Summary

- The Financial Reporting Standard 102 was introduced in January 2015 and caused major upheaval in pensions accounting.
- FRS 102 is a single accounting standard that replaces all previous UK GAAP texts. DB sponsors are expected to report an increased P&L charge as they move from reporting an expected return on assets to presenting their net interest cost.
- Sponsor pension disclosures are expected to be shorter and the asset-ceiling restriction could be less restrictive.
- The IASB is currently conducting a review into employee benefits. The board is currently running two research projects. The first looks at pensions accounting, while the second examines discount rates across the whole of IFRS. The main sticking point under IFRS is that the IAS 19 projected unit credit measurement approach struggles to cope with plans that are neither pure DB nor pure DC.
- Since the last update to the SORP in 2007, not only has the FRC introduced FRS 102, but the government has also made a number of legislative and regulatory changes.
- One issue to emerge earlier last year following the introduction of the new accounting framework was the concern that the pricing hierarchy in FRS 102 differs from IFRS hierarchy. Experts warned this throws up challenges when schemes come to agree reporting formats with investment managers and custodians.

Revolution and evolution

Pension schemes and their sponsors faced major accounting challenges with the introduction of FRS 102 during 2015. Yet the frantic pace of change on the accounting and regulatory fronts is set to continue during 2016, Stephen Bouvier writes

The big bang in UK financial reporting was the introduction from 1 January 2015 of Financial Reporting Standard 102. And nowhere was the upheaval more apparent than in pensions accounting, where preparers looking after both defined benefit and defined contribution pension schemes have had to reckon not only with the new accounting regime, but also wider regulatory and, indeed, international developments.

By way of a recap, FRS 102 is a single accounting standard that replaces all previous UK GAAP texts. In essence, it is a localised version of the International Accounting Standards Board's IFRS for SMEs. And one year on from the introduction of FRS 102, many UK businesses are now in the process of publishing their first set of full-year accounts under the new reporting regime.

As for its impact on the bottom line, Towers Watson senior consultant Andrew Mandley says he expects to see DB sponsors report an increased P&L charge as they move from reporting an expected return on assets to presenting their net interest cost.

"Although in the past groups might have been able to take advantage of the exemption in FRS 17 that allowed all employers to account for pensions purely on a cash basis," he explains "in future at least one employer will need to fully recognise pension costs and liabilities in their accounts."

He continues: "Given that many UK schemes still have a relatively high investment in higher-return assets, the move to the new FRS 102 approach will often mean a lower effective return on assets and so a higher P&L charge." But, he adds, on the plus side, those same scheme sponsors should find their pension disclosures are shorter and that the asset-ceiling restriction could be less restrictive.

Beginning of the journey

But despite the massive upheaval in UK financial reporting, the evolution in pensions accounting has only just

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started. When the IASB published its 2011 revisions to IAS 19, it was clear that the revised standard would remain in place only for as long as it took the board to complete a fundamental review of employee benefits. That review is now in full swing.

The board is currently running two research projects. The first looks at pensions accounting, while the second examines discount rates across the whole of IFRS. The main sticking point under IFRS is that the IAS 19 projected unit credit measurement approach struggles to cope with plans that are neither pure DB nor pure DC. Back in 2008, the IASB was forced to abandon a discussion paper that attempted to develop a new form of fair-value measurement for pensions.

"They are both very slow-burn, long-term projects and they are both not going to change pensions accounting in the next year or two," Aon Hewitt consultant actuary Martin Lowes notes.

"What does come out of the preliminary research that we have seen so far, however, is that although we think of pensions as being mark-to-market, it is mark-to-market in a way that is different to anything else that is mark-to-market."

Meanwhile, Mercer UK's head of pensions accounting Warren Singer agrees the project is long-term. "I have no feel for where it is going to go next other than it's going to get there slowly. The discount rate and pensions research projects have been around for so long that it feels that ultimately they are going to have to look at it properly.

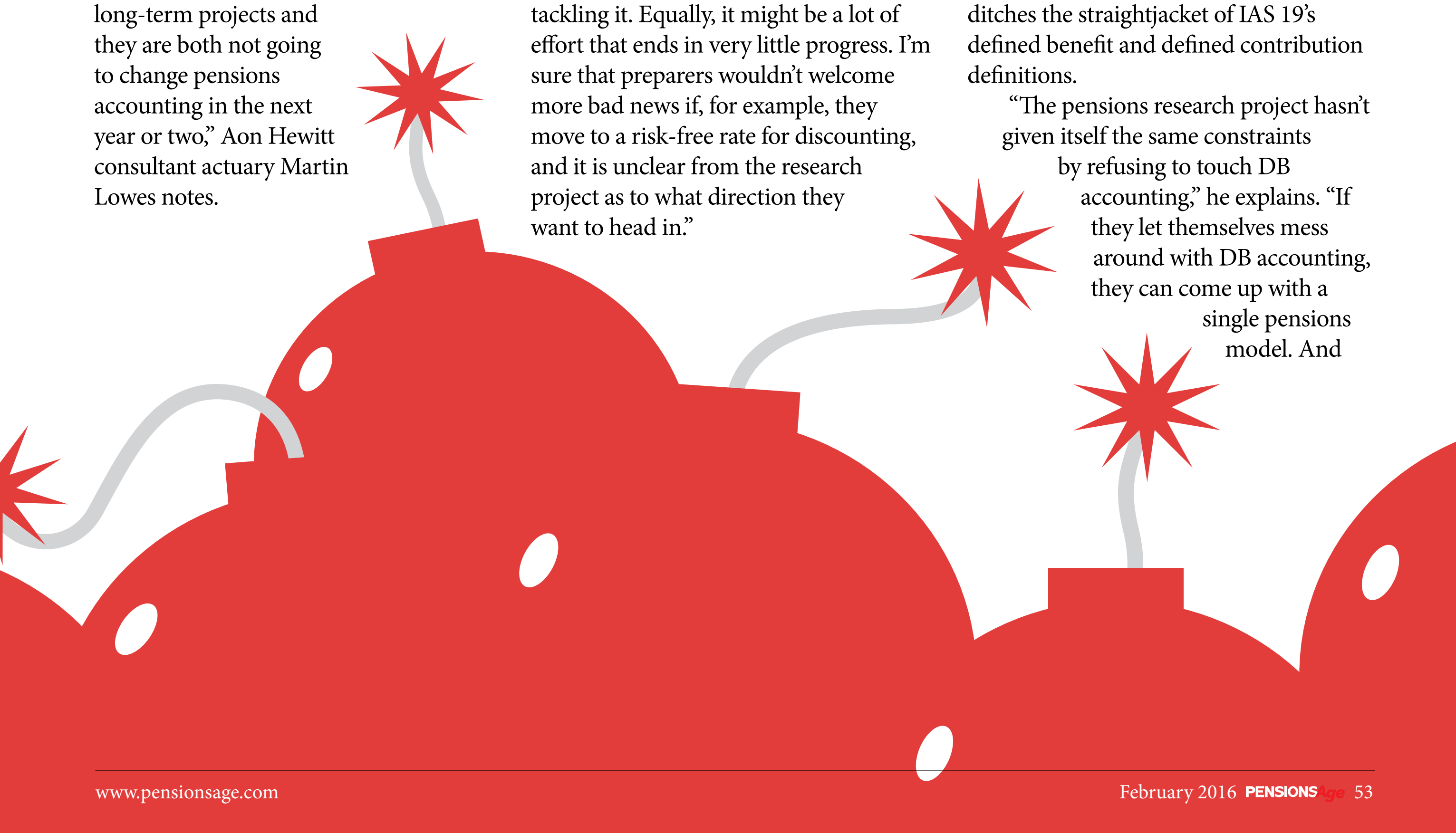
"Coming up with a coherent conceptual measurement basis would allow them to have a good crack at tackling it. Equally, it might be a lot of effort that ends in very little progress. I'm sure that preparers wouldn't welcome more bad news if, for example, they move to a risk-free rate for discounting, and it is unclear from the research project as to what direction they want to head in."

"You can see that there is only one place where you have a AA corporate bond rate and that is pensions accounting. That is both an anomaly and food for thought"

Projects

But priorities aside, Lowes is nonetheless hopeful that the IASB will be able to develop a new pensions-measurement model – but only if it avoids the trap its 2008 discussion paper fell into and ditches the straightjacket of IAS 19's defined benefit and defined contribution definitions.

"The pensions research project hasn't given itself the same constraints by refusing to touch DB accounting," he explains. "If they let themselves mess around with DB accounting, they can come up with a single pensions model. And



"If (the IASB) let themselves mess around with DB accounting, they can come up with a single pensions model"

if you want to allow for credit risk, you need to do it on an entity-specific bond rate rather than using an arbitrary rate.

"DC has no credit risk and DB assumes the risk from a fairly arbitrary point using a AA corporate bond rate. If you look at the board's preliminary discount-rate research paper, it is not trying to come up with the 'right' answer, but rather seeing how different IFRSs approach it.

"You can see that there is only one place where you have a AA corporate bond rate and that is pensions accounting. That is both an anomaly and food for thought. Long-term that thinking is going to go somewhere, but it is a question of priorities measured against more burning issues."

But wherever those projects lead, there are also major accounting changes in store for UK pensions schemes and not just the businesses that sponsor them. In common with their sponsors, UK schemes have, in recent years, had to navigate a series of complex changes not only to the accounting framework, but also to pensions legislation and the regulatory framework.

Again, it is FRS 102 that specifies their accounting requirements, together with a Statement of Recommended Practice. The FRC delegates responsibility for developing and maintaining the SORP to the Pensions Research Accountants Group, a private sector export body.

Since the last update to the SORP in 2007, not only has the FRC introduced FRS 102, but the government has also made a number of legislative and regulatory changes. For example, the UK pensions landscape has witnessed the introduction of auto-enrolment as well as a growing number of pension schemes entering the Pension Protection Fund.

Pricing hierarchy

One issue to emerge earlier last year following the introduction of the new accounting framework was the concern that the pricing hierarchy in FRS 102 differs from IFRS hierarchy. Experts warned this throws up challenges when schemes come to agree reporting formats with investment managers and custodians – especially where the schemes report under FRS 102 and IFRS.

In a bid to address the concerns, the FRC issued FRED 62 on 4 November 2015. Separately, the DWP launched a consultation on aligning the disclosure framework in the Occupational Pension Scheme Regulations with FRS 102 and the pensions SORP. That process closed on 11 December, and pension schemes must now wait and see whether both the DWP and the FRC finalise their work before the schemes have to publish their accounts in July.

"Inevitably it will take time from the end of the consultation period to issue the final changes," Lowes states. "It would be helpful if the FRC could signal as soon as possible after the end of the consultation period that they plan to proceed broadly as detailed in the ED. People will be starting work on the asset disclosures and they need reassurance that they can concentrate on the proposed asset splits aligned with IAS 19."

Written by Stephen Bouvier, a freelance journalist