



SORP 2007 - MAKING ITS PRESENCE FELT

In May 2007, the Statement of Recommended Practice (SORP) for pensions was revised to take into consideration changes in accounting standards and their impact on pension scheme accounts.

The revised SORP is effective for accounting periods commencing on or after 6 April 2007 and the effect of the changes came into place for pension schemes with accounting periods ending on or after 5 April 2008. Given that the majority of pension schemes have accounting periods ending 31 December, the revised SORP will be making its presence felt as we fast approach the end of this year. This article identifies and addresses the key changes and implications of the revisions and how these changes may affect the pension scheme accountant, the trustee and the auditor.

THE PENSIONS SORP

An SORP is a recommendation on accounting practices for specialised industries or sectors. The SORP applies to all pension schemes giving a true and fair view in their financial statements and it is used to adopt best industry practice in accounting for pensions and preparing annual reports.

There is a convergence project underway to bring Irish and UK accounting standards in line with international accounting standards. The SORP has been updated to take account of the Financial Reporting Standards (FRS) issued in respect of financial instruments FRS 25, 26 and 29. Although these standards are not adopted in their entirety, the Pensions Research Accountants Group (PRAG) considered it appropriate to incorporate some aspects of the standards in the SORP, to bring consistency between

investment valuations for pension schemes and company reporting. Amongst other changes, the SORP addresses industry developments in the more widespread use of derivatives and the new categorisation of contributions.

Key changes and implications of the revised SORP

1. Quoted Investments;
2. Contributions;
3. Transaction costs;
4. Accounting for derivatives; and
5. Scheme liability / actuarial disclosures.

1. QUOTED INVESTMENTS

Perhaps the biggest impact for most schemes will be that there is a change in the method of valuation of investments, where there is an active market for those investments. The most common of these types of investments are quoted securities or pooled investment vehicles such as unitised funds. The introduction of fair value accounting (through the new accounting standards and SORP) means the use of the latest quoted prices available for these investments, i.e. the use of bid price for assets, the offer price for liabilities, or a single price if that is the market convention. Prior to this revised SORP, the mid price (rather than bid) was used for pricing these investments. It is worth noting that fair value accounting principles also apply to unquoted investments.

Implications

A change from mid to bid pricing of quoted investments is a change in accounting policy and may therefore require a prior period adjustment and restatement of the comparative figures. The SORP outlines in its transitional provisions that changes must be accounted for in compliance with FRS 3: Reporting Financial Performance and FRS 18: Accounting Policies. However, if the difference arising is deemed immaterial, the provisions allow for the adjustment to be accounted for in the current year. Therefore, I would expect that most schemes will make the move from mid to bid pricing by accounting for the adjustment through the current year change in market value and not by restating comparatives on the grounds of immateriality. A matter is material if its omission or misstatement would reasonably influence the decisions of a user of the financial statements. The concept of materiality is very subjective and therefore it would be wise for the trustees to consider materiality in conjunction with the scheme's auditors.

Where the effect of the change in accounting policy is deemed immaterial and the comparatives are not restated, the SORP requires disclosure of the accounting policies on which comparatives are based and the main adjustments that would ensure compliance with the new accounting policies. However, these adjustments need not be quantified. Finally, even where the potential adjustment is immaterial, trustees wishing to restate comparative amounts are not prohibited from doing so.

2) CONTRIBUTIONS

The SORP requires analysis of contributions between normal, augmentation, deficit funding and other. In short, the SORP now recognises that the previously used term "special" actually covered a number of different types of contributions, consequently the new categories allow for greater transparency.

Contributions for augmentation of benefits are contributions payable to provide new benefits to, or to augment benefits for, specified members.

Deficit funding contributions are contributions payable for a limited period or as a single payment. They are to improve the funding position of the scheme and normally relate to past service benefit accruals.

Implications

All contributions should be accounted for in accordance with the agreement under which they are being paid or, if none, on a receipts basis. The notes to the accounts should explain why and for how long any additional contributions are payable. Where there are changes in the presentation of the analysis of contributions, the comparative amounts should also be adjusted.

3) TRANSACTION COSTS

Transaction costs are incremental costs that are directly attributable to the acquisition or disposal of an investment. An incremental cost is one that would not have been incurred if the scheme had not acquired or disposed of the investment. These costs include fees and commissions paid to agents, transfer taxes and duties and are added to the purchase cost or netted against sale proceeds, as appropriate. For example, incremental costs will arise where there is a bulk transfer from one scheme to another. While there is no requirement to account separately for these costs, there is now a requirement to disclose them.

Implications

Under the revised SORP, obtaining comparative disclosures for investment transaction costs is not required where it is impractical or costly to do so. This is a sensible approach since the disclosure is in note form only and many investment managers and custodians would have to amend their systems to generate this information.

4) ACCOUNTING FOR DERIVATIVES

Derivatives are also valued at fair value and the SORP sets out in detail how these values are to be estimated and how the derivatives are to be disclosed.

Implications

The main implications for derivatives, of the revised SORP, are the additional disclosures required. To assist further with the accounting and disclosure requirements of derivatives, PRAG issued detailed guidance: Accounting for Derivatives in Pension Schemes.

5) Scheme liability / actuarial disclosures

The revised SORP also requires that the note which states that long term pension liabilities are not accounted for as part of the net assets must be included under the net assets statement.

HOW THE CHANGES MAY AFFECT YOU

The Pension Accountant

The changes to the SORP will increase the work burden. The biggest challenge for you is completion of the pension accounts and Trustee Annual Report (TAR) within the budgeted time, cost and resources. No doubt this will be testing given that your role involves liaising with, and co-ordinating responses from several information providers (many of whom need to be familiar with the changes). As with any change, there is uncertainty, which in turn can slow the accounts preparation process. Being informed and familiar with the requirements of the SORP, along with effective planning, should minimise delays and cost overruns.

The Trustee

As the Trustee, you are deemed ultimately responsible for the pension scheme and its accounts. Given that the adoption of the changes could result in delays in preparing accounts, there is a greater risk of missing a reporting deadline. In practice, the Trustee relies on the professionals engaged by the scheme (pension accountants, administrators, investment managers, actuaries, auditors etc.) to provide advice, guidance and assistance in all matters concerned with pension scheme administration and compliance. The key for you is to communicate regularly and clearly with the professionals and to provide assistance and support to them so that they can achieve their deliverables.

Consider reviewing service level agreements to ensure the professionals are clear on what is required and expected of them, for example investment managers may need advance notice of the requirement to generate investment valuation reports at bid price.

The Auditor

The revised SORP will result in a learning need for relevant auditors at all levels. Early and regular communication with the audit client is key to address changes resulting from the SORP, for example, in order to discuss client estimates of materiality, prior period adjustments and disclosures (as applicable). The aim is to avoid unnecessary and time consuming queries, which could delay the accounts sign off process further down the line.

In summary, the revised SORP strives to apply best practice to pension scheme accounts, in order to bring them in line with accounts prepared under current generally accepted accounting principles (GAAP).

The adoption of the revisions to the SORP will require additional work and patience during its implementation. However, the SORP has been revised before and, as with any revision, interested parties inevitably get up to speed and soon appreciate the advantages of the proposed accounting, presentation and disclosure requirements.

The good news is that it should only be in the short-term that the revised SORP will make its presence felt.

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