The Future of Financial Reporting: NAPF Response to ASB Financial Reporting Exposure Drafts (FREDs) 46-48

National Association of Pension Funds

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The Future of Financial Reporting:
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Summary

- We welcome the Accounting Standards Board's project to simplify and consolidate the framework for financial reporting in the UK and the Republic of Ireland. We also welcome two important decisions by the ASB on pension scheme accounting: not to go ahead with its earlier proposals to require 'publicly accountable' entities to prepare accounts under EU-adopted International Financial Reporting Standards (IFRSs); and to resist pressures to require pension schemes to account for the scheme sponsor's pension obligation in their own financial statements.

- Our response focuses on new disclosure proposals for pension schemes that would involve considerable expense for a number of larger schemes without contributing to the objectives of pension scheme accounts, and which in many respects would be counterproductive. We believe that including pension schemes within the definition of 'financial institution' is incorrect, particularly as this appears to be the basis for requiring pension schemes to make the same disclosures as banks and other financial institutions, with additional disclosures on top. Treating pension schemes like other financial institutions for the purposes of disclosures fails to recognise their very different nature (as reflected in their different legislative regime) and the very different purpose for which their financial statements are prepared.

- We recommend that pension schemes be removed from the category of financial institutions and that the Pensions Statement of Recommended Practice (SORP) specify what additional disclosures, if any, are appropriate for pension schemes.

1 About the NAPF

The National Association of Pension Funds (NAPF) is the leading voice of workplace pensions in the UK. We speak for 1,200 pension schemes with some 15 million members and assets of around £800 billion. NAPF members also include over 400 businesses providing essential services to the pensions sector. Our members are interested in the future of financial reporting in the UK on a number of accounts:

- our members are interested as major investors, advisers and investment managers, in the usefulness of the financial statements of the companies in which they invest;

- they are also interested in financial statements that provide a realistic view of employers' pensions obligations and do not discourage the provision of good quality pensions;

- our pension scheme members are interested, as institutions responsible for the pensions of millions of workers, in a framework for scheme accounting that meets the needs of trustees and scheme beneficiaries – current employees, deferred members and pensioners; and

- in the case of defined benefit schemes, the audited net asset value in the scheme accounts is a primary input into the triennial actuarial valuation, which in turn has a direct influence on future contribution rates and the management of the scheme.

2 Scope of response and general considerations

2.1 We welcome the Accounting Standards Board's project to simplify and consolidate the framework for financial reporting in the UK and the Republic of Ireland. We also welcome two important decisions by the ASB on pension scheme accounting:

- firstly, the ASB's decision not to go ahead with its earlier proposals to require 'publicly accountable' entities to prepare accounts under EU-adopted International Financial Reporting Standards (IFRSs), which would have obliged pension schemes to disclose their derivative exposures in line with the requirements of IFRS 7 'Financial Instruments: Disclosures'; and

- secondly, the ASB's decision to resist pressures to require pension schemes to account for the scheme sponsor's pension obligation in their own financial statements; we explain in our response to Question 6 why it would be incorrect for them to do so.

2.2 Our response focuses on the impact of the proposals set out in FREDs 46-48 on pension scheme accounting, particularly the disclosure requirements set out in paragraphs 34.17-34.40 of FRED 48. The proposed disclosure requirements will involve considerable expense for a number of larger pension schemes. We do not feel that the ASB has provided a justification for the proposed disclosures, nor even an explanation of the purpose that they are intended to serve. We feel that the proposed disclosures will not contribute to meeting the needs of trustees and scheme beneficiaries and that their complexity and focus on investment analysis will be counterproductive.

3 Answers to specific questions

3.1 *Q4: Do you agree with the definition of a financial institution? If not, please provide your reasons and suggest how the definition might be improved.*

3.1.1 We do not agree with the inclusion of 'retirement benefit plans' within the definition of 'financial institution', particularly as this appears to be the basis for requiring pension schemes to make the same disclosures as banks and other financial institutions, with additional disclosures on top. In our view the financial institution disclosures set out in paragraphs 34.17-34.40 will not assist trustees in the running of pension schemes. From the point of view of members, these disclosures will shift the centre of gravity of accounts away from pension provision and scheme stewardship towards investment analysis. We believe that members will find this unhelpful and confusing. In any case, for defined benefit members, investment risk is irrelevant compared to the risk that the sponsor and guarantor of their scheme will fail. For defined contribution members, investment risk is relevant, but any communication with members on the subject should be tailored to members' individual holdings and simplified; scheme-level risk disclosures based on accounting standards will be at best unhelpful and at worst misleading.

3.1.2 Pension schemes are major investors in the financial markets but in other respects they are very different to other financial institutions. In the UK, pension schemes are set up under trust with the sole purpose of providing for their members' retirement benefits. They are subject to their own legislative and regulatory framework, based on the Pensions Acts and separate from the framework for other financial institutions, and they have their own regulator, the Pensions Regulator (tPR). In view of their different purpose and the different legislative framework to which they are subject, financial reporting requirements directed at the needs of the users of the accounts of other financial institutions are not appropriate for pension schemes.

3.1.3 Scheme accounts are essentially stewardship accounts, directed primarily at providing an assurance to beneficiaries and their advisers about the assets under the trustees' control. They are not intended to provide a wide range of users with a basis for economic decisions. Funding decisions by the trustees and the sponsor are made on the basis of actuarial valuations; investment decisions are taken on the basis of investment reports and other reports prepared by the scheme's advisers; while shareholders and creditors of the sponsor will look to the sponsor's accounts for the impact of the pension scheme on the sponsor's financial position. The additional disclosures are therefore likely to serve only to make the financial statements more complex, more costly to prepare and less useful to those for whom they are intended.

3.1.4 Furthermore, inclusion of pension schemes in the financial institution category will have the consequence that if the accounting standard changes in such a way as to require financial institutions generally to make additional or altered disclosures, the same disclosures will automatically apply to pension schemes, however inappropriate they may be.

3.1.5 Additional costs for schemes and complexity for users need to be justified in terms of other benefits. We do not feel that the ASB has done this. We note the ASB envisages that there will continue to be a Statement of Recommended Practice (SORP) dealing with the financial reports of pension schemes, to assist with the interpretation and application of FRS 102. One way of dealing with the above difficulties would be to remove pension schemes from the financial institutions category, and then allow the SORP to specify what additional disclosures, if any, are appropriate for pension schemes. This would also have the benefit of allowing pension scheme disclosures to be altered in response to changed pensions or actuarial regulation without having to alter FRS 102.

3.2 ***Q6: The ASB is requesting comment on the proposals for the financial statements of retirement benefit plans, including:***

- ***Do you consider that the proposals provide sufficient guidance?***
- ***Do you agree with the proposed disclosures about the liability to pay pensions benefits?***

3.2.1 Our comments in section 3.1 should not be interpreted as being concerns about FRED 48 giving insufficient guidance on implementation. The proposed disclosure requirements set out in paragraphs 34.17-34.40 are reasonably clear, but in our view should simply not apply to pension schemes.

3.2.2 We feel that the impact of the proposed requirements to disclose actuarial information (for example actuarial information prepared for statutory valuations) whether as part of, or alongside, the financial statements is unclear. Much of this information is already available to those who need it. A requirement to include it with the financial statements raises questions about whether it would come within the scope of the audit and, if so, on what basis the auditor would be expected to form an opinion on reports prepared by qualified advisers according to actuarial rather than financial reporting standards. Paragraphs 34.37 and 34.43-34.45 are open to several interpretations on this point, and we feel that this is another area that would be best left to the SORP, or left out altogether, especially in view of the fact that regulations already require publication of the relevant items.

3.2.3 We welcome the ASB's decision to resist pressures to require pension schemes to account for the scheme sponsor's pension obligation in their own financial statements. In defined benefit schemes the obligation to pay pensions is an obligation on the employer (the scheme sponsor), not on the scheme, although the trustees have a role, defined by law, in seeking adequate funding for the pension promise. It would therefore not be a reflection of reality to require the scheme to account for the pension obligation in its own financial statements.