New accounting disclosures focus on risk

Market insights on how to deal with the latest IAS19

An amended standard for pensions reporting in corporate accounting, IAS19 Employee Benefits, was published in June 2011 and is effective for financial periods beginning on or after 1 January 2013. This is significant as the amendments include important changes to disclosure requirements for pensions. In particular, the new requirements move away from a checklist approach to a more principles-based approach with an emphasis on risk.

Your management will need to invest time and use their judgment in deciding what to include and how much detail to provide in future formal accounts. You'll also need to collect additional information about any overseas entities in order to comply.

Understanding the potential impact for you

Apart from the need to comply with the new requirements, the amended standard gives companies the opportunity to demonstrate the measures that they're taking to manage pensions risk and so presents an opportunity to improve investor perceptions. Not doing so may lead investors to draw the wrong conclusions.

Getting your timescales right

The revised IAS19 is effective for financial periods beginning on or after 1 January 2013. We recommend that you start considering how your internal reporting processes and timetable will need to be adjusted for the additional information required. You'll also need to think about how you approach the questions on risk so you're fully prepared when the amendments become effective. This could be particularly important if pensions represent a considerable risk for your business or if you're a multinational company with pensions obligations in a number of different territories. Tools such as Skyval (see page 6) can help generate some of the new information required.

Meeting the new disclosure objectives

Three new disclosure objectives must be met:

1. Explain the characteristics of, and risks associated with, the entity's defined benefit (DB) plans.
2. Identify and explain the amounts in the entity's financial statements arising from its DB plans.
3. Explain how the DB plans may affect the entity's future cash flows regarding timing, amount and uncertainty.

We look at these objectives further below. We've also included insights from analysts on the kind of information they value and their expectations under these three objectives. The challenge is how to present information clearly and concisely, but with a coherent message that can be easily understood by readers of the accounts.

Knowing which items to include

There's no exhaustive list of which items you should include. Much of the current financial information is still required, such as reconciliations of assets and liabilities. But the revised IAS19 also requires companies to disclose any additional information needed to satisfy the three objectives. The additional items or explanation will depend heavily on your individual circumstances and we expect to see a wide variation in the level of content provided.

There's potential to reduce the volume of disclosures by taking out some of the less informative elements and some information that is no longer needed. Unrecognised gains/losses are no longer relevant. Explicit breakdown between funded and unfunded plans, the five-year history of assets and medical trend cost rates (if they're not material) are also no longer required.

Objective 1 - Characteristics/risks of my plans

In the table below, we've set out the items which the new standard requires you to disclose.

Requirement of standard	Example/considerations
Nature of plan	Type of DB plan, e.g. final salary, career average, cash balance, with brief description of how ultimate benefits are determined.
Any other entity responsible for the governance of the plan	For example, plan trustees or supervisory board.
Description of the regulatory framework and its impact on the plan	For a UK plan, details of the recovery plan and its impact (if any) on the asset ceiling.
Description of the risks the plan exposes the company to, focusing on any unusual or highly concentrated risks	Table with description of the important common risks, e.g. interest rate, price inflation, longevity, salary inflation, investment. Any plan/entity-specific risks for those plans which are material to the group – see examples below.
Descriptions of any special events, such as curtailments, settlements, etc	Opportunity to describe any actions taken to reduce or manage pensions risk, e.g. benefit changes, member incentive exercises, buy-out, longevity hedging.

Examples of highly concentrated risks:

- Significant asset holding in equities of one country or industry type.
- Significant holding in property, especially where the plan is small and the holding constitutes a single commercial property.

Examples of unusual plan/entity-specific risks:

- Uncertainties over the contractual obligation to benefits which have not yet been resolved.
- Significant risk of triggering immediate debt payments to the pension plan due to the group structure.
- Contractual right for members to transfer-in benefits from other plans on fixed terms.

Objective 2 - Explain the amounts in my financial statements

The standard is more specific here in setting out the information that should be disclosed. This is the requirement that companies will be most familiar with as the majority of it isn't new.

Requirement of standard:
A reconciliation of the balance sheet position over the year.
Separate reconciliations of the present value of the DB obligation, plan assets and the effect of the asset ceiling over the year.
A breakdown of assets between major asset classes and between quoted/unquoted assets.
Information on the level of self-investment in the plan assets.
Disclosure of the significant actuarial assumptions used.

While none of these requirements are completely new, some have changed slightly. The revised standard states that the asset class split should distinguish the nature and risks of those assets but doesn't specify what the asset split should be, although it does give an example. This may lead to more information being shown than has previously been the case.

Analysts are keen to see more details of the assets in which the pension schemes are invested. Peter Reilly, Head of Industrial Sector, Equity Research at Deutsche Bank, thinks that the asset class descriptions should indicate how well the assets match the liabilities, for example, average bond duration or a split of the bonds between fixed interest/index-linked.

Other items which could be included:

- For bonds, the split between corporate bonds and government bonds.
- Return-seeking assets are often aggregated, but it would be more informative to disclose explicitly the investments in, say, quoted equities, private equity, property, diversified growth funds etc.
- More detailed information on non-standard asset classes, such as derivatives.

Objective 3 - Timing, amount and uncertainty of future cashflows

Requirement of standard	
Sensitivity analysis for the significant actuarial assumptions, showing the impact on the DB obligation and including the methods and assumptions used plus any changes from the previous period	Consider showing the impact of changes in market conditions on net liability, not just DB obligation, e.g. a movement in bond yields. This could help to demonstrate management of financial risks.
Description of any asset-liability matching strategies to manage risk	Describe how risks are being managed/reduced, e.g. interest rate, inflation or longevity hedging. Also consider: • describing other risk management strategies such as liability management exercises not already disclosed, and • mentioning strategies considered and rejected (and why).
Indication of future cashflows, including at least next year's contributions and a description of the funding arrangements/policy that affect contributions	In the UK, consider: • a summary of the current schedule of contributions, perhaps given in the context of a medium/long-term plan to address a funding shortfall and address risks • any non-cash funding agreed/being negotiated • timing of the next funding valuation, and • information on funding valuations, for example, results and assumptions (although not specifically required, analysts would like to see more funding information – see below).
Information on maturity profile	Duration is required as a minimum. But analysts would prefer companies to go further, for example: • a breakdown of the liabilities by active, deferred and pensioner members, and • charting expected future benefit payments – an example can be found in BT's accounts, which include a graph to show the estimated term of the scheme's liabilities, illustrating the peak point and the end date, rather than simply the average.

On funding, Peter Elwin, Head of European Pensions, Valuation and Accounting Research at JP Morgan, notes that while there is value in the information provided by the plan's valuation for funding purposes, ideally, companies would provide the results and assumptions from the most recent actuarial valuation alongside the accounting disclosures, so users can compare the two different valuation bases.

Take into account the needs of the users of my financial statements

A balance needs to be struck between providing enough relevant information to allow users to understand the risks, without disclosing so much information that users lose sight of what's important.

The relative size of the pension scheme compared to the size of the company is an important factor in deciding how much detail should be included in the disclosure note. A company will want to provide confidence to potential investors that a significant pension scheme is being managed well and that the cost of the scheme isn't detrimental to the business.

If your company has a number of different schemes in various countries, you'll need to think carefully about how to present the financial information. We would expect more detail in the disclosures on the largest schemes or those associated with the greatest risks. Information in respect of smaller or less risky schemes could be summarised or aggregated in some way, to avoid taking up too much space.

Disclosing the right information for multi-employer pension or group plans

The accounting for multi-employer plans has not changed. But more information has to be disclosed. This includes:

- narrative information on how the company's contributions to the plan are determined
- the extent to which the company is liable for meeting other companies' obligations under the pension plan, and
- a description of any agreed allocation of a deficit or surplus upon withdrawal from the plan or the wind-up of the plan.

The disclosure requirements for plans that share risks between entities under common control (i.e. group plans rather than multi-employer plans) haven't changed. But the new standard does enable entities like these to cross-reference with disclosures of other group entities in certain circumstances to help reduce the volume of disclosures.

Disclosing the right information in respect of any limit on the DB asset

If a company doesn't have an unconditional right to a refund of surplus, there may be a limit on the DB asset that can be recognised on the balance sheet, or an additional liability arising from a minimum funding requirement.

Where this applies, you'll have to disclose a reconciliation of the effect of the asset limit (or additional liability), as well as how the maximum economic benefit available was determined, i.e. whether it relates to a refund or a reduction in future contributions or both.

Make the most of the opportunity

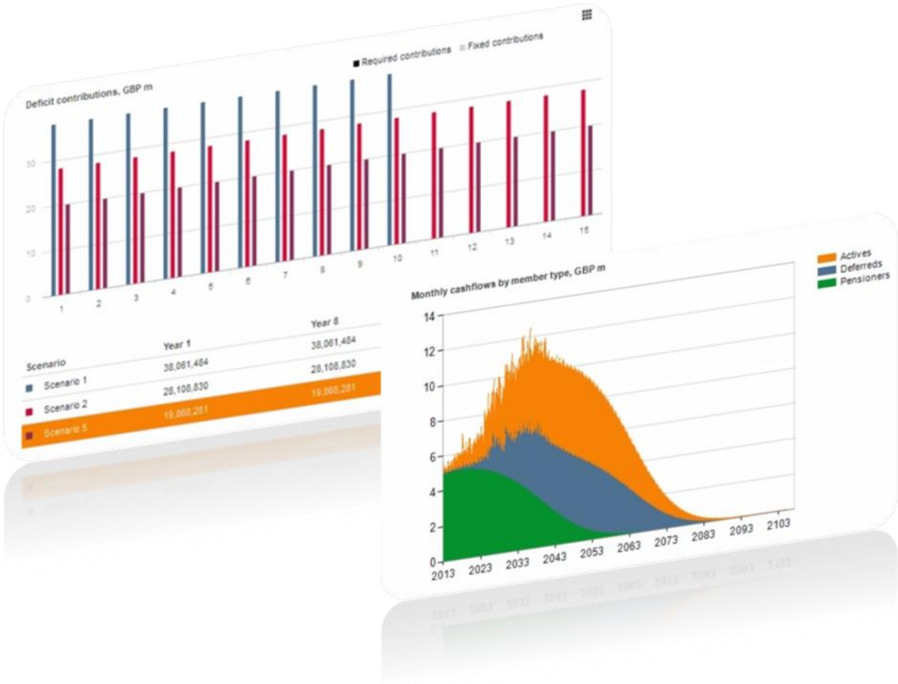
Accounting figures and disclosures have always had their limitations. They still do and still will. Some people will regard these new requirements as a pain. Other people will see them as a fantastic opportunity. That opportunity has always been there, but inevitably with these disclosures becoming a formal requirement we expect to see an upgrade in the usefulness of corporate pensions reporting.

Using Skyval

Turning data into decisions

Our new online pensions modelling tool, Skyval, can reduce the effort involved in preparing corporate pensions disclosure information. Skyval will revolutionise the way companies and trustees manage, monitor and take decisions about their pensions issues. Skyval allows users to perform in real-time:

- updates of funding and accounting actuarial valuations
- risk management analysis
- sensitivity testing under a variety of economic scenarios and what-ifs
- ability to drill down into detailed scheme and market information, including cashflows, and
- summary dashboard reporting on key pension scheme metrics.



Skyval is an exclusive platform with functionality and interfaces specifically designed to meet the requirements of those involved in dealing with pensions issues. Users will be able to access output covering IAS 19 accounting disclosures and benchmarking, investment strategy and pensions risk management, and scheme funding analysis. Skyval is available to support advisory work and, for appropriate organisations, sponsors and trustees will also be able to access Skyval directly, obtaining at first hand information and analysis only previously available through advisers.

Skyval

- Helps companies and trustees understand and manage their defined benefit pension liabilities quickly and efficiently
- Can be used directly in-house by selected employers and trustees
- Contains analysis to support decision-making in an intuitive and readily accessible format

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