of that reduction.

### **3.24 Defined contribution assets**

- 3.24.1 In defined contribution schemes contributions may be invested separately for the benefit of named individuals for whom they were paid rather than into a common fund of assets. The individual member's benefits are defined by the contributions invested for the member and, while the corresponding money purchase assets remain under the legal ownership of the trustees, they are segregated and cannot be used to pay benefits for anyone other than the member (or other beneficiaries in respect of the member). These assets are therefore designated as being held solely for the benefit of the named members. Alternatively, defined contribution investments may be held on a pooled basis by the investment manager such that the investment manager cannot identify investments by member, the administrator keeps records of the allocation of investments by member, and the investments are "allocated" to members.
- 3.24.2 This SORP recommends that the financial statements should explain that defined contribution assets are allocated to provide benefits to the individuals on whose behalf the contributions were paid. The notes to the financial statements should disclose investments designated to members, investments allocated to members and investments not designated or allocated to members which are held for the general purpose of the scheme.

#### ***Self-annuitisation***

- 3.24.3 Some hybrid pension schemes allow members to purchase their pension benefits within the scheme using their defined contribution pot. This is referred to as self-annuitisation and normally takes the form of a transfer of defined contribution assets to the defined benefit section. The defined benefit section then provides the on-going pension to the member who becomes a member of the defined benefit section of the scheme. This typically enables members to benefit from more attractive annuity rates compared to the open market. In these circumstances this SORP recommends that the transfer of investments is reported as a transfer between sections in the Fund Account.
- 3.24.4 The member will also be reported in the membership statistics as leaving the defined contribution section and joining the defined benefit section.
- 3.24.5 The example hybrid financial statements set out in Appendix 1 illustrates defined contribution disclosures.

### **3.25 Additional voluntary contribution (AVC) arrangements**

- 3.25.1 Trustees of occupational pension schemes in the United Kingdom were required to provide an AVC arrangement and the paragraphs that follow apply only to schemes affected by the United Kingdom requirements (the treatment of AVC arrangements by schemes in the Republic of Ireland is dealt with below in Appendix 6). The law required that scheme rules must secure that any voluntary contributions paid by a member are used to provide additional benefits for or in respect of the member, and the value of the additional benefits must be reasonable in relation to the amount of the voluntary contributions and the value of other benefits under the scheme. Following the Finance Act 2004, from 6 April 2006 schemes are no longer required to provide such arrangements, however many schemes still have such arrangements in place.
- 3.25.2 In practice, the nature of AVC arrangements can vary. For example, AVCs may be pooled with other contributions or invested as part of the scheme's normal investment operations and used to acquire additional benefits within the provisions of the principal

scheme. Alternatively AVCs are invested separately from the scheme's main assets (for example with insurance companies and building societies) and used to acquire additional money purchase benefits (where benefits are dependent upon the value of each member's AVC fund at retirement).

- 3.25.3 AVCs and related investments, investment returns and benefit payments are accounted for within the pension scheme's financial statements in accordance with FRS 102 and this SORP. Where the scheme documentation requires that the AVCs must be used to provide money purchase benefits and that the AVC assets must be separately identifiable and isolated from other scheme assets and liabilities, AVC assets should be accounted for in a manner consistent with the treatment of defined contribution assets as described above.
- 3.25.4 The notes to the pension scheme financial statements should include an explanation of the type of AVC arrangement and state how the AVCs are invested (for example as an integral part of the scheme's assets or with third parties and, in the latter case, the institution and type of fund).
- 3.25.5 If AVC assets are held within a scheme's defined contribution investments, for example in a hybrid scheme where defined benefit members can invest AVCs in the defined contribution investment arrangements, the AVCs and related investment can be reported within the defined contribution section with disclosure of the amounts relating to AVCs and AVC investments.
- 3.25.6 In practice, certain AVC providers are unable to supply details of movements on the fund to a specified Statement of Net Assets date, typically because calculations of interest and other income allocations are made to a different timetable. If the provider does not supply information as at the scheme year-end, the financial statements should include the information at a date as near as practicable to the scheme year-end, adjusted for cash movements in the intervening period. Similarly, where practical difficulties arise in obtaining the necessary up-to-date information within the limited period allowed for preparation of financial statements, the financial statements should use the latest available information, adjusted for subsequent cash movements, and explain the treatment adopted in the notes to the financial statements.
- 3.25.7 A suggested format for the disclosure of AVCs within defined benefit schemes is set out in Appendix 1.
- 3.25.8 In the Republic of Ireland, the requirements to prepare an Annual Report for pension schemes under the Irish Disclosure Regulations apply to AVC Schemes. Where AVC's are separately invested from other scheme contributions, in the form of a defined contribution scheme they should be disclosed separately in the fund account and the net assets statement. Where they are not significant to the Statement of Net Assets they can be accounted for within the financial statements of the scheme or in the notes thereto.

### **3.26 Multiple benefit structures**

- 3.26.1 Schemes may have multiple benefit structures under one trust deed. For example:
- a scheme may be a hybrid scheme with a defined benefit section and a defined contribution section;
  - a scheme may have a number of separate defined benefit sections which are financially ring fenced from one another; or

- a scheme may have a number of benefit structures that are provided from a common pool of assets.

3.26.2 FRS 102 requires the following approach:

**A retirement benefit plan may be a defined benefit plan, a defined contribution plan, or have both defined benefit and defined contribution elements. The financial statements shall distinguish between defined benefit and defined contribution elements, where material (FRS 102:34.34).**

3.26.3 In considering the approach to disclosing financial information in relation to multiple benefit structures the trustees also have regard to the requirements of the pension scheme's trust deed and rules in relation to financial reporting. Subject to any requirements set out therein the SORP's recommendations are set out below.

***Hybrid***

3.26.4 This SORP recommends a columnar analysis of the income and expenditure attributable to defined benefit and defined contribution arrangements within the Fund Account and separate reporting of the net assets attributable to defined benefit and defined contribution arrangements in the Statement of Net Assets. Transfers between the two sections of the scheme are dealt with as transfers between sections in the respective columns within the Fund Account. Transfers between sections should only include funds transferring from one section to another.

3.26.5 If the scheme has multiple defined benefit sections or defined contribution sections it is not necessary to report these sections separately. They can be aggregated into one set of figures for defined benefit operations and defined contribution operations. An example of hybrid presentations is set out in Appendix 1.

***Ringfenced defined benefit sections***

3.26.6 For schemes with ring fenced defined benefit sections which meet the requirements set out in paragraph 1, Schedule 2, of the Occupational Pension Scheme Funding Regulations 2005, (contributions payable in respect of an employer are allocated to that employer's section and a specific part or proportion of the assets of the scheme is attributable to each section and cannot be used for the purpose of any other section) that paragraph applies the requirement to obtain audited financial statements for the purpose of the scheme funding valuation to each section as if it were a separate scheme. Therefore trustees should consider the most appropriate approach to meeting this requirement.

3.26.7 Where separate audited financial information is prepared for each section the scheme is still required to prepare scheme level financial statements to satisfy the Audited Accounts Regulations.

***Common pool of assets***

3.26.8 If a scheme has multiple benefit structures that are met from a common pool of assets and the Scheme Actuary performs a single Scheme Funding valuation at scheme level there is no distinction required for the different benefit structures within the financial statements.

### 3.27 Foreign exchange rates

3.27.1 FRS 102 requires a reporting entity to identify its functional currency. Functional currency is defined as follows:

**An entity's functional currency is the currency of the primary economic environment in which the entity operates. (FRS 102:30.2)**

3.27.2 When determining its functional currency a pension scheme should consider the currency of its main items of income and expenditure. A pension scheme will normally collect contributions and pay benefits in the currency of the country in which it operates. It may invest in overseas currencies as part of its investment strategy but these currencies will ultimately be realised and converted into the currency used to settle benefits. Therefore this SORP recommends that pension schemes determine their functional currency by reference to the currency used in its dealings with members.

3.27.3 **Monetary items denominated in a foreign currency should be translated into the functional currency using the closing exchange rates at the scheme year-end date.(FRS 102:30.9)**

3.27.4 **Foreign currency transactions should be recorded in the functional currency at the spot exchange rate at the date of the transaction. (FRS 102:30.7)**

3.27.5 **FRS 102 allows an approximation to the spot rate for practical purposes: The date of a transaction is the date on which the transaction first qualifies for recognition in accordance with this FRS. For practical reasons, a rate that approximates the actual rate at the date of the transaction is often used, for example, an average rate for a week or a month might be used for all transactions in each foreign currency occurring during that period. However, if exchange rates fluctuate significantly, the use of the average rate for a period is inappropriate. (FRS 102: 30.8)**

3.27.6 FRS 102 requires foreign exchange gains and losses on monetary items to be recognised in profit and loss for the period (FRS 102:30.10). This SORP recommends that foreign exchange gains and losses arising from investment activities are reported within the Fund Account within the account caption most relevant to the transaction which gave rise to the gain or loss. For example foreign exchange gains or losses arising on foreign currency investments and cash balances would be reported within change in market value.

3.27.7 FRS 102 requires the disclosure of the amount of foreign exchange differences recognised in profit or loss during the period, except for those arising on financial instruments measured at fair value through profit or loss (FRS 102:30.25). Therefore foreign exchange differences reported within change in market value which arise on financial instruments (such as securities, cash and other investment balances) are not required to be disclosed. Foreign exchange gains and losses arising on investments that are not financial instruments, for example investment properties, will need to be disclosed.

3.27.8 FRS 102 allows an entity to present its financial statements in any currency. The chosen currency is the presentation currency. If the presentation currency is different from the functional currency the entity has to convert the functional currency to the presentation currency for reporting purposes. It is not expected that pension schemes will have a presentation currency that is different from the functional currency.

### 3.28 **Going concern**

3.28.1 FRS 102 requires the following in relation to going concern.

3.28.2 **When preparing financial statements, the management of an entity using this FRS shall make an assessment of the entity's ability to continue as a going concern. An entity is a going concern unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so. In assessing whether the going concern assumption is appropriate, management takes into account all available information about the future, which is at least, but is not limited to, twelve months from the date when the financial statements are authorised for issue. (FRS 102: 3.8).**

3.28.3 **When management is aware, in making its assessment, of material uncertainties related to events or conditions that cast significant doubt upon the entity's ability to continue as a going concern, the entity shall disclose those uncertainties. When an entity does not prepare financial statements on a going concern basis, it shall disclose that fact, together with the basis on which it prepared the financial statements and the reason why the entity is not regarded as a going concern.(FRS 102: 3.9)**

3.28.4 The actuarial valuation and related report are the primary source of information regarding the ability of a defined benefit scheme to meet the benefit promises, although it should be noted that this may ultimately be dependent upon the employer's continued ability to fund the scheme in accordance with funding rates advised by the actuary. The financial statements of the pension scheme itself do not provide any relevant information in this context other than to set out the type and value of the scheme's assets at a particular point in time. For defined contribution schemes, the concept of solvency does not apply because the obligations of the scheme to pay benefits are dependent upon the funds available. Schemes that are closed to new members, or to which there will be no further contributions, are accounted for in the same way as continuing funds.

3.28.5 In view of the above, the going concern concept does not play the same fundamental role in the measurement and classification of assets and liabilities in pension scheme financial statements as it does in the financial statements of commercial entities. Accordingly, the basis of preparation of the financial statements does not need to refer to the going concern concept unless the trustees or employer have taken the formal decision to wind up the scheme or there has been a cessation event (these are normally set out in the trust deed and rules).

3.28.6 Where a defined benefit scheme is significantly underfunded it will continue to be treated as a going concern for accounting purposes unless a decision has been made to wind up the scheme.

3.28.7 If a pension scheme enters the Pension Protection Fund assessment period as a result of the insolvency of the employer it may continue as a stand-alone scheme if its funding levels are sufficient on a PPF benefit basis, or if not, its assets and liabilities will transfer to the PPF and the scheme will be wound up. Whilst the pension scheme is in the PPF

assessment period, and the outcome of the assessment is uncertain, the financial statements continue to be prepared on a going concern basis. The financial statements should disclose that the scheme is in the assessment period, that the assessment is in progress and the financial statements have been prepared on a going concern basis.

- 3.28.8 If the financial statements are prepared on a scheme cessation basis, this should be explained in the basis of preparation note together with the reasons why (both scheme-related and employer-related) and the impact, if any, on the bases of valuing the scheme's assets and liabilities should be disclosed in the notes to the financial statements.
- 3.28.9 For multi-employer sectionalised schemes, each section should be considered separately for these purposes.

### **3.29 Pension Protection Fund (United Kingdom only)**

- 3.29.1 The Pension Protection Fund was established under the Pensions Act 2004 to pay compensation to members of eligible defined benefit pension schemes, when the sponsoring employer has suffered a qualifying insolvency event, and where the scheme is assessed as having insufficient assets to cover PPF levels of compensation.

#### ***Effect of employer insolvency and assessment period entry***

- 3.29.2 When an employer sponsoring an occupational pension scheme experiences an insolvency event the PPF has a duty to validate whether the scheme is eligible for protection, and whether the insolvency is a qualifying event in accordance with the legislation. Where both of these criteria are met, the scheme enters a PPF assessment period, during which the trustees are required to obtain an actuarial valuation of the scheme under s.143 of the Pensions Act 2004. The result of this valuation will determine whether the scheme is accepted into the PPF (because it cannot cover PPF levels of compensation) or whether it will continue as a closed scheme; or proceed to buy out in the insurance market at levels higher than PPF compensation.
- 3.29.3 This valuation is carried out at the "relevant date" defined in the legislation as the day before the insolvency event. Trustees will normally be required to obtain audited financial statements, as at the relevant date, in order to provide the actuary with an audited net asset value of the scheme to incorporate into their valuation. These financial statements should be prepared in accordance with the requirements of FRS 102 and the recommendations of this SORP, including its recommendations on the valuation of assets where the trustees intend (or are obliged) to wind the scheme up. These financial statements do not need to be accompanied by other disclosures required for the annual report unless they are also being prepared as the scheme's statutory financial statements required under the Audited Accounts Regulations.

#### ***Ongoing obligation to obtain audited financial statements during assessment period***

- 3.29.4 The entry of a scheme into a PPF assessment period does not exempt the scheme from the usual regulatory requirement to obtain audited financial statements under the Audited Accounts Regulations at regular intervals, usually annually.
- 3.29.5 The annual statutory financial statements will have to account for any assets accruing to the scheme as a result of the recovery activities of the PPF from the insolvency of the employer. Valuing these assets may require the use of judgement and estimation techniques, for example to estimate the dividend receivable from the insolvency practitioner against the scheme's section 75 debt; or to assign a value to the loans or

equity stakes obtained in a restructured business. Even if the trustees decide to assign no value to these assets, the financial statements should note their existence.

- 3.29.6 These financial statements will also have to account for any assets pledged by the employer to the scheme, contingent on the employer's insolvency to which following the employer's insolvency the scheme has legal entitlement. These contingent assets will normally have been certified prior to the insolvency to the PPF in order to reduce the levy payable to the PPF. Valuing these assets may require the use of judgement and estimation techniques, for example to estimate the actual amount recoverable from the insolvency practitioner. Even if the trustees decide to assign no value to these assets, the financial statements should note their existence.

***Multi-employer schemes and segregation***

- 3.29.7 Where a number of employers, usually part of the same employer group, participate in and contribute to the scheme the insolvency of one (or more, but not all) of the sponsoring employers will lead to the requirement to ascertain a net asset value for the part(s) of the scheme associated with the insolvent employer(s) at the relevant date and to maintain the financial transactions and net assets of that part of the scheme on a segregated basis from that date, in order to assess whether only the part(s) should be accepted into the PPF.
- 3.29.8 In these circumstances, it is recommended that trustees consider the recommendations of this SORP regarding the presentation of the financial statements of schemes with multiple benefit structures, in order to present the transactions and balances of the parts of the scheme associated with solvent and insolvent employers in a columnar format.
- 3.29.9 The PPF has issued guidance on segregation for multi-employer schemes which is available on its website and the ICAEW has issued guidance to auditors in ICAEW Technical Release Tech12/2013BL 'Audit Reporting on Financial Statements of Pension Schemes prepared for segregation under the Pension Protection Fund multi-employer regulations'.

***Impact of transfer to the PPF***

- 3.29.10 Once the Board's decision in respect of schemes transferring into the PPF becomes binding, the Board will issue a Notice to the scheme's trustees. As soon as the trustees have acknowledged receipt, the Notice has the effect of transferring immediately into PPF ownership all of the assets and liabilities of the scheme. The trustees and the PPF will arrange for the transition of the scheme's investments and other net assets into the PPF's management; the trustees will cease paying pensions, and the PPF will start paying compensation, to scheme members.
- 3.29.11 Where the assets of the scheme are held by means of a common investment funds, it will usually not be possible to transfer ownership of the CIF units to the PPF. In these cases the CIF units will have to be liquidated. In some cases it may be possible for the CIF operator to make an in-specie transfer of underlying assets to the PPF, but the CIF operator will want to ensure fair treatment of all unit holders, and in particular that continuing unit holders do not suffer any loss as a result. In other cases it may be necessary for the scheme to take the proceeds of the CIF units as cash, which will then be transferred to the PPF.

3.29.12 Where the trustees hold annuity policies in the scheme's name, and have been receiving the income arising from those policies, the PPF will make arrangements to re-direct that income into the PPF. These policies are assets of the scheme which transfer into PPF ownership in the same way as any other assets, with the Board effectively becoming the policy holder, replacing the trustees.

***Financial statements at the transfer date***

3.29.13 In line with this SORP's recommendations on the preparation of financial statements at scheme closure, it is recommended that trustees prepare financial statements as at the effective date of the Transfer Notice from the PPF. In the case of segregated schemes, trustees should consider obtaining audited financial statements showing the transfer of the net assets of the segregated part(s) to the PPF in order to gain assurance that trustees have retained the appropriate portion of the scheme's assets to support the part of the scheme continuing with solvent employers.

3.29.14 It is recommended that the transfer of the net assets of the scheme to the PPF be disclosed as a separate line item in the Fund Account, not amalgamated with Benefit Payments as part of Dealings with Members.

3.29.15 It is also recommended that the notes to the financial statements disclose separately the investment assets (analysed by investment class as recommended in this SORP for net asset statement disclosure purposes), current assets and current liabilities of the scheme which transferred to the PPF at the transfer date in accordance with the Transfer Notice.

### **3.30 Schemes winding up and similar situations**

3.30.1 In a scheme cessation the trustees consider, and if thought appropriate modify, the bases on which scheme assets are valued. The primary considerations will be the intended time scale and processes for winding up/discontinuance and, as a general rule, the values placed on assets should be consistent with those which may reasonably be expected to be achieved in an orderly winding up with appropriate allowance for the costs of realisation. Some considerations in relation to the main types of scheme investment are:

- quoted readily realisable investments will normally continue to be valued on a bid basis as recommended in paragraph 3.12.5. However, in some cases an adjustment should be considered with the objective of valuing investments at net realisable value;
- unquoted securities, should be valued at the trustees' estimate of net realisable value;
- illiquid pooled arrangements such as private equity funds should be valued at the expected realisable value, for example disposal in a secondary market would typically be at a discount to the net asset value;
- insurance policies will need to be valued using a method appropriate to the circumstances of the scheme; in many cases, this will be the surrender value where the policies are expected to be surrendered or the value obtainable through disposal in a secondary market. However if policies are to be assigned to members no change to valuation is required;
- for other less liquid assets, such as property, the net realisable value may be a distressed value under a forced sale; and

- recoverability of any contributions due to the scheme is also relevant where the employer is in difficulty, in administration or is insolvent.

3.30.2 Early redemption penalties and sale costs should also be taken into account.

3.30.3 The bases of valuation used should be disclosed in the accounting policies.

3.30.4 Certain additional disclosures may be made in the Annual Report, such as:

- the resultant change in investment policy;
- claims and contingent assets;
- the extent and accounting treatment of unpaid contributions;
- an explanation of the role of any independent trustee appointed;
- any temporary embargo on benefit payments; and
- likely timescales for winding up, to the extent these can be assessed.

3.30.5 Under United Kingdom current regulations, schemes with less than two (in the Republic of Ireland schemes with less than one hundred active and deferred) members are exempt from preparing accounts but trust law requires trustees to demonstrate how they have discharged their trust. This SORP therefore recommends that as a matter of good practice trustees prepare final winding up financial statements even when the scheme membership has declined below this limit during the scheme year as a result of winding up activities. Trustees are therefore able to demonstrate that all members' benefits have been secured and all scheme assets finally disbursed in accordance with the scheme rules and relevant regulations. These final financial statements should be prepared on an accruals basis where appropriate, showing assets (for example cash at bank) and current liabilities (such as benefits and fees payable) which total zero net assets.

### 3.31 **Related party transactions**

#### *The need for disclosure*

3.31.1 FRS 102 requires "**An entity to include in its financial statements the disclosures necessary to draw attention to the possibility that its financial position and profit or loss have been affected by the existence of related parties and by transactions and outstanding balances with such parties**"(FRS 102: 33.1). The relations between parties involved in pension schemes, and the transactions between these parties, will vary from scheme to scheme, and therefore the following guidance cannot be exhaustive.

#### *The related parties of pension schemes*

3.31.2 FRS 102 states that:

- a) **a person or a close member of that person's family is related to a reporting entity if that person:**
  - (i) **has control or joint control over the reporting entity;**
  - (ii) **has significant influence over the reporting entity; or**
  - (iii) **is a member of the key management personnel of the reporting entity or of a parent of the reporting entity; and**

- b) an entity is related to a reporting entity if any of the following conditions apply:**
  - (i) the entity and the reporting entity are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others);**
  - (ii) one entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member);**
  - (iii) both entities are joint ventures of the same third party;.**
  - (iv) one entity is a joint venture of a third entity and the other entity is an associate of the third entity;**
  - (v) the entity is a post-employment benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity. If the reporting entity is itself such a plan, the sponsoring employers are also related to the reporting entity;**
  - (vi) the entity is controlled or jointly controlled by a person identified in (a); or**
  - (vii) a person identified in (a)(i) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity). (FRS 102: 33.2)**

**3.31.3 In considering each possible related party relationship, an entity shall assess the substance of the relationship and not merely the legal form. (FRS 102: 33.3)**

**3.31.4 FRS 102 states that the following are not related parties:**

- two entities simply because they have a director or other member of key management personnel in common or because a member of key management personnel of one entity has significant influence over the other entity; and**
- customer, supplier, franchisor, distributor or general agent with whom an entity transacts a significant volume of business, merely by virtue of the resulting economic dependence. (FRS 102: 34.4)**

**3.31.5 FRS 102 defines key management personnel as follows:**

**Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity. (FRS 102: 33.6)**

- 3.31.6 In the context of pension schemes key management personnel are normally the trustees or trustee directors where the trustee is a corporate entity. Pension managers, investment managers, custodians and administrators are not normally considered to be key management personnel since they are directed and controlled by the trustees.
- 3.31.7 If persons other than trustees have the same powers as trustees within a scheme's governance arrangements, for example they sit on committees side by side with the same rights as trustees, they are key management personnel.
- 3.31.8 The related parties of pension schemes therefore fall into two broad categories:
- a) employer-related; and
  - b) trustee-related.

***Employer-related parties***

- 3.31.9 Each participating employer should be considered a related party. Employer-related parties also include companies and businesses controlled by, or under the same control as, the sponsoring employer. A director of an employer would not be a related party of a pension scheme unless they were in a position to control or exert significant influence over both the pension scheme and the employer.
- 3.31.10 This SORP recommends that related parties should also include other pension schemes for the benefit of employees of companies and businesses related to the employers, or for the benefit of the employees of any entity that is itself a related party of the reporting pension scheme.

***Trustee-related parties***

- 3.31.11 Trustee-related parties include:
- a) trustees and their *close families*;
  - b) key management (that is the directors) of a corporate trustee and their *close families*;
  - c) entities controlled by, and associates and joint ventures of, the scheme itself;
  - d) companies and businesses controlled by the trustees or their close families;
  - e) companies and businesses controlled by the key management of a corporate trustee, or their close families;
  - f) other pension schemes that have a majority of trustees in common with the scheme.

***Disclosure of key management personnel compensation***

- 3.31.12 FRS 102 requires the disclosure of key management personnel compensation. FRS 102 defines compensation as follows:

**Compensation includes all employee benefits (as defined in Section 28 Employee Benefits) including those in the form of share-based payments (see Section 26 Share-**

based Payment). Employee benefits include all forms of consideration paid, payable or provided by the entity, or on behalf of the entity (eg by its parent or by a shareholder), in exchange for services rendered to the entity. It also includes such consideration paid on behalf of a parent of the entity in respect of goods or services provided to the entity. (FRS 102: 33.6)

3.31.13 **An entity shall disclose key management personnel compensation in total. (FRS 102: 33.7)**

3.31.14 This disclosure would normally relate to remuneration of trustees for their services to the scheme, whether paid by the scheme or by another entity such as the employer. It would not normally apply to remuneration of scheme management for example the pension manager, since the pension manager would not normally be considered key management personnel.

***Related party transactions***

3.31.15 **A related party transaction is defined as the transfer of assets or liabilities or the performance of services by, to or for a related party irrespective of whether a price is charged (FRS 102: Glossary).**

3.31.16 The following examples are given to illustrate transactions which, if material, would require disclosure in the financial statements of pension schemes as a related party transaction under FRS 102:

- a) the purchase, sale, lease, rental or hire of assets by a pension scheme from or to a related party irrespective of how the price (if any) was determined;
- b) the provision by a pension scheme to a related party of assets as loans, or as collateral to loans, of any description, irrespective of any direct or indirect economic benefit to the pension scheme;
- c) the provision by a related party ( such as the employer) of a guarantee to a third party in relation to a liability or obligation of the pension scheme;
- d) provisions or write-offs made by the scheme against amounts due from or to related parties; and
- e) the provision of services to a pension scheme by a related party irrespective of whether a price is charged, including the provision of scheme administration services by the employer or by employees of the employer.

***Disclosure of transactions and balances***

3.31.17 FRS 102 requires the following disclosures in relation to related party transactions:

**If an entity has related party transactions, it shall disclose the nature of the related party relationship as well as information about the transactions, outstanding balances and commitments necessary for an understanding of the potential effect of the relationship on the financial statements. At a minimum, disclosures shall include:**

- a) **the amount of the transactions.**
  - b) **the amount of outstanding balances and:**
    - i) **their terms and conditions, including whether they are secured, and the nature of the consideration to be provided in settlement; and**
    - (ii) **details of any guarantees given or received.**
  - c) **provisions for uncollectible receivables related to the amount of outstanding balances; and**
  - d) **the expense recognised during the period in respect of bad or doubtful debts due from related parties.**
- 3.31.18 **Such transactions could include purchases, sales, or transfers of goods or services, leases, guarantees and settlements by the entity on behalf of the related party or vice versa. (FRS 102:33.9)**
- 3.31.19 **An entity shall make the disclosures required by paragraph 33.9 separately for each of the following categories:**
- a) **entities with control, joint control or significant influence over the entity;**
  - b) **entities over which the entity has control, joint control or significant influence;**
  - c) **key management personnel of the entity or its parent (in the aggregate); and**
  - d) **other related parties(FRS 102 :33.10).**
- 3.31.20 **An entity shall not state that related party transactions were made on terms equivalent to those that prevail in arm's length transactions unless such terms can be substantiated. (FRS 102:33.13)**
- 3.31.21 **An entity may disclose items of a similar nature in the aggregate except when separate disclosure is necessary for an understanding of the effects of related party transactions on the financial statements of the entity. (FRS 102:33.14)**
- 3.31.22 **The following are examples of transactions for which it would normally be sufficient to make disclosures on an aggregated basis:**
- a) **payment of employer and employee contributions - employer contributions and employee contributions are normally disclosed in aggregate in the Fund Account (or notes thereto) and further information on a disaggregated basis (such as names and contributions of each employer) is normally unnecessary;**
  - b) **payment of fees and expenses paid to trustees by the scheme, in aggregate, should be separately disclosed. Where trustees are paid by the employer and this is not recharged to the scheme, the amount paid to the trustees in aggregate should be disclosed in the notes to the financial statements. Where trustees are paid employees of the sponsoring employer and carry out trustee duties in company**

time, this does not require such disclosure as a related party transaction. However, payments for goods or services to trustees or scheme advisors outside of the normal course of business (such as the purchase of an asset from a trustee or adviser) would require disclosure as a related party transaction.

- 3.31.23 Trustees may be in receipt of pension benefits through the scheme or contributions may have been paid in respect of trustees. Provided these transactions arise solely in the individual's capacity as a beneficiary of the pension scheme and are either non-discretionary or are made on terms normally granted to members, the disclosure of individual transactions is normally unnecessary. It would normally be sufficient to disclose the status of the trustee as a person in respect of whom contributions have been paid or as a person in receipt of benefits.
- 3.31.24 Where administration costs, investment management expenses and other services such as secretarial and management support are borne directly by a participating employer and not recharged to the scheme, that fact should be disclosed as a related party transaction. In such cases, disclosure of the amounts involved is unnecessary as there is no 'cost' to the scheme.

### **3.32 Employer related investments**

- 3.32.1 In the United Kingdom employer related investments are required to be disclosed in the Annual Report by the Disclosure of Information Regulations. The Audited Accounts Regulations also requires the financial statements to contain particulars of any employer related investments.
- 3.32.2 The definition of employer related investments is set out in the Investment Regulations and is widely drawn and include securities issued by the employer, loans to the employer and any investment property occupied by the employer. They also include investments made indirectly through pooled investment vehicles.
- 3.32.3 The Disclosure of Information Regulations requires the following disclosure:
- a statement as to the percentage of the scheme's resources invested in employer related investments at the end of the year;
  - if that percentage exceeds 5%, the percentage of the scheme's resources that are employer related investments but which do not count towards the statutory restrictions (as set out in S40(1) of the Pension Act 1995) on employer related investment. These reliefs from counting towards the statutory restrictions are set out in Regulation 13 of the Investment Regulations; and
  - where employer related investments exceed the statutory restrictions, the steps the trustees or managers of the scheme have taken, or propose to take, to secure that the scheme complies with that section and the time when any proposed steps will be taken.
- 3.32.4 Trustees therefore have to determine the extent of employer related investment at the year-end in relation to direct investments and investments made through pooled investment vehicles. This can present practical challenges for some types of pooled vehicle, and may be onerous where a scheme has many pooled arrangements. The disclosures required by legislation as described above do not require the actual percentage of scheme investments to be disclosed, the Disclosure Regulations refer to a statement 'as

to' the percentage whilst the Audited Accounts Regulations refers to '*particulars*'. This SORP recommends that where practicable the percentage of employer related investment at the year-end is disclosed, but where this is impractical, the trustees make a reasonable estimation of the percentage of employer related investment, if any, and disclose whether it is above or below the statutory restriction of 5%. Where it is estimated to be above 5% the trustees should consider the disclosures required in relation to the steps to be taken to bring the level below the statutory restriction.

3.32.5 The Disclosure of Information Regulations provide an alternative disclosure option for schemes with members from different employers (this approach applies to both direct and indirect investments):

- list the largest 100 investments by value held by the scheme at the year-end stating what percentage of the resources of the scheme each investment represents;
- identify which of the investments listed above are employer related investment; and
- if more than 5% of the resources of the scheme are invested in employer related investments in relation to any one employer, disclose the employer related investments, the name of the employer, the steps the scheme has taken or proposes to take to reduce the percentage to 5% or less and the time when proposed steps will be taken.

3.32.6 The statutory restrictions on employer related investment are set out in the Investment Regulations and include a limit of 5% of scheme resources for investments and no loans to employers. For multi-employer schemes that meet the conditions set out in Regulation 16 of the Investment Regulations, this limit applies to each section as if it were a separate scheme. In addition, the total employer related investment for all employers is restricted to 20% of total scheme resources.

3.32.7 In the Republic of Ireland, details of any self investment of the assets of the scheme at any time during the scheme year must be disclosed, unless the assets of the scheme are wholly invested in managed funds.

### ***Contributions***

3.32.8 Contributions unpaid at the scheme year-end but not at that date due to be remitted to the scheme, under the terms of the Schedule of Contributions or Payment Schedule, and which are remitted after the scheme year-end in accordance with those terms, do not constitute employer-related investment. Any contributions that remain outstanding after the due date as set out in the Schedule do constitute an employer-related investment. They are however exempt from counting towards the statutory restrictions for employer-related investment but are included in the disclosures made in respect of employer related investments.

3.32.9 In the Republic of Ireland Section 58A of the Irish 1990 Act provides that self investment arises when employee contributions (for defined benefit and defined contribution schemes) and employer contributions (for defined contribution schemes) are not paid over to the scheme within 21 days of the end of the month in which the contribution was deducted from the members salary, or the end of the month to which they relate. In respect of employer contributions due for a defined benefit scheme, no self investment arises when contributions are paid in line with the timings noted by the Actuary, or stated in the scheme Rules, or otherwise within 30 days or less of the scheme year-end. The

notes to the financial statements should refer to whether contributions due for the year have or have not been paid over within 30 days of the year-end date and also disclose instances of self investment during the scheme year. Additionally, if contributions are not received within 30 days of the scheme year end, the statement in the audit report should be modified to note this.

### 3.33 **Report on actuarial liabilities**

3.33.1 The United Kingdom Audited Accounts Regulations (Audited Accounts Regulations 3 (b) (iii)) and the Republic of Ireland Disclosure Regulations require pension scheme financial statements to show a true and fair view of the liabilities of the scheme other than the liabilities to pay pensions and benefits after the end of the scheme year. FRS 102 does not require pension scheme financial statements to include the liability in relation to the promised retirement benefits:

**A defined benefit plan is not required to recognise a liability in relation to the promised retirement benefits(FRS 102:34.47).**

3.33.2 FRS 102 does require the following disclosure in relation to actuarial liabilities:

**A defined benefit plan shall disclose, in a report alongside the financial statements, information regarding the actuarial present value of promised retirement benefits including:**

- a) **a statement of the actuarial present value of promised retirement benefits, based on the most recent valuation of the scheme;**
- b) **the date of the most recent valuation of the scheme; and**
- c) **the significant actuarial assumptions made and the method used to calculate the actuarial present value of promised retirement benefits(FRS 34.48).**

3.33.3 This SORP recommends that:

- the above information is disclosed within the annual report as part of the Trustees' Report and that the disclosure is based on the most recent scheme funding valuation required under s.224 of the Pensions Act 2004 for United Kingdom schemes and the Actuarial Valuation prepared under Section 56 of the Irish 1990 Act, for schemes in the Republic of Ireland; and
- the net assets of the scheme at the date of the valuation is also disclosed in this report if the valuation date is different from the reporting date of the financial statements.

3.33.4 In the United Kingdom the information on the actuarial present value of promised retirement benefits is included in the Summary Funding Statement that is required to be prepared following the scheme funding valuation.

3.33.5 The information on the significant actuarial assumptions and the method used to calculate the actuarial present value of promised retirement benefits is included in the Statement of Funding Principles which is produced as part of the scheme funding valuation.

3.33.6 The Disclosure of Information Regulations require the annual report to contain a copy of the appropriate certificate by the actuary under section 227 of the 2004 Act about the

adequacy of the contributions payable towards the scheme. (Disclosure of Information Regulations, Schedule 3, Part 2, 6).

- 3.33.7 This SORP recommends that for defined benefit schemes the financial statements should explain that they do not take account of liabilities to pay pensions and other benefits after the scheme year-end but rather summarise the transactions and net assets of the scheme. The explanation should be given prominence because the disclosure is fundamental to an understanding of the financial statements and should be made at the foot of the Statement of Net Assets.
- 3.33.8 In the United Kingdom, for a defined benefit scheme, the note should refer the reader of the financial statements to the Report on Actuarial Liabilities, which does take account of the long-term liabilities of the scheme. In the Republic of Ireland the note should refer the reader of the financial statements to the Report on Actuarial Liabilities, the Actuarial Funding Certificate, the Actuarial Funding Certificate Funding Standard Reserve Certificate and the actuary's Annual Statement.
- 3.33.9 For multi-employer schemes with financially ringfenced sections, actuarial liabilities are normally determined for each section. In this case, the above information may be disclosed on an aggregate basis or by section.

### 3.34 **Contingent liabilities and contractual commitments**

- 3.34.1 Under FRS 102 a contingent liability is defined as **'either a possible but uncertain obligation or a present obligation that is not probable and/or cannot be reliably determined (FRS 102:21.6 and 21.7)**. Unless the possibility of settling the contingent liability is remote or it is not material, disclosure should be made of the estimated financial effect and an indication of the uncertainties relating to the amount or timing and any possible reimbursement (FRS 102:21.15). For example, claims against the scheme or the costs of litigation.
- 3.34.2 This SORP also recommends that where the scheme has a material capital commitment at the end of the scheme year, for example a contractual commitment to purchase a property or to pay calls on shares, the nature and amount of the commitment should be disclosed.

### 3.35 **Contingent assets**

- 3.35.1 FRS 102 defines a contingent asset as a possible asset that arises from past events and whose existence will be confirmed only by the occurrence of one or more uncertain future events not wholly within the scheme's control (FRS 102 Appendix 1 Glossary).
- 3.35.2 Under FRS 102 a contingent asset **should not be recognised in the financial statements however it should be disclosed where the inflow of economic benefits is probable. When the flow of future economic benefits to the scheme is virtually certain, then the asset is no longer contingent and is recognised in the financial statements. (FRS 102:21.13)**.
- 3.35.3 A contingent asset should be disclosed in the notes to the financial statements when an inflow of economic benefit is probable. In such circumstances, disclosure should be made of the nature of the contingent asset at the net asset date and where practicable, an estimate of its financial effect.
- 3.35.4 Where a contingent asset is recognised by the Pension Protection Fund for levy purposes this does not necessarily mean that the asset should be included in the scheme's financial statements.

3.35.5 Trustees may have arrangements 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. These arrangements may be in a number of forms including letters of credit, guarantees and escrow accounts. These arrangements are not disclosed as contingent assets in the financial statements until such time as they represent probable inflows to the scheme. Since this information is generally useful to readers of the annual report to understand the security of scheme funding arrangements, this SORP recommends that these arrangements are disclosed in the Trustees' Report whether or not they qualify as contingent assets for financial reporting purposes.

### 3.36 **Subsequent events**

3.36.1 FRS 102 defines subsequent events as:

**Those events, both favourable and unfavourable, that occur between the end of the reporting period and the date the financial statements are authorised for issue. There are two types of events:**

- a) **those that provide evidence of conditions that existed at the end of the reporting period (adjusting events); and**
- b) **those that are indicative of conditions that arose after the end of the reporting period (non-adjusting events)(FRS 102:32.2).**

3.36.2 FRS 102 requires the amounts recognised in the financial statements to be adjusted for adjusting events whereas non-adjusting events are not adjusted for but are disclosed, including the nature of the event and an estimate of its financial effect, or a statement that such an estimate cannot be made.

3.36.3 Examples of adjusting events include receipt of more up to date information on the value of investments at the year-end, for example, private equity funds often provide statements at the reporting date which are based on underlying valuations, typically three to six months prior to the reporting date.

3.36.4 Examples of non-adjusting events include scheme mergers and major transfers in and out, for example bulk buy-outs.

### 3.37 **Approval of financial statements**

3.37.1 The date of approval of the financial statements by the trustees should be disclosed as required by FRS 102: 32.9 either on the face of the Statement of Net Assets or in a note to the financial statements. In the United Kingdom, this approval should be indicated by the signature of at least one trustee (or director of corporate trustees). In the Republic of Ireland approval should be indicated by the signature of two trustees (or directors of a corporate trustee) or if there is only one trustee by that trustee.

## Appendix 1 – Illustrative format of financial statements

This appendix, which does not form part of the Statement of Recommended Practice, is provided to illustrate how FRS 102 and the SORP might be applied to the financial statements of a hybrid pension scheme. The notes illustrated below deal with providing additional analysis of items in the primary statements. They do not cover all the disclosures recommended by FRS 102 the SORP or by the Regulations.

### Fund Account

		20X6			
	Note	<b>Defined benefit section £000</b>	<b>Defined contribution section £000</b>	<b>Total £000</b>	20X5 £000
<b>Contributions and benefits</b>					
Employer contributions		351	67	418	331
Employee contributions		339	83	422	462
		<hr/>	<hr/>	<hr/>	<hr/>
<b>Total contributions</b>	3	690	150	840	793
Transfers in	4	6,018	16	6,034	7
Other income		25	-	25	-
		<hr/>	<hr/>	<hr/>	<hr/>
		6,733	166	6,899	800
Benefits paid or payable	5	(12,115)	(45)	(12,160)	(11,729)
Payments to and on account of leavers	6	(33)	(47)	(80)	(106)
Other payments		(30)	(8)	(38)	(37)
Administrative expenses	7	(28)	(8)	(36)	(41)
		<hr/>	<hr/>	<hr/>	<hr/>
<b>Net (withdrawals)/ additions from dealings with members</b>		(5,473)	58	(5,415)	(11,113)
		<hr/>	<hr/>	<hr/>	<hr/>
<b>Returns on investments</b>					
Investment income	9	4,573	-	4,573	3,554
Change in market value of investments	11	7,585	98	7,683	536
Taxation	8	(14)	-	(14)	(12)
Investment management expenses	10	(373)	(5)	(378)	(381)
		<hr/>	<hr/>	<hr/>	<hr/>
<b>Net return on investments</b>		11,771	93	11,864	3,697
		<hr/>	<hr/>	<hr/>	<hr/>
<b>Net increase/(decrease) in the fund during the year</b>		6,298	151	6,449	(7,416)
<b>Net assets of the scheme</b>					
At 1 January		74,643	645	75,288	82,704
		<hr/>	<hr/>	<hr/>	<hr/>
At 31 December		80,941	796	81,737	75,288
		<hr/>	<hr/>	<hr/>	<hr/>

**STATEMENT OF RECOMMENDED PRACTICE**  
*Financial Reports of Pension Schemes*

**Statement of Net Assets**  
(available for benefits)

	<i>Note</i>	<b>20X6</b>		<b>Total</b>	20X5
		<b>Defined benefit section</b>	<b>Defined contribution section</b>		
		£000	£000	£000	£000
<b>Investment assets:</b>	11				
Equities		20,636	-	20,636	17,411
Bonds		48,306	-	48,306	44,224
Property		4,350	-	4,350	3,500
Pooled investment vehicles	12	6,571	815	7,386	7,685
Derivatives	13	355	-	355	345
Insurance policies	14	350	-	350	344
AVC investments		316	-	316	260
Cash		27	-	27	26
Other investment balances		12	-	12	12
		80,923	815	81,738	73,807
<b>Investment liabilities:</b>	11				
Derivatives	13	(25)	-	(25)	(13)
Other investment balances		(5)	-	(5)	(5)
		(30)	-	(30)	(23)
<b>Total net investments</b>		80,893	815	81,708	73,789
<b>Current assets</b>	19	60	7	67	152
<b>Current liabilities</b>	20	(12)	(26)	(38)	(97)
<b>Net assets of the scheme at 31 December</b>		80,941	796	81,737	73,844

The financial statements summarise the transactions of the Scheme and deal with the net assets at the disposal of the Trustees. They do not take account of obligations to pay pensions and benefits which fall due after the end of the Scheme year. The actuarial position of the Scheme, which takes into account such obligations for the defined benefit section, is dealt with in the Report on Scheme Liabilities on page XX of the Annual Report and these financial statements should be read in conjunction with this report.

These accounts were approved by the Trustees on *(date)*.

## **Notes to the Financial Statements**

### **(1) Basis of preparation**

The accounts have been prepared in accordance with the Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996, Financial Reporting Standard 102 – The Financial Reporting Standard applicable in the UK and Republic of Ireland issued by the Financial Reporting Council and with the guidance set out in the Statement of Recommended Practice (Revised September 2014).

### **(2) Accounting policies**

The principal accounting policies of the Scheme are as follows:

- (i) Contributions
  - (a) Employee normal contributions, including AVCs, are accounted for by the Trustees when they are deducted from pay by the Employer, except for the first contribution due where the employee has been auto-enrolled by the Employer in which case it is accounted for when received by the Scheme
  - (b) Employer normal contributions that are expressed as a rate of salary are accounted for on the same basis as the employees' contributions, in accordance with the Schedule of Contributions in force during the year.
  - (c) Employer augmentation contributions are accounted for in accordance with the agreement under which they are payable.
  - (d) Employer deficit funding contributions are accounted for on the on the due dates on which they are payable under the Schedule of Contributions or on receipt if earlier with the agreement of the employer and trustees.
  - (e) Employer S75 debt contributions are accounted for when a reasonable estimate of the amount receivable can be determined.
- (ii) Payments to members
  - (a) Benefits are accounted for in the period in which the member notifies the Trustees of his decision on the type or amount of benefit to be taken, or if there is no member choice, on the date of retiring or leaving.
  - (b) Pensions in payment are accounted for in the period to which they relate.
  - (c) Individual transfers in or out of the Scheme are accounted for when member liability is accepted or, discharged which is normally when the transfer amount is paid or received.
  - (d) Group transfers are accounted for in accordance with the terms of the transfer agreement.

- (iii) Opt-outs are accounted for when the Scheme is notified of the opt-out.
- (iv) Expenses are accounted for on an accruals basis.
- (v) Investment income:
  - (a) Dividends from equities are accounted for on the ex-div date.
  - (b) Income from bonds is accounted for on an accruals basis and includes interest bought and sold on investment purchases and sales.
  - (c) Rental income is accounted for on an accruals basis.
  - (d) Income from pooled investment vehicles is accounted for when declared by the pooled manager.
  - (e) Receipts from annuity policies are accounted for as investment income.
- (vi) The change in market value of investments during the year comprises all increases and decreases in the market value of investments held at any time during the year, including profits and losses realised on sales of investments during the year.
- (vii) Investments are included at fair value as described below:
  - (a) Quoted securities are stated at the official price, of the stock exchange on which they are quoted, at the date of the Statement of Net Assets. Quoted securities where the official price is not recent are valued using available information from market participants.
  - (b) Unquoted securities are included at fair value estimated by the Trustees using appropriate valuation techniques. Private equity investments are valued in accordance with the valuation guidelines of the International Private Equity and Venture Capital Valuation Guidelines. Unquoted bonds are valued using available information from market participants.
  - (c) Accrued interest is excluded from the market value of fixed income securities and is included in invested income receivable.
  - (d) Investment properties have been valued in accordance with the Royal Institution of Chartered Surveyors' Valuation Standards UK PS 1.1 Valuation for Financial Statements. The valuations have been carried out at 31 December 20X6 by George and Co Ltd, Chartered Surveyors, who have recent experience in the locations and class of the investment properties held by the Scheme.
  - (e) Unitised pooled investment vehicles have been valued at the latest available bid price or single price provided by the pooled investment manager. Shares in other pooled arrangements have been valued at the latest available net asset

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value (NAV), determined in accordance with fair value principles, provided by the pooled investment manager.

- (f) Annuities have been valued by the Scheme Actuary at the amount of the related obligation, determined using the most recent Scheme Funding valuation assumptions updated for market conditions at the reporting date.
- (g) With profit insurance policies are reported at the policy value provided by the insurance company based on the cumulative reversionary bonuses declared and the current terminal bonus.
- (h) Exchange traded derivatives are based on settlement prices for derivative assets and liabilities at the reporting date.
- (i) Over the counter (OTC) derivatives are valued using the following valuation techniques:
  - 1) Swaps – current value of future cash flows arising from the swap determined using discounted cash flow models and market data at the reporting date.
  - 2) Forward foreign exchange – the gain or loss that would arise from closing out the contract at the reporting date by entering into an equal and opposite contact at that date.
- (j) The Scheme functional and presentation currency is pounds sterling. Monetary items denominated in foreign currency are translated into sterling using the closing exchange rates at the Scheme year end. Foreign currency transactions are recorded in sterling at the spot exchange rate at the date of the transaction.

**(3) Contributions**

	<b>20X6</b>		
	<b>Defined benefit section</b>	<b>Defined contribution section</b>	<b>Total</b>
	<b>£000</b>	<b>£000</b>	<b>£000</b>
Employer contributions			
Normal	285	67	352
Deficit funding	56	-	56
Augmentation	5	-	5
S75 debt	5	-	5
Employee contributions			
Normal	285	67	352
Additional voluntary contributions	54	16	70
	690	150	840
	690	150	840

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	<b>20X5</b>		
Employer contributions			
Normal	309	22	331
Deficit funding	56	-	56
Augmentation	6	-	6
S75 debt	-	-	-
Employee contributions			
Normal	309	22	331
Additional voluntary contributions	54	15	69
	734	59	793
	734	59	793

Deficit funding contributions of £56,000 per annum are being paid by the Employer into the Scheme for a period of three years in accordance with a recovery plan in order to improve the Scheme's funding position.

Employer normal contributions include contributions in respect of salary sacrifice arrangements made available to certain members by the Employer.

A participating employer, JBL Limited, withdrew from the Scheme on 1 September 20X5. The S75 debt determined amounted to £5,000. This debt was settled by the Employer during the Scheme year.

**(4) Transfers in**

	<b>20X6</b>		
	<b>Defined benefit section</b>	<b>Defined contribution section</b>	<b>Total</b>
	<b>£000</b>	<b>£000</b>	<b>£000</b>
Group transfers in from other schemes	6,016	-	6,016
Individual transfers in from other schemes	2	16	18
	6,018	16	6,034
	6,018	16	6,034
	<b>20X5</b>		
Group transfers in from other schemes	-	-	-
Individual transfers in from other schemes	7	-	7
	7	-	7
	7	-	7

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The group transfer of £6.016 million represents the assets transferred in respect of members of the AB Manufacturing Limited Pension Scheme who transferred in on 31 March 20X5. The group transfer comprised £6 million of investments assets and £16,000 cash.

**(5) Benefits paid or payable**

	<b>20X6</b>		
	<b>Defined benefit section</b>	<b>Defined contribution section</b>	<b>Total</b>
	<b>£000</b>	<b>£000</b>	<b>£000</b>
Pensions	11,770	-	11,770
Commutation of pensions and lump sum retirement benefits	245	-	245
Purchase of annuities	-	45	45
Lump sum death benefits	75	-	75
Taxation where lifetime or annual allowance exceeded	25	-	25
	<hr/>	<hr/>	<hr/>
	12,115	45	12,160
	<hr/>	<hr/>	<hr/>
	<b>20X5</b>		
Pensions	11,464	-	11,464
Commutation of pensions and lump sum retirement benefits	230	-	230
Purchase of annuities	-	-	-
Lump sum death benefits	-	-	-
Taxation where lifetime or annual allowance exceeded	35	-	35
	<hr/>	<hr/>	<hr/>
	11,729	-	11,729
	<hr/>	<hr/>	<hr/>

Taxation arising on benefits paid or payable is in respect of members whose benefits exceeded the lifetime or annual allowance and who elected to take lower benefits from the Scheme in exchange for the Scheme settling their tax liability.

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**(6) Payments to and on account of leavers**

	<b>20X6</b>		<b>Total</b>
	<b>Defined benefit section</b>	<b>Defined contribution section</b>	
	<b>£000</b>	<b>£000</b>	
Refunds of contributions in respect of non-vested leavers	7	20	27
Opt-outs	-	2	2
Individual transfers out to other schemes	26	25	51
	33	47	80
	33	47	80
	<b>20X5</b>		
Refunds of contributions in respect of non-vested leavers	10	60	70
Opt-outs	-	2	2
Individual transfers out to other schemes	34	-	34
	44	62	106
	44	62	106

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**(7) Administrative expenses**

	<b>20X6</b>		
	<b>Defined benefit section</b>	<b>Defined contribution section</b>	<b>Total</b>
	<b>£000</b>	<b>£000</b>	<b>£000</b>
Administration and processing	16	5	21
Professional fees	12	3	15
	28	8	36
	28	8	36
	<b>20X5</b>		
Administration and processing	16	5	21
Professional fees	18	2	20
	34	7	41
	34	7	41

The Scheme bears all costs of administration. Direct costs are charged to the section to which they relate. Indirect costs are allocated between sections based on an allocation methodology agreed by the Trustees.

**(8) Taxation**

The Scheme is a registered Pension Scheme under Chapter 2 of Part 4 of the Finance Act 2004 and is therefore exempt from income tax and capital gains tax.



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**(11) Reconciliation of investments held at the beginning and the end of the year**

	Value at 31 December 20X5	Purchases at cost and derivative payments	Sales proceeds and derivative receipts	Change in market value	Value at 31 December 20X6
	£000	£000	£000	£000	£000
<b>Defined Benefit Section</b>					
Equities	17,411	36	(5)	3,194	20,636
Bonds	44,224	387	(233)	3,928	48,306
Property	3,500	-	-	850	4,350
Pooled investment vehicles	6,990	32	(35)	(416)	6,571
Derivatives	332	8	(20)	10	330
Insurance policies	344	-	-	6	350
AVC investments	260	50	(7)	13	316
	73,061	513	(300)	7,585	80,859
Cash	26				27
Other investment balances	7				7
	73,094				80,893
<b>Defined Contribution Section</b>					
Pooled investment vehicles	695	187	(165)	98	815

Transaction costs are included in the cost of purchases and sale proceeds. Direct transaction costs include costs charged to the Scheme such as fees, commissions and stamp duty.

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Transaction costs analysed by main asset class and type of cost are as follows:

	<b>Fees £000</b>	<b>Commission £000</b>	<b>Taxes £000</b>	<b>Total £000</b>	<b>20X4 £000</b>
Equities	10	30	5	45	15
Bonds	50	5	20	75	95
Other	5	3	2	10	10
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
	65	38	27	130	120
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
20X4	60	35	25	-	120
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>

In addition to the transaction costs disclosed above, indirect costs are incurred through the bid-offer spread on investments within pooled investment vehicles. The amount of indirect costs is not separately provided to the Scheme.

For the DC section investments purchased by the Scheme are allocated to provide benefits to the individuals on whose behalf corresponding contributions are paid. The investment manager holds the investment units on a pooled basis for the Trustees. The Scheme administrator allocates investment units to members. The Trustees may hold investment units representing the value of employer contributions that have been retained by the Scheme that relate to members leaving the Scheme prior to vesting.

Defined contribution assets are allocated to members and the Trustees as follows:

	<b>20X6 £000</b>	20X5 £000
Members	<b>791</b>	672
Trustees	<b>24</b>	23
	<hr/>	<hr/>
	<b>815</b>	695
	<hr/>	<hr/>

**(12) Pooled investment vehicles**

The Scheme's investments in pooled investment vehicles at the year end comprised:

	<b>20X6</b>	20X5
	<b>£000</b>	£000
<b>Defined Benefit Section</b>		
Equity	<b>5,050</b>	4,950
Bonds	<b>900</b>	965
Hedge funds	<b>363</b>	426
Private equity	<b>258</b>	649
	<b>6,571</b>	6,990
	<b>6,571</b>	6,990
 <b>Defined Contribution Section</b>		
Equity	<b>700</b>	590
Bonds	<b>75</b>	70
Cash	<b>20</b>	20
Diversified growth	<b>20</b>	15
	<b>815</b>	695
	<b>815</b>	695

**(13) Derivatives**

*Objectives and policies*

The Trustees have authorised the use of derivatives by their investment managers as part of their investment strategy for the Scheme as follows:

Futures – the Trustees did not want cash held to be “out of the market” and therefore bought exchange traded index based futures contracts which had an underlying economic value broadly equivalent to cash held.

Swaps – the Trustees’ aim is to match as far as possible the Liability Driven Investment (LDI) portfolio and the Scheme’s long term liabilities, in particular in relation to their sensitivities to interest rate movements. Due to the lack of available long dated bonds the Trustees have entered into OTC interest rate swaps during the year that extend the duration of the fixed income portfolio to better match the long term liabilities of the Scheme.

Forward foreign exchange – in order to maintain appropriate diversification of investments within the portfolio and take advantage of overseas investment returns, a proportion of the underlying investment portfolio is invested overseas. To balance the risk of investing in foreign currencies whilst having an obligation to settle benefits in Sterling, a currency hedging programme, using forward foreign exchange contracts, has

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been put in place to reduce the currency exposure of these overseas investments to the targeted level.

At the year end the Scheme had the following derivatives:

	20X6		20X5	
	Asset £000	Liabilities £000	Asset £000	Liabilities £000
Futures	88	(13)	80	(8)
OTC Swaps	252	(10)	250	-
Forward FX contracts	15	(2)	15	(5)
	355	(25)	345	(13)

A summary of the Scheme's outstanding derivative contracts at the year end aggregated by key characteristics is set out below:

**(i) Swaps**

Nature	Notional amounts £	Duration	Asset value £000	Liability value £000
Interest rate swaps (Pay 5% for LIBOR)	15,000,000	Expires June 16 – June 18	252	(10)
<b>Total 20X6</b>	15,000,000		252	(10)
<b>Total 20X5</b>	10,000,000		250	-

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**(ii) Futures**

Nature	Economic exposure	Duration	Asset value	Liability value
	£		£000	£000
Nikkei stock futures bought	40,000	May 2016	88	-
FTSE 100 stock futures sold	(10,000)	June 2016	-	(13)
<b>Total 20X6</b>	30,000		88	(13)
<b>Total 20X5</b>	25,000		80	(8)

**(iii) Forward Foreign Exchange (FX)**

Contract	Settlement date	Currency bought	Currency sold	Asset value	Liability value
				£000	£000
Forward OTCs	1-2 months	£150	\$300	15	(2)
<b>Total 20X6</b>				15	(2)
<b>Total 20X5</b>				15	(5)

**(14) Insurance policies**

The Scheme held insurance policies at the year end as follows:

	20X6 £000	20X5 £000
Annuities with XYZ Insurance	177	175
With profits policy ABC Insurance Company	173	169
	<b>350</b>	344

The annuities have been reported at the value of the related benefits as determined by the Scheme Actuary. The with profits policies have been reported at the values advised by ABC Insurance Company.

**(15) Defined Benefit Section AVC investments**

The Trustees hold assets invested separately from the main Defined Benefit Section investments to secure additional benefits on a money purchase basis for those Defined Benefit Section members electing to pay Additional Voluntary Contributions. Members participating in this arrangement each receive an annual statement made up to 31 December confirming the amounts held in their account and the movements in the year. The aggregate amounts of AVC investments are as follows:

	<b>20X6</b>	20X5
	<b>£000</b>	£000
ABC Building Society	<b>153</b>	136
XYZ Life Assurance Company	<b>163</b>	124
	<b>316</b>	260

**(16) Fair value determination**

The fair value of financial instruments has been estimated using the following fair value hierarchy:

- Category (a) The quoted price for an identical asset in an active market at the reporting date.
  
- Category (b) When quoted prices are unavailable, the price of a recent transaction for an identical asset adjusted if necessary.
  
- Category (c) Where a quoted price is not available and recent transactions of an identical asset on their own are not a good estimate of fair value, the fair value is determined by using a valuation technique that uses:
  - c (i) observable market data; or
  - c (ii) non-observable data.

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The Scheme's investment assets and liabilities have been fair valued using the above hierarchy categories as follows:

	Category (a) £000	Category (b) £000	Category c (i) £000	Category c (ii) £000	Total £000
<b>Defined benefit section</b>					
<b>At 31 December 20X6</b>					
Equities	20,636	-	-	-	20,636
Bonds	-	3,200	45,106	-	48,306
Property	-	-	2,350	2,000	4,350
Pooled investment vehicles	5,050	900	363	258	6,571
Derivatives	75	-	255	-	330
Insurance policies	-	-	-	350	350
AVC investments	153	-	-	163	316
Cash	27	-	-	-	27
Other investment balances	7	-	-	-	7
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
<b>Defined contributions section</b>	25,948	4,100	48,074	2,771	80,893
Pooled investment vehicles	720	75	20	-	815
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
	26,668	4,175	48,094	2,771	81,708
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>

	Category (a) £000	Category (b) £000	Category (c) i £000	Category (c) ii £000	Total £000
<b>Defined benefit section</b>					
<b>At 31 December 20X5</b>					
Equities	17,411	-	-	-	17,411
Bonds	-	2,600	41,624	-	44,224
Property	-	-	1,500	2,000	3,500
Pooled investment vehicles	4,950	965	426	649	6,990
Derivatives	72	-	260	-	332
Insurance policies	-	-	-	344	344
AVC investments	136	-	-	124	260
Cash	26	-	-	-	26
Other investment balances	7	-	-	-	7
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
<b>Defined contributions section</b>	22,602	3,565	43,810	3,117	73,094
Pooled investment vehicles	610	70	15	-	695
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
	23,212	3,635	43,825	3,117	73,789
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>

**(17) Financial instrument risk disclosures**

**(a) Investment risks**

FRS 102 requires the disclosure of information in relation to certain investment risks. These risks are set out by FRS 102 as follows:

Credit risk: this is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation.

Market risk: this comprises currency risk, interest rate risk and other price risk.

- Currency risk: this is the risk that the fair value or future cash flows of a financial asset will fluctuate because of changes in foreign exchange rates.
- Interest rate risk: this is the risk that the fair value or future cash flows of a financial asset will fluctuate because of changes in market interest rates.
- Other price risk: this is the risk that the fair value or future cash flows of a financial asset will fluctuate because of changes in market prices (other than those arising from interest rate risk or currency risk), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments traded in the market.

The Scheme has exposure to these risks because of the investments it makes in following the investment strategy set out below. The objective of the Trustees is to manage investment risks, including credit risk and market risk, within agreed risk limits which are set taking into account the Scheme's strategic investment objectives. These risk limits are implemented through the investment management agreements in place with the Scheme's investment managers and monitored by the Trustees by regular reviews of the investment portfolio.

Further information on the trustees' approach to risk management, credit and market risk is set out below. This does not include the legacy insurance policies nor AVC investments as these are not considered significant in relation to the overall investments of the Scheme.

**(17) Financial instrument risk disclosures (continued)**

**(b) Defined Benefit Section**

**(i) Investment Strategy**

The main investment objective of the Scheme is to maintain a portfolio of suitable assets of appropriate liquidity which will generate investment returns to meet, together with future contributions, the benefits of the Scheme payable under the trust deed and rules as they fall due.

The Trustees set the investment strategy for the Scheme taking into account considerations such as the strength of the employer covenant, the long term liabilities of the Scheme and the funding agreed with the Employer. The investment strategy is set out in its Statement of Investment Principles (SIP).

The current strategy is to hold:

- 60% in investments that move in line with the long term liabilities of the Scheme. This is referred to as Liability Driven Investment (LDI) and comprises UK and overseas government and corporate bonds and interest rate swaps.
- 40% in return seeking investments comprising UK and overseas equities, equities futures, investment property, hedge funds and private equity.
- 15% of the above in overseas currencies. To achieve this the trustees have put in place a currency hedging strategy using forward foreign exchange rates.

**(ii) Credit risk**

The Scheme is subject to credit risk because the Scheme directly invests in bonds, OTC derivatives, has cash balances and undertakes stock lending activities. The Scheme also invests in pooled investment vehicles and is therefore directly exposed to credit risk in relation to the instruments it holds in the pooled investment vehicle and is indirectly exposed to credit risks arising on the financial instruments held by the pooled investment vehicles.

Credit risk arising on bonds held directly is mitigated by investing in government bonds where the credit risk is minimal, or corporate bonds which are rated at least investment grade. Credit risk arising on other investments is mitigated by mandates required by all counterparties to be at least investment grade credit rated.

Credit risk arising on derivatives depends on whether the derivative is exchange traded or over the counter. Over the counter derivative contracts are not guaranteed by any regulated exchange and therefore the Scheme is subject to risk of failure of the counterparty. The credit risk for OTC swaps is reduced by collateral arrangements. At the year end the Scheme held collateral of £240,000 in respect of OTC swaps. Credit risk also arises on forward foreign currency contracts. There are no collateral arrangements for these contracts but all counterparties are required to be at least investment grade.

**(17) Financial instrument risk disclosures (continued)**

Cash is held within financial institutions which are at least investment grade credit rated.

The Trustees manage the credit risk arising from stock lending activities by restricting the amount of overall stock that may be lent, only lending to approved borrowers who are rated investment grade, limiting the amount that can be lent to any one borrower and putting in place collateral arrangements. At the year end the Scheme had lent £5.4 million of UK public sector securities and £2 million of UK quoted securities and held collateral in the form of cash and fixed interest securities with a value of 105% of stock lent.

Direct credit risk arising from pooled investment vehicles is mitigated by the underlying assets of the pooled arrangements being ring-fenced from the pooled manager, the regulatory environments in which the pooled managers operate and diversification of investments amongst a number of pooled arrangements. Trustees carry out due diligence checks on the appointment of new pooled investment managers and on an ongoing basis monitor any changes to the regulatory and operating environment of the pooled manager.

A summary of pooled investment vehicles by type of arrangement is as follows:

	<b>20X6</b>	20X5
	<b>£000</b>	£000
Unit linked insurance contracts	800	750
Authorised unit trusts	5,150	5,165
Open ended investment companies	363	426
Shares of limited liability partnerships	258	649
	<hr/>	<hr/>
	6,571	6,990
	<hr/>	<hr/>

Indirect credit risk arises in relation to underlying investments held in pooled investment vehicles. At the year end the total value of underlying investments subject to credit risk was £850,000 (20X5: £920,000) as advised by the pooled managers. This risk is mitigated by requiring pooled managers to invest in at least investment grade credit rated investments.

**(iii) Currency risk**

The Scheme is subject to currency risk because some of the Scheme's investments are held in overseas markets, either as segregated investments or via pooled investment vehicles. The Trustees have set a benchmark limit to overseas currency exposure of 15% of the total portfolio value.

**(17) Financial instrument risk disclosures (continued)**

The Scheme's total net unhedged exposure by major currency at the year end was as follows:

	<b>20X6</b>	20X5
	<b>£000</b>	£000
<b>Currency</b>		
US Dollar	7,633	6,036
Japanese Yen	4,258	4,653
Other	243	275

The above analysis includes the net exposure to foreign currency arising from the underlying investments in the pooled investment vehicles held by the Scheme as advised by the pooled investment manager.

**(iv) Interest rate risk**

The Scheme is subject to interest rate risk because some of the Scheme's investments are held in bonds, interest rate swaps, either as segregated investments or through pooled vehicles, and cash. The Trustees have set a benchmark for total investment in bonds and interest rate swaps of 60% of the total investment portfolio as part of their LDI investment strategy. Under this strategy if interest rates fall the value of LDI investments will rise to help match the increase in actuarial liabilities arising from a fall in the discount rate. Similarly, if interest rates rise the LDI investments will fall in value as will the actuarial liabilities because of an increase in the discount rate. At the year end the LDI portfolio represented 60% of the total investment portfolio (20X5: 60%).

The exposure to interest rate risk arising from the underlying investments in pooled investment vehicles held by the Scheme as advised by the pooled investment manager was £850,000 (20X5: £920,000).

**(v) Other price risk**

Other price risk arises principally in relation to the Scheme's return seeking portfolio which includes directly held equities, equities held in pooled vehicles, equity futures, hedge funds, private equity and investment properties.

The scheme manages this exposure to overall price movements by constructing a diverse portfolio of investments across various markets. Pooled investment vehicles at the year end, other than hedge funds, had underlying other price risk exposure of £4.8 million (20X5: £4.5 million).

The trustees regard hedge funds as an asset class in their own right and do not monitor other price risk at the underlying investment level.

**(17) Financial instrument risk disclosures (continued)**

**(c) Defined Contribution Section**

**(i) Investment strategy**

The Trustees' objective is to make available to members of the Scheme an appropriate range of investment options designed to generate income and capital growth, which together with new contributions from members and their employer, will provide a retirement amount with which the member can purchase a pension annuity (or other type of retirement product). The Statement of Investment Principles outlines the investment objectives and strategy for the Defined Contribution assets of the Scheme.

The investment funds offered to members are white label funds provided by XYZ Insurance Company as follows:

- Equity
- Bonds
- Cash
- Diversified Growth

The Trustees have an investment management agreement in place with XYZ Insurance Company that sets out guidelines for the underlying investments held by the funds. The day to day management of the underlying investments of the funds is the responsibility of XYZ Insurance Company, including the direct management of credit and market risks.

The Trustees monitor the underlying risks by quarterly investment reviews with XYZ Insurance Company.

**(ii) Credit risk**

The Defined Contribution section is subject to direct credit risk in relation to XYZ Insurance Company through its holding in unit linked insurance funds provided by XYZ Insurance Company.

XYZ Insurance Company is regulated by the Financial Conduct Authority and maintains separate funds for its policy holders. The trustees monitor the creditworthiness of XYZ Insurance Company by reviewing published credit ratings. XYZ Insurance Company invests all the Scheme's funds in its own investment unit linked funds and it does not use other investment funds or reinsurance arrangements. In the event of default by XYZ Insurance Company the scheme is protected by the Financial Services Compensation Scheme.

**(17) Financial instrument risk disclosures (continued)**

The Defined Contribution Section is also subject to indirect credit and market risk arising from the underlying investments held in the white label funds. The analysis of these risks set out below is at Scheme level. Member level risk exposures will be dependent on the funds invested in by members.

At the Scheme year-end the following investment funds had indirect credit risk at the amount disclosed below as advised by XYZ Insurance Company.

	<b>20X6</b>	20X5
	<b>£000</b>	£000
Bonds	<b>75</b>	70
Cash	<b>20</b>	20
Diversified growth	<b>26</b>	15

The Trustees have set credit quality investment guidelines with XYZ Insurance Company which include the requirement that the financial instruments and all counterparties are at least investment grade. XYZ Insurance Company has confirmed that at the year- end all underlying credit quality was at least investment grade.

**(iii) Market risk**

The Scheme's Defined Contribution Section is subject to indirect foreign exchange, interest rate and other price risk arising from the underlying financial instruments held in the funds managed by XYZ Insurance Company.

The underlying market risks for the funds held by the Scheme at the year-end by fair value as advised by XYZ Insurance Company are set out below:

<b>Fund</b>	<b>20X6</b>		
	<b>Foreign exchange £000</b>	<b>Interest rate £000</b>	<b>Other price £000</b>
Equity	105	-	700
Bond	10	75	-
Cash	5	20	-
Diversified assets	2	10	10
<b>Fund</b>	<b>20X5</b>		
Equity	84	-	590
Bond	10	70	-
Cash	5	20	-
Diversified assets	5	5	10

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**(18) Self investment**

The Scheme holds an investment of 10,987 ABC Group plc ordinary shares at the year-end, the value of which represents 1.5% of the Scheme's net assets. The Scheme also had indirect holdings of ABC Group PLC ordinary shares through its pooled investment vehicles which amounted to 1% of the Scheme's net assets at the year-end.

**(19) Current assets**

	<b>Defined benefit section £000</b>	<b>20X6 Defined contribution section £000</b>	<b>Total £000</b>
Contributions due from employer in respect of:			
Employer	16	5	21
Employees	13	-	13
Cash balances	31	2	33
	60	7	67
		<b>20X5</b>	
Contributions due from employer in respect of:			
Employer	3	2	5
Employees	20	7	27
Cash balances	115	5	120
	138	14	152

**(20) Current liabilities**

	<b>Defined benefit section £000</b>	<b>20X6 Defined contribution section £000</b>	<b>Total £000</b>
Accrued expenses	(12)	(26)	(38)
		<b>20X5</b>	
Accrued expenses	(65)	(32)	(97)

**(21) Related party transactions**

The Trustees received total fees of £3,000 for their services to the Scheme.

## **Alternative combined presentation of notes 13 – Derivatives and 17– Investment Risk**

### **(b) Defined Benefit Section**

#### **(i) Investment strategy and use of derivatives**

The main investment objective of the Scheme is to maintain a portfolio of suitable assets of appropriate liquidity which will generate investment returns to meet, together with future contributions, the benefits of the Scheme payable under the trust deed and rules as they fall due.

The Trustees set the investment strategy for the Scheme taking into account considerations such as the strength of the employer covenant, the long term liabilities of the Scheme and the funding agreed with the Employer. The investment strategy is set out in its Statement of Investment Principles (SIP).

The current strategy is to hold:

- 60% in investments that move in line with the long term liabilities of the Scheme. This is referred to as Liability Driven Investment (LDI) and comprises UK and overseas government and corporate bonds and interest rate swaps. The Trustees have entered interest rate swaps during the year that extend the duration of the LDI portfolio to better match the long term liabilities of the Scheme.
- 40% in return seeking investments comprising UK and overseas equities, investment property, hedge funds and private equity. The trustees have authorised the use of equity futures contracts to hedge cash into the market to maintain strategic equity exposures.
- 15% of the above in overseas currencies. To achieve this the trustees have put in place a currency hedging strategy using forward foreign exchange rates.

#### **(ii) Credit risk**

The Scheme is subject to credit risk because the Scheme directly invests in bonds, OTC derivatives, has cash balances and undertakes stock lending activities. The Scheme also invests in pooled investment vehicles and is therefore directly exposed to credit risk in relation to the instruments it holds in the pooled investment vehicles and is indirectly exposed to credit risks arising on the financial instruments held by the pooled investment vehicles.

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Credit risk arising on bonds held directly is mitigated by investing in government bonds where the credit risk is minimal, or corporate bonds which are rated at least investment grade. Credit risk arising on other investments is mitigated by mandates required by all counterparties to be at least investment grade.

Credit risk arising on derivatives depends on whether the derivative is exchange traded or over the counter. Over the counter derivative contracts are not guaranteed by any regulated exchange and therefore the Scheme is subject to risk of failure of the counterparty. The credit risk for OTC swaps is reduced by collateral arrangements. At the year end the Scheme held collateral of £240,000 in respect of OTC swaps. Credit risk also arises on forward foreign currency contracts. There are no collateral arrangements for these contracts but all counterparties are at least investment grade credit rated.

Cash is held within financial institutions which are at least investment grade credit rated.

The Trustees manage the credit risk arising from stock lending activities by restricting the amount of overall stock that may be lent, only lending to approved borrowers who are rated investment grade and above, limiting the amount that can be lent to any one borrower and putting in place collateral arrangements. At the year end the Scheme had lent £5.4 million of UK public sector securities and £2 million of UK quoted securities and held collateral in the form of cash and fixed interest securities with a value of 105% of stock lent.

Direct credit risk arising from pooled investment vehicles is mitigated by the underlying assets of the pooled arrangements being ring-fenced from the pooled manager, the regulatory environments in which the pooled managers operate and diversification of investments amongst a number of pooled arrangements. Trustees carry out due diligence checks on the appointment of new pooled investment managers and on an ongoing basis monitor any changes to the regulatory and operating environment of the pooled manager.

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A summary of pooled investment vehicles by type of arrangement is as follows:

	<b>20X6</b>	20X5
	<b>£000</b>	£000
Unit linked insurance contracts	800	750
Authorised unit trusts	5,150	5,165
Open ended investment companies	363	426
Share of limited liability partnerships	258	649
	<hr/>	<hr/>
	6,571	6,990
	<hr/>	<hr/>

Indirect credit risk arises in relation to underlying investments held in pooled investment vehicles. At the year end the total value of underlying investments subject to credit risk was £850,000 (20X5: £920,000) as advised by the pooled managers. This risk is mitigated by requiring pooled managers to invest in at least investment grade credit rated investments.

**(iii) Currency risk**

The Scheme is subject to currency risk because some of the Scheme's investments are held in overseas markets, either as segregated investments or via pooled investment vehicles. The Trustees have set a benchmark limit to overseas currency exposure of 15% of the total portfolio value.

The Scheme's total net unhedged exposure by major currency at the year end was as follows:

	<b>20X6</b>	20X5
	<b>£000</b>	£000
<b>Currency</b>		
US Dollar	7,633	6,036
Japanese Yen	4,258	4,653
Other	243	275

The above analysis includes the net exposure to foreign currency arising from the underlying investments in the pooled investment vehicles held by the Scheme as advised by the pooled investment manager.

**STATEMENT OF RECOMMENDED PRACTICE**  
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Under the currency hedging arrangement the Scheme had open FX contracts at the year end as follows:

Contract	Settlement date	Currency bought	Currency sold	Asset value £000	Liability value £000
Forward OTCs	1-2 months	£150	\$300	15	(2)
<b>Total 20X6</b>				15	(2)
<b>Total 20X5</b>				15	(5)

**(iv) Interest rate risk**

The Scheme is subject to interest rate risk because some of the Scheme's investments are held in bonds, interest rate swaps, either as segregated investments or through pooled vehicles, and cash. The Trustees have set a benchmark for total investment in bonds and interest rate swaps of 60% of the total investment portfolio as part of their LDI investment strategy. Under this strategy if interest rates fall the value of LDI investments will rise to help match the increase in actuarial liabilities arising from a fall in the discount rate. Similarly, if interest rates rise the LDI investments will fall in value as will the actuarial liabilities because of an increase in the discount rate. At the year end the LDI portfolio represented 60% of the total investment portfolio (20X5: 60%).

The exposure to interest rate risk arising from the underlying investments in pooled investment vehicles held by the Scheme as advised by the pooled investment manager was £850,000 (20X5: £920,000).

A summary of the key characteristics of the outstanding swap contracts at the year end is as follows:

Nature	Notional amount £	Duration	Asset value £000	Liability value £000
Interest rate swaps (Pay 5% for LIBOR)	15,000,000	Expires June 16 – June 18	252	(10)
<b>Total 20X6</b>	15,000,000		252	(10)
<b>Total 20X5</b>	10,000,000		250	-

**(v) Other price risk**

Other price risk arises principally in relation to the Scheme's return seeking portfolio which includes directly held equities, equities held in pooled vehicles, equity futures, hedge funds, private equity and investment properties. The Scheme manages this exposure to overall price movement by constructing a diverse portfolio of investments across various markets. Pooled vehicles at the year end, other than hedge funds, have underlying other price risk exposure of £4.8 million (20X5: £4.5 million). The trustees regard hedge funds as an asset class in their own right and do not monitor other price risk at the underlying investment level.

The Scheme had exchange traded stock index futures outstanding at the year end relating to its equity portfolio as follows:

Nature	Economic exposure £	Duration	Asset value £000	Liability value £000
Nikkei stock futures bought	40,000	May 2016	88	-
FTSE 100 stock futures sold	(10,000)	June 2016	-	(13)
	-----		-----	-----
Total 20X6	30,000		88	(13)
	-----		-----	-----
Total 20X5	25,000		80	(8)
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**Alternative presentation of notes 1 and 2 on first year of transition to FRS 102**

**(1) Basis of preparation**

The accounts have been prepared in accordance with the Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996, Financial Reporting Standard 102 – The Financial Reporting Standard applicable in the UK and Republic of Ireland issued by the Financial Reporting Council and with the guidance set out in the Statement of Recommended Practice (Revised September 2014). This is the first year FRS 102 and the Revised SORP have applied to the Scheme’s financial statements.

**(2) Transition to FRS 102**

	<b>1 January 20X5</b>	<b>31 December 20X5</b>
	<b>£000</b>	<b>£000</b>
Net assets of the Scheme as previously stated	82,539	75,113
Effect of transition-valuation of annuity policies	165	175
	82,704	75,288
Net assets of the Scheme as restated	82,704	75,288
		20X5
		£’000
Net decrease in fund as previously reported		(7,405)
Effect of transition – valuation of annuity policies		(11)
		(7,416)
Net decrease in fund as restated		(7,416)

Annuity policies were previously included in the Statement of Net Assets at Nil value as permitted by the Audited Accounts Regulations and the previous SORP. Under FRS 102 annuity policies are reported at the value of the related obligation to pay future benefits funded by the annuity policy.



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**Pay increases:** general pay increases of 1.5% per annum above the term dependent rates for the future retail price inflation(NB not a significant assumption if few active members).

**Mortality:** for the period in retirement, standard tables S1PMA with a scaling factor of 98% for male active members, 103% for male deferred members and 99% for male pensioner members and S1PFA with a scaling factor of 103% for female active members, 107% for female deferred members and 111% for female pensioner members.

## **Appendix 3 – Annual Report disclosure requirements in the UK**

This appendix, which does not form part of the Statement of Recommended Practice, sets out the content of the Annual Report required by UK legislation and other UK requirements. It does not cover the audit reports or the trustee statement of responsibilities in relation to the financial statements and statement on contributions, which are provided by Practice Note 15 The Audit of Occupational Pension Schemes in the United Kingdom.

The text in the appendix is cross-referenced in the margin to the Occupational Pension Schemes (Disclosure of Information) Regulations 2013, for example “Sch 3 (1)” refers to paragraph 1 of Schedule 3 to the Regulations, and to FRS 102.

It is generally good practice for the Trustees’ Report to be approved by all the trustees and signed and dated by them or on their behalf.

The required disclosures have been set out in the context of a Trustees’ Report that comprises separate sections for:

- Scheme management;
- Investment management;
- Compliance matters; and
- The Report of Actuarial liabilities

### **Scheme management**

FRS 102 3.24  
a) and b)

The legal form of the scheme, address of its principal place of business, nature of operations and principal activities.

Particulars of the management of the scheme including:

Sch. 3 (17)

- names of the trustees (or directors, if the scheme has only corporate trustees) who served during the scheme year

Sch. 3 (18)

- the provisions of the scheme in relation to the appointment of trustees and their removal from office and, in the case of a scheme where none of the trustees is an individual, the provisions in the articles of association of each trustee that relate to the appointment and removal from office of any directors

### ***Scheme advisers***

Sch. 3 (19)

The names of the professional advisers to the trustees and other individuals and organisations who have acted for or were retained by the trustees during the year, with an indication of any change since the previous year, including:

- the scheme actuary;

- the scheme auditors;
- the investment manager(s);
- the legal adviser;
- the administrator of the scheme benefits;
- the custodians of the scheme assets;
- the banker(s); and
- the secretary to the trustees.

***Scheme audit***

Sch. 3 (24) &  
Sch. 3 (5)

- A statement confirming that the accounts have been prepared and audited in accordance with regulations made under sections 41(1) and (6) of the Pensions Act 1995 (unless the scheme is exempt from such a requirement by virtue of regulations made under that section); and

Sch. 3 (25 & 26)

- Where the auditor's statement made in accordance with regulations made under section 41(1)(a) and (2)(b) of the 1995 Act (about contributions payable to the scheme) is negative or qualified, an account of the reasons why and a statement as to how the situation has been or is likely to be resolved (and, similarly, if such a situation in respect of a previous scheme year was not resolved in a previous year, a statement as to how it has been or is likely to be resolved).

***Scheme membership***

Sch. 3 (21)

The number of beneficiaries, active, deferred and pensioner members as at any one date during the year.

***Pension increases***

Sch. 3 (22)

Except in the case of a money purchase scheme, the percentage increase made (otherwise than in accordance with a legislative requirement) during the year (or, if there have been different increases for different individuals or groups of individuals, the maximum, minimum and average percentage increases) to:

- a) pensions that were payable; and
- b) deferred pensions

with a statement whether the increases were to any extent discretionary.

Sch. 3 (23)

***Transfers at less than cash equivalent***

Except in the case of a money purchase scheme that is a wholly insured scheme, the following information:

- where any cash equivalents or guaranteed cash equivalents (within the meaning of Chapter 4 of Part 4 or Chapter 2 of Part 4A of the 1993 Act) paid during the year were

not calculated and verified in the manner prescribed by regulations made under sections 97 or 101I of the 1993 Act<sup>1</sup> (calculation of cash equivalents), as the case may be, a statement explaining why;

- where any of the cash equivalents or guaranteed cash equivalents paid during the year were less than the amount for which section 94(1) of the 1993 Act<sup>2</sup> (right to cash equivalent) provides, a statement to that effect together with information as to why they were less;
- a statement of when full values became, or are likely to become, available (A cash equivalent is the amount which a pension scheme member is entitled under social security legislation to have applied as a transfer payment to another permitted pension scheme or a buy-out policy.); and
- a statement whether discretionary benefits are included in the calculation of transfer values and, if so, the method by which the value of discretionary benefits is addressed.

***Contact for further information***

Sch. 3 (20)

The postal and electronic address to which enquiries about the scheme generally or about an individual's entitlement to benefit should be sent.

**Investment management**

Sch. 3 (27)

***Investment managers***

The names of those who have managed the scheme's investments during the year, and the extent of delegation of this function by the trustees.

***Investment principles***

Sch. 3 (28)

A statement as to whether the trustees have produced a Statement of Investment Principles as required by section 35 of the Pensions Act 1995<sup>3</sup> (investment principles) and that a copy is available on request (unless the scheme is exempt from such a requirement by virtue of the regulations made under that section).

Sch. 3 (30) (d)  
& (e)

Where the scheme is one to which section 35 of the 1995 Act applies;

- the trustees' policy (if any) relating to rights (including voting rights) attaching to the investments; and
- the extent (if at all) to which social, environmental or ethical considerations are taken into account in the selection, retention and realisation of investments.

Sch. 3 (30) (c)

***Review of investment performance***

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<sup>1</sup> Section 97 was amended by the 1995 Act, section 173 and Schedule 6, paragraph 4(a) to (c) and the Child Support, Pensions and Social Security Act 2000, section 56 and Schedule 5, paragraph 8(1). Section 101I was inserted by the 1999 Act, section 37.

<sup>2</sup> Section 94(1) was amended by the 1995 Act, section 154(1) and (2).

<sup>3</sup> Section 35 was substituted by the 2004 Act, section 244.

Where the scheme is one to which section 35 of the 1995 Act applies, the investment report contains a review of the performance of the scheme's investment performance during the year (and except where the scheme has existed for less than three scheme years, during a period of not less than three and not more than five scheme years ending with the year) including an assessment of the nature, disposition, marketability, security and valuation of the scheme's assets.

Sch. 3 (30) (a) &  
(b)

#### ***Departures from Investment principles***

In those cases where the trustees are required to maintain a Statement of Investment Principles by section 35 of the Pensions Act 1995, the investment report should contain a statement by the trustees or the fund manager of any investments made for the scheme during the year that were not made in accordance with the Statement of Investment Principles, a statement by the trustees or the fund manager giving the reasons why and explaining what action, if any, is proposed to be taken, or has been taken, to remedy the position. This explanation should also be provided for departures made in previous years, if the investments involved continue to be held at the scheme year-end.

Sch. 3 (29)

#### ***Custodial arrangements***

A note of the trustees' policy for the custody of the scheme assets, except in relation to a wholly insured scheme (a scheme where all the benefits are secured by one or more insurance policies or annuities).

Sch. 3 (32)

#### ***Employer -related investments***

Except where the scheme is a trust scheme that applies to earners in employments under different employers, where the scheme has employer-related investments, as defined by section 40(2) of the 1995 Act a statement:

- as to the percentage of the scheme's resources invested in such investments at the end of the year;
- if that percentage exceeds 5%, of the percentage of the scheme's resources that are investments to which regulation 13 of the Occupational Pension Schemes (Investment) Regulations 2005<sup>4</sup> (investments to which restrictions do not apply) applies; and
- if any resources of the scheme are invested in contravention of subsection 91) of section 40 of the 1995 Act –
  - (i) as to the steps the trustees or managers of the scheme have taken or propose to take to secure that the scheme complies with that section; and
  - (ii) as to the time when any proposed steps will be taken.

Where the scheme is a trust scheme that applies to earners in employment under different employers, the above statement must be provided or a statement:

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<sup>4</sup> Section 40 was amended by the 2004 Act, section 319(1) and Schedule 12, paragraphs 34 and 51 and SI 2004/355.

Sch. 3 (33)

- listing the 100 largest investments by value held by the scheme as at the year-end and stating what percentage of the resources of the scheme each such investment represents,
- identifying which of these investments are employer-related investments, and
- if, as at the year-end, more than 5% of the resources of the scheme are invested in employer related investments in contravention of section 40 of the 1995 Act in relation to a particular employer-
  - (i) listing the employer-related investments and the name of the employer concerned
  - (ii) as to the steps the scheme has taken or proposes to take to ensure that the percentage is reduced to 5% or less; and
  - (iii) as to the time when any proposed steps will be taken.

### **Compliance matters**

The paragraphs below set out the disclosures that could normally be included in the compliance statement.

Sch. 3 (15)

#### **Changes in and other matters relating to scheme advisers**

Where there has been a change of Scheme auditor or Scheme actuary, a copy of any Declaration made by the retiring auditor or actuary in accordance with the relevant regulations. This should be referred to and commented upon in the Trustees' Report.

FRS 102 34.48)

### **Report on actuarial liabilities**

A defined benefit plan shall disclose, in a report alongside the financial statements, information regarding the actuarial present value of promised retirement benefits including:

- a) a statement of the actuarial present value of promised retirement benefits, based on the most recent valuation of the scheme;
- b) the date of the most recent valuation of the scheme; and
- c) the significant actuarial assumptions made and the method used to calculate the actuarial present value of promised retirement benefits

### **Actuarial certificates**

Sch 3.6

If Part 3 of the 2004 Act applies, a copy of the certificate by the actuary under section 227 of the 2004 Act (Schedules of Contributions) about the adequacy of the contributions payable to the scheme.

## **Appendix 4 – Annual report disclosure requirements in the Republic of Ireland**

This appendix, which does not form part of the Statement of Recommended Practice, sets out the additional content of the Annual Report required by the legislation in the Republic of Ireland. It does not cover the audit reports or the trustee statement of responsibilities in relation to the financial statements and statement on contributions, which are provided by Practice Note 15(I) The Audit of Occupational Pension Schemes in the Republic of Ireland.

The text in the appendix is cross referenced in the margin to The Occupational Pension Schemes (Disclosure of Information) Regulations 2006 (as amended) for the Republic of Ireland.

The following additional disclosure requirements must accompany the audited accounts.

### **Scheme management**

Sch B (23)

A statement as to whether the relevant scheme is a defined benefit scheme or defined contribution scheme for the purposes of the Act.

Sch B (1a)

The names of the trustees (trustee or directors, if the scheme has corporate trustees) who served during the year and at the date of signing the Annual Report.

Sch B (1b)

Where there is more than one employer participating in the scheme at the end of the scheme year to which the annual report relates a list of such participating employers must be given.

### ***Scheme advisors***

Sch B (2)

The names of each actuary, auditor, investment manager(s), solicitor, bank, custodian and administrator acting for or retained by the trustees during the scheme year (and where different) those retained at the date of signing of the annual report with an indication of any change since the previous year.

### ***Contact for further information***

Sch B (3)

The name or title, and address of the person to where inquiries about the scheme generally or about an individual's entitlement to benefit should be sent.

### ***Scheme membership***

The number of active, deferred, risk only (members in relevant employment where the only benefit under the scheme is death in service benefit) and pensioner members as at any one date during the year. The number of pensioners and deferred pensioner members need not include any member or person in respect of whom an insurance policy has been purchased which has been specifically allocated to the provision of benefits for, and which provides all the benefits payable under the scheme to those members (or other

persons in respect of particular members, or both) and such policies have been excluded from the accounts in accordance with Schedule A. Any material changes in scheme membership details since the previous scheme year should be accompanied by an explanatory note.

### ***Actuarial information***

Details of the measures in any funding proposal, prepared in accordance with Section 49 of the Irish 1990 Act, which relates to the scheme year in respect of which the annual report is being prepared.

### ***Financial developments***

A review by the trustees of the financial development of the scheme during the year as shown by the audited accounts and a statement explaining the latest actuarial funding certificate, funding standard reserve certificate and funding proposal submitted to the Pensions Board (as applicable).

Sch B (7)

Where the accounts of the scheme refer to a significant post year-end item, a statement by the trustees in relation to that item.

Sch B (13)

A statement of material transactions which have occurred at any time during the year with related parties (within the meaning of Financial Reporting Standard 8, “Related Party Disclosures”), irrespective of whether a price was charged.

Sch B (20)

## **Investment management**

The name and address of each person or organisation concerned in the management of the investments of the scheme during the year and the extent of any delegation of this function by the trustees.

Sch B (8)

Whether or not the scheme is bearing the costs of any investment manager and if so the basis on which such investment manager is paid.

Sch B (9)

An investment report containing the latest statement of investment policy principles, a review of the investment performance of the schemes fund during the scheme year and the nature, disposition, marketability, security and valuation of the scheme’s assets plus a statement by the trustees or the individual investment manager, of the principles of investment policy pursued during the year on behalf of the scheme, and any material change in these policies during the year. The investment report should be consistent with the audited accounts.

Sch B (10)

## **Compliance matters**

The paragraphs below set out the disclosures that could normally be included in the compliance section of the trustees report.

### ***Internal Dispute Resolution***

Sch B (18)

An explanation of the internal dispute resolution mechanism if this is not included in the scheme booklet (Sch B (18)).

### ***Contributions***

Sch B (16)

A statement by the trustees that they have appropriate systems in place to ensure that contributions payable are received in line with legislative requirements (section 58A of the Act) as applicable or otherwise within 30 days of the end of the scheme year and that contributions payable have been paid in accordance with the rules of the scheme and the recommendations of the actuary if appropriate.

### ***Pension increases***

Sch B (6)

A statement must be made detailing whether or not increases were made during the year to pensions in payment and deferred pensions, the percentage of such increases, whether any increases were discretionary, the extent to which the increases were discretionary and by whom the discretion was exercised. If there have been different increases for different individuals or groups of individuals, the average percentage increase or the range of increases within these groups must be disclosed. In addition there should be a statement detailing whether there were pensions or pension increases being paid by or at the request of the trustees for which the scheme would not have a liability in the event of its winding up and whether the persons concerned have been notified in writing by or at the request of the trustees.

### ***Trustees***

A statement confirming that the trustees and, if applicable, the administrator, have access to:

- the Trustee handbook produced by the Pensions Board; and
- the Guidance Notes issues by the Pensions Board from time to time

Sch B (12)

A statement as to whether the trustees have access to appropriate training on their duties and responsibilities as trustees, a statement as to whether in the case of a scheme established by trust, the trustees have received training as required by section 59AA (inserted by Section 28 of the Social Welfare and Pensions Act 2008 (No. 2 of 2008)) of the Act and a statement of any costs and expenses incurred in relation to trustee training in the scheme year which have been met out of the resources of the scheme.

Sch B (11)

A statement that the right of members to select or approve the selection of trustees to the scheme is set out in the Occupational Pension Schemes (Member Participation in the Selection of Persons for Appointment as Trustees) (No. 3) Regulations, 1994 (SI 1994/376), where a scheme is a relevant scheme as defined in those Regulations (applicable for schemes of 50 member or more)

### ***Basic Scheme information***

Sch B (4)

Where any changes have been made since the previous scheme year in the basic information about the scheme a statement that a change has been made and that the members concerned have been notified in accordance with article 11(4).

Sch B (14)

A statement that the scheme has been registered with the Pensions Board and the registration number.

### ***Risk statements***

Sch B (17)

Unless already disclosed, an analysis of the financial, technical and other risks faced by the pension scheme and the nature and distribution of these risks (SCH B (17)). In the case of defined benefit schemes an additional Risk Statement substantially in the form set out in Schedule M must be included.

Sch B (25)

A statement substantially in the form of Statement M of the Irish Disclosure Regulations which may only be modified if the trustees are of the reasonable opinion that any part of the statement could not apply to the scheme or that the modifications will better explain the nature and effect of the matters referred to in the statement.

### ***Sovereign Annuity statement***

Where on the last day of the scheme year to which an annual report relates, the actuary to the scheme is valuing all or any pensions in payment under the scheme on the basis outlined in the guidance issued by the Board in relation to Section 42 of the Irish 1990 Act, a statement substantially in the form set out in Schedule N to the Irish Disclosure Regulations.

### **Actuarial certificates**

Sch B (21)

A copy of the latest actuarial funding certificate (if any) and the latest Funding Standard Reserve Certificate (if any) prepared under section 42 of the Irish 1990 Act.

### **Valuation Report for Defined Contributions**

AA 7 (S)

A copy of the valuation report prepared in accordance with article 6(6) in relation to that year.

## **Appendix 5 – Note on legal requirements in the UK**

Section 41 of the Pensions Act 1995 enables regulations to be made to require trustees (or managers) of occupational pension schemes to obtain and make available copies of certain prescribed documents. The prescribed documents include:

- audited accounts; and
- the auditor's statement about contributions under the scheme.

The Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996 (SI 1996/1975) impose requirements under section 41 referred to above as follows:

Regulation 2 requires that the trustees or managers of an occupational pension scheme (other than those to whom the requirement of section 47(1)(a) of the Pensions Act 1995 to appoint an auditor does not apply) shall obtain, not more than seven months after the end of each scheme year, audited accounts for that scheme year prepared in accordance with regulation 3, together with the auditor's statement about contributions under the scheme, prepared in accordance with regulation 4.

Regulation 2 also provides that the requirement to obtain audited accounts does not apply to earmarked schemes. An ear-marked scheme is an occupational pension scheme under which all the benefits other than death benefits are money purchase benefits and all the benefits are secured by one or more policies of insurance or annuity contracts and such policies or contracts are specifically allocated to the provision of benefits for individual members or any other person who has a right to benefits under the scheme. However, the requirements to obtain an auditor's statement about contributions under the scheme and to produce an Annual Report do apply. The trustees on receiving a request from persons specified in section 41(4) of the Pensions Act 1995 (including members and spouses of members) shall:

- make available a copy of the most recent accounts published in relation to the insurance companies (whether as part of a group of companies or otherwise) with which they hold earmarked policies of insurance or annuity contracts in relation to that person; and
- make that information available to the person who requested it within a reasonable time of receiving the request.

The trustees shall also provide each member within 12 months of the end of each scheme year with a statement detailing the amount of contributions credited to the member during that scheme year.

Where the trustees or managers fail to obtain accounts audited by the auditor or the auditor's statement about contributions under the scheme, and there is no reasonable excuse for the failure to do so, Regulation 2 provides that they shall be liable to pay to the Pensions Regulator (TPR), within 28 days from the date of its imposition, a penalty not exceeding £5,000 in the case of an individual trustee and £50,000 in any other case.

Regulation 3 provides that the audited accounts shall contain the information specified in the Schedule to the Regulations and shall show a true and fair view of the financial transactions of the scheme during the scheme year and of the amount and disposition of the assets at the end of the scheme year, and of the liabilities of the scheme, other than liabilities to pay pensions and benefits after the end of the scheme year. Regulation 3 also requires the audited accounts to include a report by the auditor indicating whether, in the auditor's opinion, the accounts contain the required information and show a true and fair view.

Regulation 4 provides that the auditor's statement about contributions under the scheme should indicate whether, in the auditor's opinion, contributions have been paid in all material respects at least in accordance with the schedule of contributions or payment schedule. If the auditor's report is negative or qualified, reasons must be given for the qualification. If there is no schedule in place during the whole or part of the scheme year, the auditor's statement must state whether or not in his opinion contributions payable to the scheme during the year have been paid in accordance with the scheme rules or contracts under which they were payable, and, where appropriate, with the recommendation of the actuary.

The Schedule to the Regulations sets out more detailed requirements for the contents of the accounts referred to in regulation 3 which are reflected in the SORP. The Schedule also includes a requirement for a statement as to whether the accounts have been prepared in accordance with the guidelines set out in the current SORP at the end of the scheme year to which the accounts relate. The statement should indicate any material departures from those guidelines. Those guidelines are set out in section 2 "Recommended Accounting Practice" of the SORP.

## **Schemes required to obtain audited accounts**

Regulations 3(1)(a) to (o) of The Occupational Pension Schemes (Scheme Administration) Regulations 1996 (SI 1996/1715) set out a number of categories of schemes to which the requirement of section 47(1)(a) of the Pensions Act 1995 to appoint an auditor does not apply and which are therefore not required to produce audited accounts under the regulations referred to in (a) above.

In these circumstances accounts which are intended to show a true and fair view are only required if audited accounts are still required under the scheme rules.

The categories of schemes exempted include, among others, the following schemes:

- Occupational pension schemes which (within the meaning of the relevant tax legislation) provide 'relevant benefits' and on or after 6 April 2006 are not 'registered schemes' unless there are 100 or more members, (see paragraph 4 below);
- Occupational pension schemes provided for, or under an enactment (including a local Act), and guaranteed by a Minister of the Crown or other public authority;
- Unfunded occupational pension schemes; and
- Occupational pension schemes with less than 2 members.

- Occupational pension schemes with a superannuation fund such as is mentioned in section 615(6) of the Income & Corporation Taxes Act 1988, unless there are 100 or more members (see paragraph 4 below).

Both defined contribution and defined benefit schemes which meet the following criteria:

- the scheme must have less than 12 members; and
- all members must be trustees (or trustee directors); and either
- the provisions of the scheme provide that all decisions which fall to be made by the trustees are made by unanimous agreement by the trustees who are members of the scheme; or
- the scheme has an independent trustee who is on the approved list maintained by The Pensions Regulator.

The Occupational Pension Schemes (Scheme Administration) Regulations 1996 (SI 1996/1715) were amended by The Occupational Pension Schemes (Administration and Audited Accounts) (Amendment) Regulations 2005 (SI 2005/2426) which introduced the requirement for an audit for certain schemes with 100 or more members as referred to in paragraph 3(g) above.

## **Disclosure requirements**

The Occupational Pension Schemes (Disclosure of Information) Regulations 2013 (SI 2013/2734) (the Disclosure Regulations) impose disclosure requirements. The relevant regulations are as follows:

Regulation 12 provides that not more than seven months after the end of each scheme year, the trustees must make available a document which contains:

- a copy of the appropriate audited accounts or auditor's statement for the scheme year (see paragraph 3(a) above);
- a copy of the latest certificate of the actuary relating to the Schedule of Contributions as to the adequacy of the contributions payable to the scheme; and
- further information specified in Schedule 3 part 5 to the Disclosure Regulations, which applies to the scheme.

Regulation 12 also sets out the terms on which copies of the document are made available and to whom they should be made available. Such persons are members, prospective members, spouses and civil partners, beneficiaries and trade unions recognised for collective bargaining purposes.

Schedule 3 requires a broad range of specific items of information to be made available, including an investment report if the scheme is required to produce a Statement of Investment Principles under section 35 of the 1995 Act. The requirements are summarised in Appendix 3 of this document, with references to Schedule 3 of the Regulations appearing in the margin of the text in those appendices.

## **Appendix 6 – Note on legal requirements in the Republic of Ireland**

This appendix, which does not form part of the Statement of Recommended Practice, provides information on legal requirements in the Republic of Ireland relating to the disclosure of financial and other information by pension schemes. The body of this document also provides reference to the requirements in the Republic of Ireland.

Section 54 of the Pensions Act, 1990 (“the Irish 1990 Act”) provides that the Minister may make regulations relative to information to be furnished by the trustees of the scheme to members of schemes and others and penalties for failure to meet these requirements.

### **Requirements to obtain audited financial statements**

The relevant regulations are as follows: Section 56 of the Irish 1990 Act sets out the requirements for certain schemes to prepare audited financial statements, actuarial valuations and liability valuation reports with exemptions for certain types of schemes (unfunded schemes, death benefit only schemes, one member arrangements, small schemes in wind up and small schemes which are frozen (members no longer accruing benefits since 1 January 1997). See below for definition of a small scheme.

The Occupational Pension Schemes (Disclosure of Information) Regulations, 2006 (as amended) (SI 2006/301) (“the Irish Disclosure Regulations”) set out requirements in relation to the disclosure of financial and other information for pension schemes. Under the Disclosure Regulations, trustees of schemes are responsible, subject to exemptions referred to below, for preparing annual accounts and the auditor is responsible for auditing the annual accounts. The Disclosure Requirements require that audited accounts and the auditor’s report on the accounts shall be made available by the trustees of the scheme, not later than nine months after the end of the scheme year to which it relates or such later date as may be approved by the Pensions Board, to persons specified in the Disclosure Regulations.

### **Requirement to prepare the Annual Report and required communications**

Article 7 of the Disclosure Regulations provides for the preparation of an Annual Report of the scheme as soon as reasonably practicable after the end of the scheme year. The Article also sets out the terms on which copies are to be made available and to whom they should be made available. A copy of the Annual Report, signed and dated by the trustees (or one Trustee if there is only one Trustee), must be made available by the trustee(s) not later than nine months after the scheme year to which it relates or such later date as may be approved by the Board. The Annual Report must contain the following:

- A copy of the audited accounts;
- A copy of the auditor’s report on accounts *and where the auditor’s report is qualified, a statement by the trustees of whether the matter has been resolved;*

- A copy of the latest Actuarial Funding Certificate, Funding Standard Reserve Certificate, the Annual Statement from the actuary, details of measures proposed in any funding proposal which relate to the scheme year (as applicable);
- A copy of the Valuation Report for Defined Contribution schemes; and
- Further information as specified in Schedule B (see Appendix 4).

Article 9 of the Irish Disclosure Regulations details when the reports should be made available by the trustees to relevant persons (members/prospective members of the scheme and their spouses, persons within the application of the scheme of the scheme qualifying or prospectively qualifying for its benefits or an authorised trade union) A copy of the report shall be furnished free of charge to an authorised trade union no later than nine months from the scheme year end (or such later date as may be approved by the Board) and on request to any relevant persons within four weeks of the request being made.

### **Disclosure requirements**

Article 5 and Schedule A of the Irish Disclosure Regulations provide that the audited accounts shall include the information specified in Schedule A which is applicable and material to the relevant scheme.

- a) Schedule A of the Disclosure Regulations states that the following items should be excluded from the assets and liabilities of the scheme at the end of the scheme year:
  - i) Insurance policies which have been purchased which fully match the pension obligations of the scheme in respect of specific members or other persons and for this section 53B policies shall be capable of matching a pension obligation;
  - ii) Liabilities to pay pensions in the future; and
  - iii) Additional voluntary contributions, if any, under the scheme which are separately invested.

Where additional voluntary contributions are separately invested in the form of a defined contribution scheme they should be disclosed separately from the main assets of the scheme but accounted for within the accounts of the scheme and notes thereto.

The notes thereto should, other than in the case of a scheme the resources of which are invested wholly in managed funds, include a statement of the distribution of the investments of the scheme detailing, where appropriate, particulars of any self investment of the resources of the scheme at any time during the scheme year or concentration of investment in excess of 5 per cent of the resources of the scheme at the scheme year end.

Where Section 53B policies have been purchased, the notes to the accounts shall include a statement of the value of the pensions obligations of the scheme which are matched by Section 53B policies and, where there has been a reduction in payments under any

Section 53B policies held by the scheme, a statement detailing particulars of that reduction.

- b) Schedule A of the Disclosure Regulations also contains at paragraph 5 an important requirement for a statement as to whether the accounts have been prepared in accordance with the SORP current at the end of the scheme year to which accounts relate. The statement should indicate any material departures from the SORP.
- c) Schedule B of the Disclosure Regulations details information which is to accompany the audited accounts including actuarial information. The Schedule requires specific items of information including an investment report.
- d) Schedule M of the Disclosure Regulations details prescribed wording of a Risk Statement for defined benefit schemes to be included in the audited accounts or to accompany the audited accounts.
- e) Schedule N of the Disclosure Regulations details wording to be included in the audited accounts or to accompany the audited accounts when on the last day of the scheme year the actuary is valuing all or any pensions in payment under the scheme on the basis of securing pensions in payment by the purchasing of Section 53B policies.

### **Audit opinion**

Article 5 (para 4) details that the auditor's report on the accounts is required to state whether, in the opinion of the auditor, the requirements of Schedule A are satisfied, the accounts show a true and fair view of the financial transactions of the scheme for the scheme year and of the amount and disposition of the assets and liabilities (other than liabilities to pay pensions and other benefits in the future) at the end of the scheme year. In addition, the auditor's report shall state that in the opinion of the auditor, the contributions payable to the scheme during the year, have been received by the trustees within 30 days of the end of the scheme year and that, in their opinion, such contributions have been paid in accordance with the rules of the scheme, and if appropriate, with the recommendations of the scheme actuary. If the auditor's report is qualified, reasons for the qualification must be given.

### **Valuation reports**

Article 6 of the Disclosure Regulations sets out requirements in relation to the preparation and timing of Valuation Reports. Actuarial Valuation report guidelines are detailed for defined benefit schemes and Liability Valuation Report guidelines are detailed for defined contribution schemes.

### **Exemptions from audit**

Article 8 of the Disclosure Regulations contains exemptions for certain schemes. Small schemes (those which had less than 100 members entitled to but not receiving retirement benefit) shall, in place of the full requirements for audited accounts and reports, have the option of issuing an alternative Annual Report, which must be prepared by a qualified auditor or, where some or all of the benefits are secured under contracts of assurance with one or more life assurance companies, by a person designated by that company/ies. This important exemption for schemes applies to “small schemes”, as defined by the regulations. The recommendations of the SORP do not apply to alternative Annual Reports, however the principles applied in valuing investments should be in line with the recommendations of the SORP.

## **Appendix 7 – Detailed investment disclosures required by the Audited Accounts Regulations**

**PRAG is liaising with the DWP with the objective of removing the prescriptive disclosure of investment classifications required by the Audited Accounts Regulation. Therefore, at present, the following should be considered part of the SORP.**

The Schedule to the Audited Accounts Regulations require the following disclosure:

- equities – disclose between quoted UK and quoted overseas and unquoted UK and unquoted overseas;
- bonds – disclose between fixed interest public sector UK and fixed interest public sector overseas; fixed interest other UK and fixed interest other overseas; and between index linked UK and index linked overseas;
- property – disclose between UK and overseas;
- pooled investment vehicles – disclose between:
  - unit trusts property UK and unit trusts property overseas;
  - managed funds property UK and managed funds property overseas;
  - unit trusts other UK and unit trusts other overseas;
  - managed funds other UK and managed funds other overseas;
- pooled investment vehicles - disclose where the company operating the vehicle is a company registered in the United Kingdom and those where it is not;
- insurance policies – disclose between UK and overseas;
- loans – disclose between UK and overseas; and
- cash deposit and cash in hand – disclose between UK and overseas; and
- other investments – disclose between UK and overseas.

In relation to the disclosure of investments between UK and overseas this will generally be by reference to the currency in which the investments held are denominated. However, trustees may regard investments as ‘overseas’ where the unit of investment is denominated in sterling but the underlying exposures are in currencies other than sterling and may wish the above disclosures to be based on this or some other appropriate perspective. This SORP regards either approach as acceptable and recommends a note should be included to explain the approach adopted.

**STATEMENT OF RECOMMENDED PRACTICE**  
*Financial Reports of Pension Schemes*

Quoted means listed on or traded on a recognised investment exchange. It is recognised that some securities have multiple listings and that the United Kingdom or overseas nature of a security may not be straightforward. The country of issue of a quoted investment will normally be determined by what the investee entity regards as its primary listing but the trustees, with advice from their investment manager, may need to make judgements as to the intent of holding such securities when preparing this UK versus overseas analysis.

‘Public sector’ securities include those issued by national, regional or local government organisations. “Other” securities include those issued by international and supra-national non-private sector organisations, as well as those issued by private sector corporations.

## **Index**

To be completed on finalisation of the SORP.