PENSIONS ACCOUNTING - A REVIEW OF THE U.K. SITUATION

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(1) GENERAL BACKGROUND

Introduction

1. At the 1978 Conference the Chairman's Address included the following passage:
"Until say ten years ago, the respective roles of the accountant and the actuary did not appear to come into conflict, or if they did the conflict was soon resolved. However, at the present time in many English-speaking countries the growth in the level of company retirement benefit costs has caused the accounting profession to question actuarial methods and techniques on the grounds that a reasonable annual charge for retirement benefits need not be the same as the amount contributed by the company to its retirement benefit plan. This could be either because the company did not contribute the amount recommended by the actuary, or because the accountant is not satisfied with the actuary's recommendation."
It is clear that, in the countries concerned, the question of accounting for pension costs and the relationship between actuaries and accountants is now of major importance. I expect it to be a main theme of the 1980 conference and hope that this paper will make some contribution to the general discussion.

2. Before beginning my comments on the current UK situation I thought it would be useful to provide some background information regarding the position of accountants in relation to pension costs. For this purpose, and indeed for the remainder of my paper, I think it is necessary to distinguish between pension fund accounts and company accounts.

Section N21

3. The only official pronouncement from the Institute of Chartered Accountants in England the Wales on accounting for pension costs was issued in February 1960 as Section N21 of the Members' Handbook on Accounting Principles. A summary of the main recommendations in N21 are set out in paragraphs 4 and 5.

4. As far as pension fund accounts are concerned the recommendations covered three main areas:

Form of Accounts: The accounts should normally consist of a balance sheet showing the amount of the fund and the net assets representing it together with a summary of the income and outgo of the fund during the year.

Accounting Treatment of Investment: There are different methods of putting values on investments (e.g. cost, cost less appropriate provision and market value), but whichever method is used, it should be followed consistently each year.

Ability of Fund to meet Obligations: This covers the requirement on actuarial information and is quite extensive. A note to the accounts should indicate the position disclosed by the latest actuarial valuation, the action taken as a result thereof and the date of the next valuation. If a significant event has occurred since the last valuation the actuary should be asked if the note needs to be modified for the next set of accounts. If the required actuarial information is not available for any reason the accounts should explain the position.

5. In the employer's accounts there will normally be a charge against revenue in respect of insurance premiums or contributions paid to a scheme. Additionally, an employer's obligations in other respects should be noted and could include:
(a) Details of any guarantee given by the employer in relation to the scheme which could materially affect his financial position.
(b) The cost of providing retirement benefits set up outside the normal conditions of the scheme.
(c) Any special contributions required (e.g. for back service liabilities) and how these are provided for in the accounts.
(d) Any advance provision made on a consistent basis to cover future non-contractual liabilities.

The Position Since 1960

6. The twin evils of rampant inflation and rock-bottom equity values which occurred in the early 1970's put some accountants into a state of near-panic over the financial stability of pension funds and the escalation of company pension costs. With the help of some calming advice from the actuarial profession the storm was weathered and a subsequent improvement in the economic situation seemed to dispel the clouds that had gathered over the pensions scene. However, the message that got through to accountants during this period was that the present guidelines in N21 were insufficient and that some further official pronouncement was needed.

7. Unfortunately no such pronouncement was forthcoming on the question of pension fund accounts and it has been left to individual firms of accountants to draw up their own guidelines in this area. These guidelines have to some extent been drawn up after consultation with individual actuaries or firms of actuaries but to the best of my knowledge there has been no official liaison between the ACA and the ICA or its largest member firms. One of the problems of individual firms' guidelines is that they are formulated by the firm's technical personnel. There have been cases where a junior manager in a firm of chartered accountants with responsibility to supervise the client's pension fund audit has expected an actuary to provide a standard type of statement for the accounts which may be unsuitable or impractical. The actuary's only recourse has been to appeal to the client or to go over the manager's head to a partner. Either option may provide a mutually acceptable compromise but can result

in some ill-feeling between the parties and considerable additional expense to the client.

The PRAG Report

8. Having seen the problems that can arise on pension fund accounting, various accountants employed by companies in the running of pension schemes got together with certain actuaries and chartered accountants to form a group known as the Pensions Research Accountants Group (or PRAG). In May 1978 PRAG produced a report entitled "Financial Reports for Pension Funds" and a summary of the main provisions of this report is set out in Appendix 1. Having been prepared by a group which was indenpendent of both professions (although seeking advice from their individual members) the report can be seen to be generally fair and unbiased. It cannot be a definitive blueprint for pension fund accounting since it has no official backing but it can certainly be adopted informally by members of both professions and used as a sound base for any subsequent pronouncement from either Institute.

The ICA Exposure Draft

9. Returning to company accounts, it is anticipated that an Exposure Draft of a proposed Statement of Standard Accounting Practice will shortly be issued by the Institute of Chartered Accountants on the subject of Accounting for Pensions. The proposed Statement will be distributed to various organisations and individuals and produced in the professional and technical press. During the period of "exposure" (probably 6 to 9 months) representations can be made on the content of the ED by accountants and any other bodies or individuals who may be directly affected by its content. This will obviously cover actuaries, both collectively and individually.
At the end of the exposure period, the Accounting Standards Committee (ASC) will meet again to consider the representations received and to decide whether a revised ED should be issued on the same basis. This is generally only necessary if substantial changes of principle need to be made to the original. If a revised ED is not thought to be necessary, the ASC will proceed with the issue of a Statement of Standard Accounting Practice (SSAP). This is generally in three parts, namely (i) an Explanatory Note, (ii) Definition of terms and (iii) Standard Accounting Treatment. Part (iii) is the basic Standard which sets out the practice to be followed. There are sometimes further parts to the Statement and there is also a Technical Release by the ASC on the publication of the SSAP.

It is interesting to note that there have been about 15 SSAP's issued at the time of writing although this total could well have increased by the date of our conference. These all cover different aspects of the accountant's function in relation to accounting for various items in company accounts.

10. Full discussions on the proposed Statement and on the remaining content of the ED will obviously be carried out in the actuarial profession generally and within the ACA in particular during the period of exposure. At the time of writing this paper such discussions have not yet taken place and so the views expressed should be taken to be entirely my own and not necessarily representative of either the ACA or indeed my own firm.

11. Having set the background to the present position in the UK regarding pensions accounting I intend, in the remainder of my paper, to cover the subject in more detail and to explain how I think various contentious issues should be dealt with. As stated earlier, I propose to distinguish between the production of pension fund accounts and the treatment of pension items in company accounts.

(2) PENSION FUND ACCOUNTS

12. In this section I am exclusively concerned with the position for self-administered schemes (including for this purpose schemes invested in insurance company managed funds) since insured pension schemes are generally of less direct interest to consulting actuaries.
The first point to bear in mind is that for many pension schemes which are not contracted-out of the earnings-related state scheme, there is no legal requirement to produce accounts at all, let alone o have them audited. However, most schemes are required to prepare annual audited accounts in accordance with the rules of the scheme. Even if this is not the case, I think that both professions would agree that it is good practice to do so.

The Auditor's Role

13. Broadly speaking the auditor's role can be seen in two alternative lights which may be described as the restricted approach and the comprehensive approach. Under the restricted approach the auditor is concerned only with whether the scheme's trustees have properly carried out their stewardship functions and whether the figures shown in the accounts are correct. His report makes no comment on the actuarial position of the scheme which is the subject of a separate statement by the actuary. Under this approach the auditor's report might be on the following lines:
"In our opinion the accounts give a true and fair view of the transactions of the scheme for the year ending ..... and of the disposition of the scheme at that date."

14. The alternative viewpoint favoured by some accountants is that, since the audit report should state that the fund's balance sheet "represents a true and fair view of the state of affairs of the fund", it is necessary for this report to include a comment on the actuarial position. This may be described as the comprehensive approach.

15. I believe the restricted approach is the correct one and I think many accountants are now prepared to accept this. There is in fact no legal or accounting requirement for the auditor to comment on the "state of affairs of the fund" and it seems inappropriate for him to do so. A pension fund is a completely different animal from a company and, due to its very nature, the balance sheet does not show its state of affairs which are of a long-term and unpredictable nature. The state of affairs of the fund is, of course, revealed by the actuarial valuation

and should, as far as the fund's accounts are concerned, be covered by a separate actuarial statement.

16. If the restricted approach is accepted by the accountant as far as his audit report is concerned, what matters should his audit cover? A check list of normal audit procedures was set out in the PRAG report and, although these procedures are outside the sphere of comment by the actuary, it is useful to him to know what checks have been put on the accounts on which his actuarial valuation is based. If all the points in the check list have been covered in the audit the actuary can be confident that the accounts are substantially correct.

17. One other function which the auditor may be able to perform is to ensure that the data provided by the trustees for the actuary's valuation is reliable. For example, the trustees may forget to submit data to the actuary in respect of a newly acquired company of which he is unaware and the auditor may realise that this has been overlooked.

18. Although, in my opinion, the auditor's role does not cover the auditing of the actuarial information provided in the accounts, I think that the scheme's actuary should be willing to discuss this information with him and, in particular, to explain the content of his actuarial valuation report. The actuary can also help the auditor by giving advice of a general nature on the terms of the trust deed and by telling him whether the contributions received and the benefits paid out have been calculated correctly.

The Actuary's Role - The Actuarial Statement

19. The actuary's role is clearly to provide information on the actuarial position of the fund. This could take the form of a note to the accounts but a separate statement (not covered by the audit report) is preferable.
The basic information contained in the statement will follow from the results of the latest actuarial valuation. Generally, the purpose of this valuation will have been to assess the rate of contributions required to be paid into the fund by employers to meet outstanding liabilities on a long-term basis. The valuation will have been carried out on what the accountants describe as a "going-concern" basis - in other words it is assumed that the fund will continue in existence after the valuation date and allowance is made for liabilities arising in respect of future service and future increases in salary of current members.

20. The actuarial statement in the first set of accounts produced after a valuation has been completed should set out the data and the results of that valuation (in particular the recommended rate of employer's contributions and from when they will be paid) and the anticipated date of the next valuation. If the scheme rules specify a fixed rate of employer's contributions then the result of the valuation will be to reveal a surplus or deficiency. The actuarial statement should indicate this result and include details of how the surplus is to be utilised or the deficiency is to be met.

21. In some cases it may be felt that a statement on the lines described in paragraph 20 should be expanded by including details of the actuarial methods and basis used for the valuation and any other relevant items. If the trustees feel that such an expanded statement is desirable, then this could take the form of a comprehensible summary of the main features of his valuation report prepared by the actuary.

22. In most cases, the recommendations made in the actuary's valuation report will have been accepted by the trustees and employer as the basis for future funding of the scheme. Where, for any reason, this is not the case, the actuarial statement should explain the position clearly. The statement might also include details of any special contributions paid into the fund by the employers which are not covered specifically by the valuation report, e.g. payments to cover individual augmentation of benefits.

THE DISCONTINUANCE POSITION STATEMENT

23. The main content of the actuarial statement has been described in paragraphs 19 to 22. However, there has been increasing pressure in recent years from accountants to include a statement on the discontinuance position. It is worth considering the nature of this statement and its validity.

24. Most accountants if pressed to state what they meant by a discontinuance statement would probably say that this was a statement to the effect that, if the fund were wound up, the market value of the assets would be sufficient to meet the accrued liabilities by purchase of annuities. There are certain problems involved in using this concept.

25. Firstly, what is meant by "accrued liabilities"? For pensioners, ex-members with frozen pensions and other beneficiaries who are not in employment, the liability is clearly to purchase the pension or frozen pension to which they are currently entitled (possibly allowing for any guaranteed future increases specified in the rules). For members in employment the position is more complex. For example, do the liabilities cover all members or only those who would receive a benefit if they were to leave service at the relevant date? Are the liabilities based on current salaries or pensionable salaries? Are the liabilities always readily determinable if the retirement benefit is not related directly to service completed?

26. My second doubt concerns the use of market values of assets. These can fluctuate significantly over fairly short periods and are therefore not necessarily a good guide to the financial position of the scheme. If the scheme were to be discontinued (a possibility which is unlikely and could possibly be foreseen) it would not usually be necessary to sell off investments immediately, or indeed at all if there were a provision to continue as a closed fund with no future contributions and no future liabilities accruing.

27. A final problem I would mention on the discontinuance statement as evisaged in paragraph 24 is that the benefits considered in determining accrued liabilities will not necessarily be the same as those

which would apply if the scheme were actually wound up.

If, in an actual winding-up situation, members received deferred annuities which were less than their accrued pensions although the discontinuance statement in the previous year's accounts stated that the liabilities for accrued pensions were fully covered by the fund's assets, then obviously great problems could arise. It is, indeed, quite feasible that the trustees of the scheme and their professional advisers would find themselves as co-defendants in a Court case brought by the members. No doubt some of my professional brethren would relish this prospect but I do not count myself in that category.

28. Since it suffers from the various objections outlined above, does the discontinuance statement have any merit? I believe it does, on the grounds that it provides an alternative minimum funding standard. However, on this basis, I would suggest that the value of the fund should not be taken as its market value but rather the value used for the purpose of the actuarial valuation. This would provide a continuity and stability of approach which would be absent if wide fluctuations in market values have to be considered. Secondly, I would take accrued liabilities for members in employment to be the liabilities (calculated on the valuation basis but excluding allowance for future salary increases) which would arise for these members if they left service at the valuation date *but had completed any qualifying conditions for obtaining frozen pensions.* If, on this basis, accrued liabilities exceeded assets I would expect the contributions recommended in the valuation report to be sufficient to reverse this situation over a fairly short period. This would be made clear in the actuarial statement.

Updating and Timing Problems

29. Actuarial valuations in the UK are still generally undertaken every 3 years rather than every year. Consequently there has been much discussion between actuaries and auditors regarding the content of the actuarial statement to the pension fund accounts during the inter-valuation period.

30. If there has been a significant event such as a change in benefits, or the sale or admission of a participating company, there may well have been a detailed investigation by the actuary of the required revision to contributions on the going-concern approach. The result of this investigation would be set out in the statement. In other circumstances the actuary would not normally expect any change in contributions to take place until the results of the next valuation are known and the statement would make this clear.

As far as the discontinuance position is concerned, this could be reviewed each year although the extent of the review and the data requested would depend on the individual circumstances of the scheme.

31. A problem may arise on timing as far as the actuarial statement is concerned. This is because the accounts for a particular year can often be audited before the results of the valuation *at that year end* are known and agreed. In some cases the auditors have refused to sign the accounts until the valuation report has been presented and the results incorporated in the actuarial statement. Alternatively, they have qualified the accounts. I think that this attitude is unreasonable and that, in these circumstances, the position could be adequately covered by a simple statement that a valuation at the date of account is being undertaken, the results of which will be shown in the actuarial statement in the following year's accounts. The statement in the following year's accounts would then, of course, need updating on the lines suggested in paragraphs 29 and 30 since it would be a year out of date.

32. A form of updated actuarial statement designed to meet most of the points made in this section of my paper is shown as Appendix 2.

(3) COMPANY ACCOUNTS

Introduction

33. In this section of the paper I will deal with the question of the provision for pension costs in company accounts and the relevant method of disclosure of matters relating thereto. I believe that it is necessary to make the distinction between company accounts and pension fund accounts since

(a) The company accounts are addressed primarily to shareholders whereas the pension fund accounts are for the benefit of various parties including the beneficiaries of the scheme. Shareholders will be concerned with the effect that pension costs have on profits and pension costs in this context can extend beyond the contributions to the pension fund.

(b) In the case of company accounts there is legislation covering the production and audit of accounts. It is, in this case, the auditor's confirmed responsibility to report that the accounts show a true and fair view of the state of affairs of the company. He must be satisfied therefore that the pension position conforms to this requirement.

34. In view of item (b) in paragraph 33, I believe that it is difficult for the actuary to impose his views on the auditor's approach to accounting for pension costs. However, I would expect accountants to seek advice from actuaries in this sphere in the same way as they seek advice from members of other professions when they meet matters outside their own field.

35. Many accountants to whom I have spoken find it difficult to understand why two different companies with the same pension schemes and membership structures (including pensionable service, salaries, etc.) should pay different levels of contributions to those schemes merely because they employed different actuaries. I have argued that the actuary only determines the pace of funding for the scheme and that, over the long term, the cost will be identical. This is true as far as it goes, but it does not satisfy the accountant in relation to pension costs shown in company accounts where his accounting principles demand a more consistent approach. Since the pension cost figure used in the company accounts determines the company's profits,

is it right that different actuarial methods and bases can affect these profit figures? Should there be a standard actuarial method and/or set of assumptions for this purpose?

The ICA Exposure Draft

36. It is with this background in mind that I turn now to the Exposure Draft (ED) to be issued by the Institute of Chartered Accountants which was briefly outlined in section (1). The ED will be split into three parts, namely, Part 1 - Explanatory Note, Part 2 - Definition of terms and Part 3 - Standard Accounting Treatment. Part 1 will constitute the bulk of the paper and will set out the background to the subject and the thinking which produced the content of the Standard in Part 3. Since the ED has not been published at the time of writing this paper, it is not possible to consider its content in detail. However, there are certain general principles which it is likely to contain and these are described in paragraphs 37 to 39 below.

37. The first general principle is that the cost of providing an employee's pension benefits should be written off over his working lifetime. This precludes the use of pay-as-you-go or terminal fund ing as a basis of assessment. Furthermore, because of their long-term uncertain nature, pension costs should be ascertained by the use of actuarial methods. Not much to object to there!

38. The second general principle which I expect the ED to establish is the going-concern concept of an employer's liabilities. Any right contained in a pension scheme's rules for the employer to suspend or reduce his obligations to the scheme should be ignored for accounting purposes. This thesis may be objected to by some actuaries but is an example of the point made in paragraph 34 above regarding the auditor's responsibilities. I think we should accept this principle if it is agreed by the accountants.

39. Following these two principles and the fundamental accounting principles of matching (or accruals), going concern, consistency and prudence, I expect the ED to state that pension costs should normally be assessed on a going-concern basis and spread over employees' future working lifetimes expressed as a percentage of their salaries and calculated by actuarial methods. I do not anticipate that a precise actuarial basis or method will be specified for this purpose.
If produced on this basis, the ED will raise two fundamental issues namely
(a) What actuarial valuation methods will be accepted as producing pension cost figures "on a going-concern basis"?
(b) Will pension costs be the same as funding rates?
I return to these questions later.

40. As well as covering the general question of assessing pension costs, the ED is likely to comment on disclosure of information in company accounts and the pension fund's discontinuance position.

A General View

41. My general reaction to the ED will be to welcome it.
Firstly, it is high time that there was a full appreciation of the cost of pensions and of their importance to company profits. Despite strenuous attempts by our profession to educate companies in this respect, I think that accountants may be able to get the message across more easily. Secondly, I am pleased to see that the accountants recognise the role of the actuary in assessing pension costs and do not attempt to lay down a precise standard method or basis for this purpose. Subject to the accountants' need to stick to their basic accounting principles it is obvious that they are prepared to listen to actuaries' advice and to accept their judgment in this area. Hopefully, this will obviate the need for legislation which will undoubtedly be more binding on our profession than the proposed Standard.
Finally, I support the emphasis on the use of a going-concern approach to pension costs. This is a realistic approach and produces stability from year to year.

Fundamental Issues

42. I would now like to turn to the two fundamental issues mentioned in paragraph 39. On the first of these issues, the main problem is in determining whether a particular actuarial method is in fact "on a going-concern valuation" (both of which will be defined in Part 2) and the actuaries will understand this basic distinction. However, it is possible to use an actuarial method for a valuation which is really a compromise between "a going-concern valuation" and "an immediate discontinuance valuation". This involves setting a projection period of, say, 20 years for the valuation and calculating the funding rate so that the immediate discontinuance position at the end of the period is satisfactory. This method is often described as "discontinuance funding" but the question is whether it will be considered as funding on a going-concern basis for the purposes of the ED.

43. The problem of whether discontinuance funding will be accepted as a basis for calculating annual pension costs should be a subject for discussion in the actuarial profession since this type of funding is commonly used for insured pension schemes. It would be possible for the Standard to be specific on this point and it could either (i) state a minimum acceptable projection period or (ii) require the actuary to certify that he would not expect the funding rate he certifies to increase at the end of the period.

44. Another question to be resolved in this context is whether an allowance can be made in the actuarial calculations of pension costs for new (or future) entrants to a scheme. Such an allowance can substantially affect the annual costs of past service deficiencies (expressed as a percentage of salaries).

Pension Costs and Funding Rates

45. The second fundamental issue raised in paragraph 39 is whether there should be a distinction between pension costs in company accounts and payments which an employer makes to an externally funded scheme or whether these two figures should be the same.

46. I think there must be a distinction since there are clearly instances in which the employer's funding pattern is varied from the recommended rate of contributions put forward by the actuary in order to suit his circumstances at a particular time (e.g. a one year's "contribution holiday").
Thus, if the employer is merely departing temporarily from a defined funding pattern recommended by the actuary, this departure can be noted and, if necessary, a provision can be made in the accounts for the difference. A compensating departure in the opposite direction at a later stage should eliminate this provision.

47. Suppose, however, that the employer is sticking to a recommended defined funding pattern put forward by the actuary but that such pattern does not conform to the accountants' Standard. This may occur because the funding method used is not accepted as being on the going-concern basis. The actuary will probably be most unhappy at having to calculate an annual cost figure which does not coincide with his recommended funding rate and serious professional problems could arise.

48. I would anticipate that, in general, annual pension cost figures relating to a pension scheme will be the same as the contributions paid to that scheme and that accountants will be prepared to interpret the Standard sufficiently widely for this position to hold good.
If the actuary is able to assure the accountant that the contribution rate used for funding purposes is (if his assumptions hold out in practice) likely to remain stable over a reasonable period then, in most cases, the accountant should be satisfied to accept this rate for the purposes of the company accounts.

49. If the ED establishes the principle that pension costs will not always be the same as funding payments to a pension scheme then the Standard will probably specify that the company should make a provision in its accounts for any shortfall. This provision effectively reduces the company's profits as shown in the accounts although it has not actually been an item of expenditure. I wounder if the accountants would be satisfied if no such provision were made, but the difference were disclosed in the notes to the accounts. This would help the company but would also enable an accurate picture of pension liabilities to be shown.

50. It is to be hoped that an exception to the Standard's general principle regarding spread of pension costs may be made in the case of lump sum payments to a pension fund. Such an exception would be most welcome since the alternative system of having prepayments in company accounts would, I believe, cause many problems.

Group Accounts

51. A particular problem in relation to the Standard is group accounts. Even if all the companies in a group are UK residents, they may have different pension schemes which are advised by different actuaries using different funding methods and actuarial assumptions. Presumably, as long as each company's costs are actuarially assessed in accordance with the Standard, it will not matter if they are not assessed in the same way and the result will be acceptable to the group auditors.
Where some companies in a group are overseas companies operating in countries where funding practices are quite different from those in the UK, the situation is even more complicated.

Professional Problems

52. The greatest professional problem arises if the accountant is not sure whether to accept the figures provided by an actuary for annual pension costs. Naturally, the general reaction of an actuary to this problem will be that, following any necessary explanation of the method and basis that he has used for the calculations, the auditor should always accept his figures. I am sure that most actuaries who are members of IACA will feel this way.
However, I think we ought also to look at the situation from the accountant's viewpoint. There will be instances in which he is not sure whether the actuary's method and basis conform with the Standard which he is obliged to follow for professional reasons. He suspects that there may be some maverick actuaries about who will be persuaded to go to the limit of their professional consciences to keep the company's costs at a bare minimum. What can he do?

53. Firstly, of course, his firm will probably have built up a record of those actuaries or firms of actuaries whose reputation is such that their views can always be accepted (this will, of course, include any ACA member!). If the actuary concerned does not fit into this category, then I think the auditor is entitled to seek independent advice on that actuary's figures from another member of our profession. He should, of course, remember that obtaining independent actuarial advice may clock up large fees for his clients which may not be really necessary.

54. Another professional point to be remembered by the consulting actuary is that his client is normally the company and/or the trustees of the company pension scheme. In most (but by no means all) cases his advice is given to both recipients and there is no conflict of opinion. In the case of assessment of pension costs for company accounts, it is clear that the actuary is giving advice only to the employer. In these circumstances he is not, of course, giving advice to the auditor and this point may sometimes be forgotten when the Standard is being followed. He may sometimes be employed directly by an auditor for a particular one-off job and in this case the auditor is his client rather than the company concerned.

55. It seems that the ED is not likely to suggest that there should be a standard actuarial basis for assess-

ing pension costs. Some accountants would, I feel sure, prefer this approach and we must hope that they do not try to take unilaterial action on it.

I think that many of the accountants' worries in this sphere would be relieved if there were some guidance from the Institute of Actuaries as to the basis which would be acceptable for the assessment of pension costs. They could, for example, specify that the main financial assumptions involved in costings should be within a certain range. I hope that the Institute will consider this matter seriously and that there will be a free and wide-ranging discussion on it (and the ED generally) within the profession. Alternatively, I wonder if the ACA could produce guidelines for its own members which might then obtain wider circulation in the profession. Some kudos could well be gained from such an operation if it were carried out successfully.

(4) CONCLUSIONS

The Position in the USA

56. I had intended that my paper would only cover the UK position but I think that it would be useful to mention the situation in the USA since some interesting comparisons can be made.

57. In the USA, an Exposure Draft on a Proposed Accounting and Reporting Standard for Defined Benefit Pension Plans was issued in July 1979 by the Financial Accounting Standards Board (FASB).

The proposed Statement in the Exposure Draft covers financial statements for defined benefit pension plans in both the private and public sectors. Basically, the requirement is that actuarial information should be published concerning the "discontinuance position" of the plan. A comparison should be made between (1) the net assets of the plan available for benefits and (2) the actuarial present value of accumulated plan benefits. For the purposes of (1), investments are taken at fair (i.e. market) value and the value of insurance contracts is calculated in accordance with ERISA requirements. For the purposes of (2), accumulated benefits are benefits in respect of service already completed and based on current salary and their value is obtained on normal actuarial principles and using assumptions appropriate to an on-going plan.

58. Although I have only set out a very potted version of the Exposure Draft requirements, it will be quite clear that these requirements vary tremendously from those applying, or likely to apply to U.K. pension schemes.

In the first place, they are extremely comprehensive. The illustration of financial statements in Appendix D of the Exposure Draft runs to about 13 pages, of which the first 4 pages are the statements on net assets and accumulated plan benefits and the remaining 9 pages are notes on those statements! There may be some UK pension schemes where annual financial reports to members are as long as this, but I suspect that they are the rare exceptions rather than the rule.

Secondly, the emphasis on financial disclosure centres on the "discontinuance position" statement and the long term funding policy seems to take second place. I believe that, in the UK, the reverse is generally true.

Finally, the requirements are very much more specific than they are in the UK although clearly any Accounting Standard produced in the UK for financial reporting on pension schemes might be equally specific. The Statement lays down quite categorically how accumulated plan benefits are calculated and also gives guidelines on the actuarial assumptions to be used.

59. The above differences may reflect a greater degree of freedom in the UK for actuaries to use their professional discretion in determining the long-term financial position of pension schemes and the contributions to be paid to them. Up to now, accountants in my country have not generally tried to interfere in the actuary's sphere and have not, for example, employed actuaries on their staff. Perhaps all this will change, but I hope not.

60. APB Opinion No. 8 has existed since 1966 and its provisions and requirements are well known. They reflect the type of funding approaches used in the USA and, for this reason, the Opinion has not found much favour over here where funding methods are generally stronger and the going concern approach favoured. The FASB also issued an Exposure Draft in July 1979 entitled "Disclosure of Pension and Other Post-Retirement Benefit Information". This sets out a proposed Statement of Financial Accounting Standards which amends APB Opinion No. 8 to fit in with the requirements on Reporting for Defined Benefit Plans as described above. The Statement is an interim measure pending the production of a Standard on Accounting by Employers for Pensions.

The Future

61. Comparison of the position in the UK with that in the USA indicates that we are experiencing similar problems on the respective roles of actuaries and accountants in relation to pension matters. However, it appears that matters have not developed so quickly and not along quite the same lines. Furthermore, it still seems difficult in our country to raise a great deal of interest in the matter, even within our own profession. For our clients, who have been battered by legislation for many years now, the prospect of any new requirements, whether in the form of accounting standards or legislation, is one which they prefer to cast to the back of their minds.

62. Nevertheless, I believe that further developments will be forthcoming soon on the question of financial accounting and reporting on pension matters. The Exposure Draft on company accounts should have been published by the end of 1979 and the period of "exposure" could therefore be nearly ended by the time of our conference. Who knows what will happen to it during this period and whether a Statement of Standard Accounting Practice will eventually emerge which bears a close resemblance to the one I have discussed?

I think the ICA will also soon put on their agenda the question of providing a Standard for reporting on pension scheme accounts. When this happens,

I hope the Institute of Actuaries will take positive action to ensure that their views are known at an early stage.

63. Finally, I would make a plea. There have, in the past, been situations arising where an auditor will include comments in accounts relating to the actuarial position of a pension fund without even consulting the actuary. Such comments can be misinformed and, in certain cases, have caused unnecessary embarrassment to the company, trustees and actuary.
This situation may arise from the tiresome "them and us" attitude that is adopted towards accountants by some actuaries and vice versa. Alternatively, it may simply arise as a result of a lack of knowledge of each other's functions. In either case I would urge more communication between the professions so that both can strive towards the same end, namely to provide a fair and accurate report on the position of the pension fund and the company's liability to provide pension benefits. I hope that the future will bring a mutual respect and appreciation of each other's roles in this respect and a willingness to discuss problems rather than ignore them. If this rapport can be achieved, all will gain and none will lose.

APPENDIX 1

MAIN PROVISIONS OF PRAG REPORT ENTITLED "FINANCIAL REPORTS FOR PENSION FUNDS"

1. There should be an annual report prepared for a pension fund comprising a trustees' report
   an acturial report
   the accounts
   an auditor's report

2. The accounts should record income and expenditure during the relevant period together with statements of net assets (at market value) at the beginning and end of the period and a summary of the changes in these assets (net asset movements). Net asset movements will be the sum of (i) income less expenditure (i.e., new money) and (ii) changes in market values of investments. The report specifies how income, expenditure and net asset statements should be completed and what items need to be included as notes.

3. The auditor's function is to make sure that the figures shown in the accounts are correct and give a true and fair view of the position in that regard. His report should reflect this function.

4. A separate report covering the actuarial position of the fund should be prepared by the actuary. Reference to this report should be made in the accounts but it should not be covered by the auditor's report. The basic content of the actuarial report is specified.

5. The trustees' report should disclose matters of interest which are not covered elsewhere in the annual report. Examples are specified and include details of membership, changes in scheme rules, investment policy and results (including those of any portfolio measurement service used) and details of trustees, participating companies and professional advisers.

6. Since the main report, if presented on the lines suggested, will be quite lengthly and complex, a simplified report should be issued to all members. Details of inclusion for this simplified version are specified.

APPENDIX 2

XYZ PENSION SCHEME

Actuarial Statement

We have undertaken an actuarial valuation of the assets and liabilities of the Scheme at 5th April 1978. The main purpose of the valuation was to assess the level of contributions required to be paid to the Scheme by the Companies in order to provide the benefits payable on the assumption that all Members remained in service until death or retirement. In order to make this assessment we used various actuarial assumptions to estimate the future expenditure of the Fund on benefits and to compare this with the expected income from investments and Members' contributions. The result was a balancing item which had to be met by Companies' contributions.

In our report to the Trustees on this valuation we recommended that, in order to meet this balance of liabilities, the Companies should pay contributions to the Fund of 8¾ per cent of Members' Pensionable Earnings with effect from 6th April 1979. From 6th April 1978 to 5th April 1979 contributions would be paid at the level of 10 per cent of Pensionable Earnings for Members accruing 1/60ths benefits and 8½ per cent of Pensionable Earnings for Members accruing 1/80ths benefits. The recommended rate of Companies' contributions will be reviewed at our next valuation of the Scheme at 5th April 1981 and we are not aware of any circumstances calling for a special review before that date.

Our investigation also established that the value of the Fund's investments and net current assets at 5th April 1978 exceeded the value of accrued liabilities where, for this purpose, accrued liabilities were liabilities at that date in respect of:-

1. Pensioners and Beneficiaries in receipt of pensions
2. Pensioners entitled to deferred benefits
3. The provision of benefits for Members in service on the assumption that they left service with entitlement under Rule 9 of the Scheme.

On the basis of certain information provided we believe that the position outlined in the preceding paragraph would also apply at 5th April 1979. However, no detailed investigation has taken place at that date and the position will be fully investigated again when we undertake our next valuation at 5th April 1981.