

# Tottel's Accountants' Digest

Issue 27 • January 2005

Including accessible, practical guidance on:

- Types of occupational pension schemes
- Summary of legislation
- Pension scheme annual report
- Detailed requirements for preparing statutory accounts
- Audit report and statement about contributions
- Appendices

## Accounting for Pension Schemes

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**Tottel's Accountants' Digest**

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# 1 Introduction

This Digest summarises the various guidance that is available for those preparing accounts for pension schemes. It sets out:

- the statutory requirements in relation to pension scheme accounts and audit; and
- the accounting principles relevant to pension schemes.

This Digest has been prepared based upon the legislation in force at the time of writing.

It also includes pro-forma accounts and practical examples of disclosure requirements.

There are many different kinds of pension arrangements, including:

- the state pension scheme, made up of:
  - the basic state pension; and
  - the State Second Pension (S2P);
- occupational pension schemes, which are set up by an employer or group of employers for the benefit of their directors and employees;
- personal pension schemes and group personal pension schemes; and
- stakeholder pension schemes, which can be either:
  - trust-based; or, more commonly
  - contract-based.

Under pensions law, only occupational pension schemes and trust-based stakeholder pension schemes are required to prepare statutory accounts and it is, therefore, these types of scheme on which the Digest will focus. There are, however, many different types of occupational pension scheme, which vary in their precise accounting requirements. The first section below, therefore, explains the various categories of occupational pension scheme and the legal accounting requirements of each.

## 2 Types of occupational pension schemes

As indicated in the introduction, there are many different types of occupational pension scheme. They can be classified using a number of different criteria such as the following, for example.

- Their relationship to the state scheme. A scheme may be contracted out of S2P, or conversely, not contracted out (sometimes, and misleadingly, referred to as 'contracted in'). Strictly speaking, the scheme itself does not contract out, but acts as a vehicle for contracting out members' employment. Members of contracted out schemes pay lower National Insurance contributions, either directly or indirectly through receipt of a rebate for those contracted out on a defined contributions (DC) basis, but do not, on retirement, receive benefits from S2P; instead, the occupational scheme itself is required to provide broadly equivalent retirement benefits to S2P.
- Whether they are funded, in which case a pool of assets is set aside to pay for benefit payments in the future; or unfunded, in which case benefits are paid from current cash flows of the employer's business (hence the alternative name for unfunded schemes, 'pay as you go schemes').
- The way in which benefits under the scheme are determined. The two main categories are defined benefit (DB) schemes (also called salary-related or final-salary schemes), under the rules of which benefits are determined usually as a proportion of salary at, or close to, retirement, and DC schemes (also called money-purchase schemes), in which benefits are determined by the size of the fund that has built up as a result of contributions and investment returns. More commonly now are also mixed benefit and hybrid schemes, which are a mixture of DB and DC schemes.
- The way in which the scheme is invested. Many smaller schemes invest solely through insurance policies and are known as insured schemes. Alternatively, schemes may invest directly in investments such as stocks and shares, bonds, property, and unitised funds and are known as self-administered schemes (note that this term has nothing to do with the actual administration of the scheme itself).
- Whether or not the scheme has tax approval. The majority of occupational pension schemes gain approval from HM Revenue & Customs (HMRC) and are known as exempt approved schemes. Such schemes enjoy considerable tax advantages compared to other long-term savings vehicles – contributions are allowable as a deduction against tax for both the employer and (up to a set limit) employees and investment gains are free of tax. Occupational pension schemes may also be unapproved or partially approved, in which case they do not enjoy all of the tax advantages mentioned above.

In addition, certain occupational pension schemes are set up under their own legislation and could be regarded as a separate category because of that.

These various categorisations of schemes are important because, under pensions legislation, different types of occupational pension schemes are subject to different requirements for appointing auditors and for producing statutory accounts. It is very important when dealing with an occupational pension scheme that the precise type of scheme is understood so that the correct requirements can be satisfied.

For the purpose of statutory accounts, there are essentially four categories of occupational pension schemes, which are described in the sections below.

### 2.1 Category 1: Pension arrangements which fall outside the scope of much of the mainstream pensions legislation

The following types of occupational pension arrangements fall outside the scope of much of the mainstream pensions legislation and are not required to appoint a scheme auditor or to prepare statutory scheme accounts.

- Pension schemes which have only one member in total.
- Schemes which provide only death benefits.
- Schemes which are unfunded.
- Schemes which are unapproved (as described above). A scheme that has sought approval from the HMRC should be treated as an approved scheme pending the formal granting of approval.
- Certain public service and statutory schemes.

An increasingly common type of company pension arrangement is the group personal pension (GPP). These are essentially personal pensions rather than occupational pensions and, therefore, they also fall outside the scope of mainstream pensions legislation.

### 2.2 Category 2: Defined contribution 'small self-administered schemes' and 'relevant ear-marked schemes'

A small self-administered scheme (SSAS) is a self-administered occupational pension scheme in which there are generally fewer than twelve members, at least two of which are connected to each other, or to a trustee or to the employer. Due to the increased flexibility in choice of investment (for example, contributions may be reinvested in the employer's business), there is a risk that this flexibility is abused. Therefore, the Inland Revenue Savings, Pensions,

Share Schemes (IR SPSS) requires that one of the trustees must be a pensioner trustee. If a SSAS satisfies the following additional requirements, then it is exempt from the requirement to appoint a scheme auditor and to prepare statutory accounts:

- all the members are trustees, including any deferred members or pensioners; and
- all decisions are made by unanimous agreement of the trustees who are members, disregarding the pensioner trustee.

It is important to note that, even where an SSAS is exempt under legislation from producing statutory accounts, the trust deed may contain a requirement to produce audited (non-statutory) accounts. Therefore, when determining the precise requirements of a scheme for producing accounts, it is always necessary to check the provisions of the trust deed.

A relevant ear-marked scheme (RES) (which must not be confused with an ear-marked scheme, discussed in 2.3 below), is similar to a SSAS, but the scheme is wholly insured rather than self-administered. As with a SSAS satisfying the requirements of 2.2 above, a relevant ear-marked scheme is exempt from appointing an auditor and from producing statutory audited accounts.

### 2.3 Category 3: Ear-marked schemes

An ear-marked scheme is defined as follows:

An occupational pension scheme which is a defined contribution scheme under which all the benefits other than death benefits are money purchase benefits, and all the benefits are secured by one or more policies of insurance or annuity contracts and such policies or contracts are specifically allocated to the provision of benefits for individual members or beneficiaries or any other person who has a right to benefits under the scheme.

Ear-marked schemes are required by legislation to appoint a scheme auditor, but are not required to produce statutory audited accounts. The auditor carries out audit work covering only the payment of contributions and reports accordingly. This report is known as the 'auditor's statement about contributions', and is discussed in greater detail in para 7.3 below.

As with certain exempt SSASs, an ear-marked scheme's trust deed may specify that audited non-statutory accounts must be produced and careful checking of the trust deed is, therefore, necessary to verify this point.

	Required to appoint a scheme auditor?	Required to produce statutory accounts?	Required to obtain the auditors' statement about contributions?
<b>Category 1</b>			
Schemes outside the scope	✗	✗	✗
<b>Category 2</b>			
Exempt SSAS/RES	✗	✗	✗
<b>Category 3</b>			
Ear-marked scheme	✓	✗	✓
<b>Category 4</b>			
Other types of occupational pension schemes	✓	✓	✓

#### 2.4 Category 4: All other types of occupational pension schemes

Occupational schemes not falling into the three categories detailed above are required by law to appoint a scheme auditor and to prepare statutory audited accounts. Failure to do either may result in fines or other penalties from The Pensions Regulator (TPR – see para 3.1 below).

#### 2.5 Summary of the 'audit regime'

The following table summaries the statutory audit and accounting requirements, based on the four categories of occupational pension scheme set out above.

## 3 Summary of legislation

### 3.1 Pensions Act, Opra and TPR

The principal legislation governing occupational pension schemes are the Pensions Act 1995 (PA 1995) and the Pensions Act 2004 (PA 2004). Under PA 1995 a statutory regulator, the Occupational Pensions Regulatory Authority (Opra), was introduced whose job was to monitor and enforce pensions legislation. Opra had very wide powers to impose penalties on trustees, employers and scheme professional advisers who failed to carry out their duties properly. These ranged from suspension and prohibition orders, to civil fines of up to £5,000 for individual trustees (or £50,000 in the case of corporate trustees) and, in the worst cases, to criminal prosecutions leading to prison sentences.

PA 2004 created a new regulator, The Pensions Regulator (TPR) which has wider powers and a new proactive and risk-focused approach to regulation. TPR took over from Opra on 6 April 2005.

The detailed provisions and requirements under the PA 1995 are contained in regulations. There are more than 40 separate sets of regulations, covering more than 1000 pages. Four of these sets of regulations are of direct relevance to pension scheme accounts, as outlined below.

### 3.2 Audited Accounts Regulations

In full, these are The Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regs 1996 (SI 1996/1975) and set out details of the following:

- the requirement for trustees to obtain audited accounts within seven months of the scheme year end;
- the penalty for failing to comply with the seven-month deadline;
- the contents of the accounts in terms of specific disclosure requirements (but not the format of the accounts); and
- the content of the audit report and the auditor's statement about contributions.

The actual format of the accounts is dealt with by the SORP, as explained below.

### 3.3 Disclosure Regulations

In full, these are The Occupational Pension Schemes (Disclosure of Information) Regs 1996 (SI 1996/1655) and, among other things set out the detailed disclosure requirements of the annual report, which is explained in section 4 below.

### 3.4 Scheme Administration Regulations

In full, these are The Occupational Pension Schemes (Scheme Administration) Regs 1996 (SI 1996/1715) and cover:

- the appointment and removal procedures for scheme auditors; and
- the detailed requirements for keeping books and records.

### 3.5 MFR Regulations and PA 2004

In full, these are The Occupational Pension Schemes (Minimum Funding Requirement and Actuarial Valuations) Regs 1996 (SI 1996/1536). PA 2004 has introduced the Statutory Funding Objective – a new requirement that a scheme must have sufficient and appropriate assets to cover its technical provisions.

In both cases, their relevance to the annual report is that they specify the form and content of actuarial statements and actuarial certificates which must be included in the annual reports of defined benefit schemes, as explained more fully in Section 4 below.

### 3.6 Statement of Recommended Practice – Financial Reports of Pension Schemes (SORP)

Because the regulations referred to in para 3.2 do not specify the format of pension scheme accounts in any detail, a statement of recommended practice was developed which sets out best practice in the area of pension scheme accounting. As with all SORPs, it is endorsed by the Accounting Standards Board. The original pensions SORP, which was known as SORP 1: Pension Scheme Accounts, was published in 1986; this was replaced in 1996 by a new SORP Financial Reports of Pension Schemes, following the introduction of the Pensions Act in April 1997. This SORP was brought fully up to date in November 2002 and is now referred to as Financial Reports of Pension Schemes (Revised November 2002). The SORP was developed and revised by the Pensions Research Accountants Group (PRAG) and is currently published by CCH Ltd, from which copies are available.

The SORP provides the format for pension scheme accounts, sets out the main principles on which pension scheme accounts should be prepared and gives detailed disclosure requirements. In the main, the disclosure requirements of the SORP mirror those set

out in the Audited Accounts Regulations, but there are one or two additional requirements, which are covered in the sections below.

Although the SORP sets out recommended practice, its provisions are effectively mandatory. This is because, under guidance issued by the Auditing Practices Board, Practice Note 15: *The audit of occupational pension schemes in the United Kingdom* (PN15), there is a strong presumption that pension scheme accounts will only show the true and fair view required by law if they comply with the recommendations of the SORP. Material non-compliance would, therefore, almost certainly lead to a qualified audit report. Both FRS 18: *Accounting Policies* and the Audited Accounts Regs set out a requirement for pension scheme accounts to disclose whether or not they comply with the SORP and to set out details of, and reasons for, non-compliance.

### 3.7 Accounting standards

The SORP has been drafted such that if its provisions are followed, the accounts will comply with all relevant accounting standards.

Preparers of pension scheme accounts may, however, encounter situations where there is no guidance in the SORP and, in such situations, they must fall back on Accounting Standards. An example is where a prior-year adjustment is necessary, either because there has been a change of accounting policy, or a fundamental error in a previous year. There is no detailed guidance on prior-year adjustments in the SORP and, therefore, FRS 3: *Reporting Financial Performance* must be followed.

## 4 Contents of the pension scheme annual report

The annual report of a pension scheme is analogous to the annual report for a company, but there are some important additional elements. The following paragraphs set out the typical contents of a scheme annual report.

### 4.1 Trustees' report

The trustees' report is the equivalent to a directors' report in a company annual report. Per the SORP, its purpose is to demonstrate accountability of the trustees to the members, employers, regulators and other persons involved in the scheme. It must contain certain information prescribed by the Disclosure Regs, including details of:

- the trustees who served during the scheme year, how they are appointed and how they may be removed. The SORP suggests that this could be extended to show changes to the trustees to the date of approval of the annual report;
- the scheme's professional advisers, including any changes in the year;
- the membership of the scheme – the number of beneficiaries and active, deferred and pensioner members at any one date during the year;
- pension increases granted to pensions in payment and deferred pensions and the extent to which they were discretionary;
- a statement as to whether the accounts have been prepared and audited in accordance with regulations made under PA 1995 s 41(1) and (6);
- a copy of any statement made on the resignation or removal of the auditor or actuary;
- employer-related investments;
- if the auditors' statement is negative or qualified, an explanation of why and how the situation will be resolved;
- a contact address for enquiries of either a general nature or about an individual's entitlement to benefit; and
- if any cash equivalents paid in the year were less than the full cash equivalent to which the member was entitled this should be disclosed together with a reason why they were less.

Other details relating to the scheme's investments must be included in an investment report, discussed in para 4.2 below.

#### 4.2 Investment report

Most schemes include a separate investment report, although strictly speaking this is part of the trustees' report and the information in it can be included in the trustees' report instead. The objectives are to outline and explain the trustees' investment policy and to review the investment performance. Wholly insured schemes which meet specified criteria are exempt from the requirement to provide an investment report. In accordance with the Disclosure Regs, the following information should be included in the investment report:

- details of who has managed the investments and the extent of any delegation of this function by the trustees;
- whether the trustees have prepared a Statement of Investment Principles (SIP) – this is a formal

document required by PA 1995, setting out the trustees' investment policies, and all schemes, except for wholly insured schemes, should have one;

- a note of the trustees' policy on the custody of investments;
- information about how the scheme's investments have performed, over the period covered by the accounts and for a three- to five-year period up to the end of the period covered by the accounts;
- information about any investments which are:
  - not made in accordance with the trustees' SIP; and
  - employer-related investments.

Many trustees ask their fund manager to draft the investment report on their behalf. However, responsibility for the investment report remains with the trustees.

#### 4.3 Compliance statement

The compliance statement is a device introduced under the revised SORP. It can be used to disclose information which is required to be disclosed in order to comply with the law (hence the term 'compliance statement'), but which is not of such significance to the users of the annual report that it requires the more prominent disclosure afforded by inclusion in the trustees' report itself. In practice, few schemes choose to use a compliance statement and instead include all the required information in the trustees' report.

#### 4.4 Statement of trustees' responsibilities

The annual report must contain a statement of trustees' responsibilities, as required by SAS 600: *Auditors' reports on financial statements*. This statement sets out to distinguish between the trustees' and the auditors' responsibilities in relation to preparation of financial statements, monitoring of contributions, keeping of books and records, and prevention and detection of fraud. If this is not provided within the trustees' report or as a separate statement, then it should be provided in the auditors' report.

#### 4.5 Audit report and auditors' statement about contributions

The contents of the audit report and statement about contributions are dealt with in section 7.

#### 4.6 Audited accounts

The audited accounts comprise two primary statements: the Fund Account (which is broadly equivalent to a profit and loss account) and a Net Assets Statement (broadly equivalent to a balance sheet). Pension scheme accounts are not required to include a cash flow statement or a statement of total recognised gains and losses. The format of the primary statements and the detailed requirements for disclosure are dealt with in para 6.1 and Appendix 1.

#### 4.7 Actuarial statement and certificate

As outlined in 3.5 above, PA 2004 has provided new requirements with regards the basis of actuarial valuations which are expected to be laid before Parliament on 22 September 2005 and, therefore, effective from 23 September 2005 (hence the significance of this date below).

As such, schemes are currently in a transitional period between the requirements of the MFR regulations and PA 2004. In summary, if the actuarial valuation date is before 23 September 2005, then the scheme is still subject to the MFR regulations and as such schemes are required to include in the annual report:

- a copy of the latest actuarial statement. This is a one or two-page extract from the full 'ongoing' actuarial valuation (as distinct from the Minimum Funding Requirement (MFR) valuation), which is updated every three years;
- a copy of the latest actuarial certificate. This is a document in which the actuary certifies that contributions shown on the schedule of contributions are sufficient to achieve the minimum funding requirement. Many schemes require an annual recertification of the contribution rates. However, schemes which have valuations with an effective date on or after 19 March 2002, and which show funding of 100% or more on an MFR basis, need not obtain annual re-certifications from the actuary.

For actuarial valuations with an effective date after 23 September 2005, schemes are subject to the new regulations. Similar to above, it is expected that two reports will be included in the annual report:

- a copy of the actuarial statement which certifies the calculation of the technical provisions; and
- a copy of the latest actuarial certificate confirming the adequacy of the schedule of contributions.

## 5 Detailed requirements for preparing statutory accounts

### 5.1 Time limits and penalties

Regulation 2 of the Audited Accounts Regs requires trustees to obtain, within seven months of the scheme year end, audited accounts. These must:

- contain the information specified in the Schedule to the Disclosure Regs; and
- show a true and fair view of:
  - the financial transactions of the scheme during the scheme year;
  - the amount and disposition of the assets at the end of the scheme year; and
  - the amount and disposition of the liabilities of the scheme, other than the liabilities to pay pensions and benefits after the end of the scheme year.

Failure to comply with the requirements set out above is a serious breach of the PA 1995, and TPR has the power to fine defaulting trustees up to £5,000 each (or £50,000 in the case of a corporate trustee) or suspend or disqualify them from acting as trustees in the future.

### 5.2 Accounting periods

Pension scheme accounting periods must be for a minimum of 6 months and a maximum of 18 months. Generally speaking, periods should be for one year. The only exceptions should be in the first and last accounting periods, where a longer or shorter period might be appropriate and in cases where the trustees wish, for a valid reason, to change the accounting date, for example, to make it coterminous with the employer's year end. It is not appropriate to prepare accounts for an extended period simply in order to avoid missing deadlines.

### 5.3 Comparative amounts

Corresponding amounts relating to the previous scheme year should be disclosed for every amount shown in the financial statements, including the notes to the financial statements, with an exemption applying to amounts of investment sales and purchases. If either the current or prior period relates to a period of more or less than 12 months, this should be disclosed. Comparative amounts are not required where audited accounts are being produced for the first time.

### 5.4 Filing requirement

Currently, there is no requirement to file the annual report and accounts for pension schemes as there is with company accounts – there is no equivalent to Companies House for pension schemes, although TPR does have the power to request copies of audited accounts. TPR will, however, begin to collect data from the majority of schemes via an annual scheme return.

### 5.5 Non-statutory accounts

The seven-month deadline and the requirement to include the information set out in the Schedule to the Disclosure Regs do not apply to non-statutory accounts. However, such accounts must comply with the SORP if they are intended to show a true and fair view – see para 3.6 above.

## 6 Pension scheme accounts – the accounting principles

### 6.1 The SORP

The SORP sets out the accounting principles under which pension scheme accounts should be prepared and the disclosures that should be made in order that the accounts show a true and fair view and contain the information prescribed by the regulations. The SORP applies to all pension scheme accounts that are required to show a true and fair view, whether or not they are statutory accounts – see para 3.6 above.

While the SORP reflects the correct application of current accounting standards to pension schemes, it is important to note that, should mandatory requirements change as a result of changes to legislation or accounting standards, the revised guidance will override the SORP until the SORP itself is updated.

The Audited Accounts Regs require pension scheme accounts to include:

- an account of the financial additions to, withdrawals from and changes in value of the fund of the scheme during the scheme year to which the accounts relate – ‘the Fund Account’; and
- a statement, as at the end of the scheme year to which the accounts relate, of the assets, and liabilities of the scheme, other than liabilities to pay pensions and benefits after the end of that scheme year – ‘the Net Assets Statement’.

The format of the Fund Account and Net Assets Statement is shown in Appendix 1.

### 6.2 Fund account

The SORP, reflecting FRS 18: *Accounting Policies*, requires that pension schemes should prepare their accounts on an accruals basis, and that this should be applied consistently from one accounting period to the next. The policies adopted in applying the accruals concept to significant categories of income and expenditure such as contributions, investment income, transfer values and benefits should be disclosed.

The text that follows sets out the correct accounting treatments for the various elements of the fund account, together with additional background material where appropriate. Scheme income is covered first, followed by scheme expenditure.

### 6.3 Contributions

Contributions will usually be receivable from the employer and employees. It is a condition of being granted tax exempt approved status (see section 2, last bullet point, above) that the employer must make contributions to the scheme. The only common circumstances in which there will be no employer contributions are where the actuary has agreed a ‘contributions holiday’ (in circumstances where a defined benefit scheme is over funded or ‘in surplus’), or where the scheme has been discontinued (usually pending wind up).

In most schemes, the rules of the scheme require employees to make contributions, but in some schemes they do not – these are known as non-contributory schemes.

The rates of employer and employee normal contributions and the due dates for their remittance to the scheme, are recorded in the contributions schedule (see para 7.1 below). Rather than being accounted for by reference to these due dates, the SORP requires such contributions to be accounted for in the period to which the corresponding wages and salaries are paid. See Example 1 below.

#### Example 1

A scheme has a 31 December year end. The schedule of contributions gives the due date for normal contributions as the 19th day of the month following the deduction of employees’ contributions from the payroll, thus they are due by 19th January. December’s contributions should be accounted for in December (because they relate to December wages) rather than January, when they are due to be paid to the scheme.

Schemes may allow employees to make additional voluntary contributions (AVCs), which go to provide additional benefits to members on retirement. AVCs are defined as contributions that a member may make in addition to those required to be made under the scheme rules. AVCs are not required to be recorded on the contributions schedule and the SORP requires them to be accounted for as soon as they are deducted from the payroll.

From time to time, the employer may be required to make special contributions, most commonly to make up an actuarial deficit in the scheme or to augment a specific member's benefits. Special contributions should be accounted for either in accordance with the agreement under which they are being made or, if there is no agreement, on a cash receipts basis. Special contributions should be disclosed separately in the accounts, with an explanation as to the period over which they will be made and the reasons why they are being made.

Special contributions will not normally be set out explicitly on the contributions schedules, as they may not be capable of being predicted with any accuracy; however, many contributions schedules include a sentence referring to, for example, 'additional contributions as may be required from time to time'.

Age-related rebates should be accounted for on an accruals basis, based on the contracted out earnings of the relevant members during the scheme year.

The various types of contributions payable to the scheme should be analysed in a note to the accounts (see Example 2). It may also be necessary to provide a

separate Summary of Contributions for which the Auditor to report on in their Statement about Contributions, as discussed in the penultimate para of 7.3 below.

#### 6.4 Transfers into the scheme

A member of a pension scheme may, subject to the rules of the schemes involved, elect to transfer across any accrued benefits from their previous membership in other pension schemes. Such transfers are known as individual transfers in. If an employer wishes to consolidate a number of related pension schemes, for example, after a company takeover, he may transfer a group of employees into the scheme, along with their accrued benefits; this is known as a bulk or group transfer in.

Individual transfers in should be recognised in the accounts only when the assets are received by the scheme, as that is the point from which the receiving scheme assumes the liability to pay benefits in relation to the assets transferred. A bulk transfer should be recognised in the accounts in accordance with the terms of the legal agreement for the transfer.

A note to the accounts should disclose an analysis of total transfers in between individual and bulk transfers.

For bulk transfers, the note should also disclose how the transfer value was paid if this was not by cash payment, for example, by transfer of ownership of investments. Care should be taken when accounting for bulk transfers, that there is consistency between the accounts and the membership reconciliation. If there is a material difference this should be disclosed in the trustees' report or the financial statements.

#### Example 2 – disclosure of contributions in the notes to the accounts

	2004	2003
	£'000	£'000
Employers		
Normal	275	265
Special	125	–
Members		
Normal	138	130
AVCs	<u>54</u>	<u>49</u>
	592	444

The employers' special contributions will be made at the rate of £125,000 for 2004 and the next three years, in order to fund the MFR shortfall.

### 6.5 Investment income

Income arising on the scheme's investments, such as interest on cash or bonds, dividends on equities and rental income on property investments, is often the second most significant source of income for a pension scheme. Certain types of investment vehicles, such as some unit trusts, do not distribute income but retain and reinvest it, hence enhancing the market value of the units.

Where investment income is distributed, it should be recognised in the accounts on an accruals basis. Dividends should be accrued when the shares are quoted 'ex-dividend'; interest should be accrued on a daily basis and rental on properties should be accrued by reference to the terms of the lease. A note to the accounts should disclose an analysis of the total investment income by major asset class.

Where investment income is not distributed, a note should be made in the accounting policy note to this effect.

### 6.6 Realised and unrealised gains or losses on investments

Since investments are required to be shown at market value in the accounts (see 6.15 below), it is necessary to recognise in the Fund Account any unrealised gains or losses arising at the year end. These are added to any realised gains or losses arising in the year (that is, profits or losses made on the sale of investments) and shown as a single figure, 'change in market value of investments' in the Fund Account.

### 6.7 Benefits and expenses

The principal expenses of pension schemes are as follows:

#### 6.8 Benefits payable

Under UK Regulations, pension scheme accounts are not required to account for liabilities to pay pensions and other benefits after the end of the scheme year. Only benefits which fall due for payment in the accounting period should be recognised in the accounts.

The membership statistics reported in the trustees' report should be consistent with the accruals treatment applied when accounting for benefits.

Benefits fall into three main categories: pensions payable, which are the regular (usually monthly) payments to the pensioners; lump-sum retirement benefits (also sometimes referred to as commutations), which represent the tax-free lump sums which new

pensioners may elect to receive; and lump-sum death benefits, which represent payments of death-in-service benefits to the dependants of active members who die in service or death-in-retirement benefits to the dependants of deceased pensioners.

Where a member has a choice of benefit, the liability passes at the later of retirement/leaving/death and the date on which the member makes their benefit selection. Where a member has no choice, the liability and, therefore, the need to account for the transaction, arises at the date of leaving/retirement. Therefore:

- Regular pension payments should be recognised in the accounts in the month to which they relate.
- Lump-sum payments should be recognised from the later of the date of retirement and the date on which the member concerned makes their benefit selection.
- Death benefits should be recognised from the date of death.

In some schemes, rather than operating a pensions payroll, pensions are settled by purchasing an annuity for the retiring member. The responsibility for paying the monthly pension is thus transferred to an insurance company. Where annuities are purchased in the name of the individual member, the treatment required by the SORP is to account for the entire capital cost of the annuity as an expense in the year of retirement. This would be described in the accounts as 'purchase of annuities'.

Alternatively, annuities may be purchased in the name of the trustees, such that the income arising on the policies is paid to the trustees in order to fund the payments to pensioners. In these circumstances, the scheme simply acts as a collecting agency and it is acceptable under the SORP for the income and expenditure (that is, the payment to the pensioner) to be netted off. Where the amounts involved are material, a note to the accounts should disclose the value of annuity income netted off against pension payments.

A note to the accounts should disclose an analysis of total benefits payable between the four categories set out above.

#### 6.9 Payments to leavers

'Leavers' refers to those who leave the scheme before retirement age and who are, therefore, not entitled to benefit payments as such. Members who have completed less than two years' service are entitled to a refund of their own contributions (but not those made

on their behalf by the employer), less a tax charge. If the scheme is contracted out of S2P, it must also pay a state scheme premium (sometimes called a contributions equivalent premium (CEP)) to the government which 'buys back' the S2P entitlement of the leaver for the period during which they were a member of the scheme.

Members who have completed more than two years' service may choose, on leaving, to keep their benefits in the scheme, which would become payable as a pension on reaching normal retirement age. In this situation, the members would become a deferred member of the scheme. However, they can also elect to have the accrued benefits paid to any new occupational pension scheme that they join, or to a personal pension. These are accounted for as 'individual transfers out' of the scheme. 'Bulk transfers' out are also possible, for example, when an employer sells one of its subsidiaries and the employees move *en masse* to a new scheme.

A transfer out should normally only be recognised in the accounts at the point that it is paid over to the receiving scheme (in other words, it should not be accrued pending payment). This is because the scheme retains liability to pay benefits in respect of the member to be transferred until the assets are actually in the hands of the receiving scheme. The member concerned should continue to be shown as a deferred member until the point at which the transfer is recognised in the accounts.

The SORP does make it clear that if significant potential transfers exist at the year end, (which for the

reasons set out above would not be accrued in the accounts), disclosure should be made of the amounts involved.

Where a bulk transfer is subject to a legal agreement in which the receiving scheme's trustees agree to accept liability in advance of the transfer of funds, the SORP's recommendation is that an accrual should be made in the accounts, in accordance with the terms of the agreement.

A note to the accounts should provide an analysis of total transfers out between individual transfers and bulk transfers.

For bulk transfers, the note should also disclose how the transfer value was paid if this was not by cash payment, for example, by transfer of ownership of investments. Care should be taken when accounting for bulk transfers, that there is consistency between the accounts and the membership reconciliation. If there is a material difference this should be disclosed in the trustees' report or the financial statements.

### 6.10 Administrative expenses

The costs of running the scheme may be borne by the scheme or the employer. If the employer bears the expenses, this fact should be disclosed in the accounts, but no figures need be included.

Where the scheme bears the expenses, they should be accounted for on an accruals basis. Disclosure should include an analysis of the most significant expense headings (see Example 3).

#### Example 3 – Analysis of administrative expenses in the notes to the accounts

	2004	2003
	£'000	£'000
Administration and processing	25	23
Actuarial fees	15	18
Audit fee	5	5
Legal and other professional fees	2	3
	47	49

### 6.11 Fees paid in respect of fund management

Fees paid to the fund manager will typically be a flat fee or a percentage of the assets under management or a combination of the two. Such fees should be recognised on an accruals basis. Where the fund is in the form of a pooled investment vehicle (this is explained in para 6.15 below), the fund management fee is often deducted from the unit price and is difficult to identify separately. In these circumstances, the fact that the unit price is adjusted should be disclosed but it is not necessary to split out the fee, add it back to the unit price and show it separately as a fund account item. Many self-administered schemes appoint their own investment custodian, and the fees for this service should be accrued and disclosed along with the management fees. Where they are significant, they could be shown separately.

Any fees paid for performance measurement services or other consultancy or advisory work should be accrued and shown separately where they are material (see Example 4 below).

### 6.12 Treatment of taxation

An exempt approved scheme (see 2.1, last bullet point, above) does not pay tax on most of its income or on the capital gains on its investments.

However, tax is effectively suffered on certain types of investment income, in particular on dividends from UK equity holdings. Since 1997, schemes are unable to recover this tax suffered and, therefore, investment income should be recognised in the fund account net of tax credits. Where investment income is received

which is subject to overseas withholding tax, the income should be recognised gross (that is, including the tax element) in the fund account and, where the tax element is irrecoverable, it should be shown as a separate tax charge.

### 6.13 Format of the fund account

When organising these various items of income and expenditure into a primary statement for the accounts, rather than simply listing total income and total expenditure, the SORP gives a more structured format which separates income and expenditure from dealings with members, from returns on investments. The SORP's recommended format for the fund account is illustrated in Appendix 1.

'Other income' and 'other payments' categories can be used for any income or expenditure that does not fall easily into the other main categories set out above. A note to the accounts should analyse and explain the individual elements within each of these headings.

### 6.14 Net assets statement

The net assets statement shows the scheme's investments at market value and the scheme's current assets and liabilities. The scheme's long-term obligations to pay pensions and benefits which fall due after the end of the scheme year are not required to be shown in the net assets statement – hence there is no balance sheet as such.

### 6.15 Valuation of investments

The basic principle for the valuation of investments is that they should be recognised in the net assets

#### Example 4 – Analysis of fund management expenses in the notes to the accounts

	2004	2003
	£'000	£'000
Administration, management and custody	56	59
Performance measurement services	5	5
Other advisory fees	14	3
	<u>75</u>	<u>67</u>

statement at their market value at the scheme year-end date. For many commonly held investments, this is straightforward – for example:

- quoted securities such as shares or bonds should be recognised at the closing price (last trade price or mid-market price) set by the stock exchange or other market on which they are quoted;
- units in pooled investment vehicles (such as unit trusts, open-ended investment companies (OEICs), managed funds and unitised insurance policies) should be recognised at the average of the closing bid/offer price quoted by the operator of the fund.

Where a market value is not readily available, the investments should be included at their fair value estimated by the trustees. The fact and reason for the use of a trustees estimation should be disclosed. For example:

- unquoted shares or bonds should be valued based on the advice of the fund manager or another appropriately qualified professional adviser, following appropriate guidance such as the British Venture Capital Association guidelines; and
- property should be valued by a qualified surveyor, based on appropriate guidance, for example, from the Royal Institution of Chartered Surveyors. The name or employing firm, and qualification of the valuer, and the date and basis of valuation should be disclosed in the notes to the financial statements.

The method of valuation used for each class of investments, and whether or not any external advice has been obtained by the trustees in estimating fair value, should be included in the disclosure of the scheme's accounting policies.

Investments with prices quoted in foreign currency should be translated at closing spot exchange rates. Any gain or loss arising on translation should be accounted for under change in market value in the fund account.

Many smaller schemes are invested wholly or partially in insurance policies. These can be more difficult to value on a market-value basis, as there is really no market as such for these kinds of investment vehicles. There are a number of ways in which it is possible to give an approximation of market value for an insurance policy, and the SORP lists these as follows:

- the premium-value basis, which is a measure of the replacement cost of the policy to the scheme;
- an actuarial value, which is based on the discounted value of future cash flows under the policy; and

- the surrender value, which is what the scheme would be likely to receive if the policy were to be surrendered.

In practice, the insurance company which provides the investment will determine the valuation method used and the trustees should ensure that the method used is one that is acceptable under the SORP. It is important to make sure that the method is used consistently from one year to another, unless the circumstances of the scheme change.

A scheme may also hold insurance policies, in the form of annuity contracts, where it uses such policies to secure members' benefits on retirement. Such annuities effectively discharge the trustees' liability to pay benefits to the individuals concerned (this liability becomes that of the insurance company which has provided the annuity) and, therefore, such policies should not be recognised in the net assets statement. The correct accounting treatments in relation to the purchase of annuities to secure benefits is explained in 6.8 above.

In ear-marked schemes (see para 2.3 above for the definition of such schemes), an insurance policy is taken out in respect of each individual member of the scheme. The contributions made to the scheme are paid into each policy and the benefits at retirement are determined by the value of the policy at retirement. The regulations allow the market value of such ear-marked insurance policies to be excluded from the net assets statement and instead the premiums payable to the insurance policies are recognised as expenses in the fund account. As noted above, ear-marked schemes are exempt from the statutory requirement to prepare accounts, hence, this accounting treatment is largely academic; however, ear-marked schemes may be required under the terms of their trust deeds to prepare accounts and, in these cases, the above accounting treatment should be adopted.

## 6.16 Recognition of defined contribution assets

In most defined contribution schemes, each member has their own 'pot' of assets, into which their contributions are invested, and which, together with the investment gains accruing, is used to provide the member with their benefits on retirement. In such schemes, there is, therefore, no common pool of assets, but a fund comprising a number of designated accounts, that is, designated as being held solely for the benefit of each named member. This designation of assets may be recorded by either the administrator or the investment manager.

The net assets statement of defined contribution schemes should reflect this structure by clearly

distinguishing between those assets which are designated to members and those which are not (such as unallocated funds arising from early leavers). The notes to the accounts should explain the fact that no common pool of assets exists. See Example 5.

### Example 5 – extract from the investments note for a defined contribution scheme

Investments purchased by the scheme are allocated to provide benefits to the individuals on whose behalf the corresponding contributions were paid. Accordingly, the assets identified as designated to members in the net assets statement do not form a common pool of assets available to members generally. Members each receive an annual statement confirming the contributions paid on their behalf and the value of their money purchase rights.

### 6.17 Recognition of assets deriving from AVCs

As stated at 6.3 above, members may make AVCs in order to provide additional benefits at retirement. There are a number of different ways in which these additional benefits can be provided, for example:

- on a defined contributions basis, where the AVCs are invested in an individual account for the member concerned. This may be with a separate provider or with the main assets of a defined contribution scheme. The accumulated fund in the account at retirement is used to provide the benefits, often by purchasing an annuity;
- on a defined benefit basis, where the AVCs are invested along with the main investments of the scheme and used to buy 'added years' of service.

The SORP requires investments arising from defined contribution AVCs to be shown separately in the net assets statement or the notes to the accounts, and the inclusion of an explanation of the type of AVC arrangement and how the contributions have been invested. See Example 6.

Where AVCs are provided on a defined benefit basis, separate disclosure is not required, although the existence of such assets should be explained.

### 6.18 Schemes with multiple benefit structures

It is increasingly common for schemes to combine the advantages of the two main types of benefit structures:

- under one trust, a scheme may have both a defined benefit section and a defined contribution section. This typically arises when a defined benefit scheme closes to new members but a defined contribution section is established within the same scheme for new members. This is a mixed benefit scheme.

### Example 6 – extract from the investments note to the accounts

#### AVC investments

The trustees hold assets invested separately from the main fund in the form of individual deposit accounts and insurance policies securing additional benefits on a defined-contribution basis for those members electing to pay additional voluntary contributions. Members participating in this arrangement each receive an annual statement made up to [scheme year-end date] confirming the amounts held to their account and the movements in the year. The aggregate amounts of AVC investments are as follows:

	2004	2003
	£'000	£'000
Midshires Bank	1,735	1,688
Legal & Prudent Life Company	12,897	10,927
	<u>14,632</u>	<u>12,615</u>

- a scheme which requires the benefit to be calculated as the better of two alternatives, for example, a defined benefit scheme which keeps a notional record of benefits as though they were accruing on a defined contribution basis (a 'defined contribution underpin'). On leaving/retirement, the benefits calculated on the two bases are compared and the higher is paid. This is a hybrid scheme.

The SORP's recommendation is for the fund account of mixed benefit schemes to be presented with a separate column for each section, together with a total column and a total column only for the comparatives. Transfers between the two sections should be dealt with in the reconciliation of movements in net assets within the fund account, see Example 7.

The net assets statement for a mixed benefit scheme should also be in two sections, such that it is clear how the total assets are split between those designated to the defined contribution members and those that form a pool to pay benefits to the defined benefit members. If one section of the scheme is not material to the scheme as a whole, an alternative approach is to adopt the recommended format for the largest section and to disclose the net assets attributable to the other section, and any movement between the sections, in a note.

### 6.19 Common investment funds

Sometimes a group of companies operate separate pension schemes but maintain a single pooling arrangement, a common investment fund (CIF), for all of the investments of the schemes. The CIF is established under a separate trust deed and each participating scheme's interest is usually expressed as units in the CIF.

The SORP suggests that it is not sufficient to simply state the number of shares in the CIF owned by the scheme, but that more information on the underlying assets should be provided. This is because, as for pooled investment vehicles, it is useful to disclose to readers the underlying economic exposure of the investments, and secondly, that the CIF is likely to be a related party as it is likely to share trustees with the pension scheme.

The SORP, therefore, recommends that pension scheme accounts should disclose the proportion of the CIF owned by the scheme at the start and end of the period and either include the financial statements of the CIF itself, or provide details of the CIF's investment portfolio and income, and state the scheme's share thereof. Sufficient information should be provided to meet the disclosure requirements of the Audited Accounts Regs and the SORP. The scheme's investment report should also include appropriate details of the CIF investments and performance.

### 6.20 Futures and options

Many large schemes use futures and options (collectively known as derivatives), most commonly to switch quickly from one asset class to another. The SORP gives full guidance on how such derivative contracts should be recognised in the accounts and the disclosures that should be made.

### 6.21 Other disclosure requirements

#### Basis of preparation

It is a requirement of the Audited Accounts Regs and of FRS 18: *Accounting Policies* that pension scheme accounts include a statement confirming that they have been prepared in accordance with the SORP. If

### Example 7 – extract from fund account of a mixed benefit scheme

	2004 <i>DB section £</i>	2004 <i>DC section £</i>	2004 <i>Total £</i>	2003 <i>Total £</i>
Net increase in the fund during the year	175,000	25,000	200,000	145,000
Net assets of the scheme:				
at 1 Jan 2004	5,720,000	850,000	6,570,000	6,425,000
Transfers between sections	(17,500)	17,500	–	–
at 31 Dec 2004	5,877,500	892,500	6,770,000	6,570,000

there are any material departures from the SORP, there must be a description of how the accounts depart from the SORP's recommendations, including the reasons why the alternative treatment adopted is deemed by the trustees to be more appropriate, details of any disclosures recommended by the SORP that have been omitted and the reasons for this.

It is also usual to indicate that the accounts have been prepared in accordance with the Audited Accounts Regs.

The basis of preparation statement must also state that the accounts do not take account of obligations to pay pensions and other benefits which fall due after the end of the scheme year. In the case of defined benefit schemes, the preparation statement should cross-refer to the actuarial statement, which does take into account these obligations.

## 6.22 Accounting policies

The accounting policies adopted when dealing with material items must be clearly explained in the notes to the accounts together with any significant estimation techniques. The critical accounting policies will normally include:

- the policies adopted in applying the accruals concept to significant categories of income and expenditure, such as contributions (including AVCs), investment income, benefits and payments to leavers;
- the methods used to value investments (see para 6.15 above);
- the basis of foreign currency translation;
- the basis on which fund management expenses are measured and disclosed.

Other, more specialised accounting policies might include the treatment of the acquisition costs on investments, the treatment of futures and options, the treatment of interest on property developments and the bases adopted for accounting for investments in subsidiary and associated undertakings.

Consistency of accounting treatment between periods is a fundamental accounting concept. A change in accounting policy should not be made unless it can be justified that it gives a fairer presentation of the transactions and disposition of the net assets of the scheme. If a change in accounting policy does occur, it should be disclosed with the reasons for the change, and if practicable the effect of a prior year adjustment on the figures of the previous year and the impact on the current year figures.

## 6.23 Investment disclosures

There are a number of disclosures that must be made in relation to the scheme's investments. The notes to the accounts should include each major category of investments at market value, including:

- insurance policies – with-profits and deposit administration type;
- fixed-interest securities – analysed between 'public sector' (for example, gilts) and 'other' (for example, corporate bonds);
- equities (ordinary shares);
- index-linked securities – analysed between 'public sector' and 'other';
- pooled investment vehicles – split between property unit trusts, other unit trusts, property managed funds and other managed funds, OEICs and unitised insurance policies;
- property;
- any investments not falling into one of the categories above (that is, 'other' investments);
- cash deposits; and
- separately invested AVCs.

Each category (where appropriate) should be further analysed between 'quoted' and 'unquoted' securities and between 'UK' and 'overseas'.

The total purchases and sales of investments in the year should be disclosed and the SORP recommends that they should be presented so that they provide, when taken together with changes in market value during the period, a reconciliation between the opening and closing portfolio of investments (see Example 8 on the following page).

Where a scheme has pooled investment vehicles, these should be analysed between those managed by UK-registered companies and those managed by overseas companies.

Any significant restrictions affecting the ability of the scheme to realise its investments at all, or at the value at which they are included in the accounts, should be disclosed.

If more than 5% of the net assets of the scheme are invested in an insurance policy, the disclosure should include their main characteristics, including:

### Example 8 – disclosure of investment movements

	Value at 1.1.04	Purchases	Sales	Change in market value	Value at 31.12.04
Fixed-interest	50,500	5,000	(3,000)	595	53,095
Equities	155,000	27,000	(35,000)	(15,750)	131,250
Pooled investment vehicles	175,000	15,000	(19,000)	(16,000)	155,000
AVCs	35,500	1,750	(2,750)	–	34,500
	<u>416,000</u>	<u>48,750</u>	<u>(59,750)</u>	<u>(31,155)</u>	<u>373,845</u>
Cash deposits	<u>12,000</u>				<u>12,750</u>
	<u>428,000</u>				<u>386,595</u>

- type of policy;
- name of the insurance company involved;
- method of bonus distribution and details of the latest bonus declaration and interim bonus rates;
- whether the policy document has been issued;
- method of valuation used and the date of the valuation;
- name of the valuer (most likely this will be the insurance company which has issued the policy); and
- amounts of premiums (contributions) paid in the year.

Details must be given of any concentration of investments, that is any single investment (other than UK government securities) that accounts for more than 5% of the net assets of the scheme.

#### 6.24 Related-party transactions

Material transactions between a pension scheme and its related parties should be disclosed in the accounts in accordance with FRS 8: *Related-Party Disclosures*. This is to ensure that the user of the accounts is aware that the position of the scheme may be affected by the existence of related parties and material transactions with them.

The related parties of pension schemes can be classified as:

- employer-related parties (including all the employers in relation to the scheme and other group companies, and their directors);
- trustee-related parties (including the trustees and

their close families, key management of a corporate trustee and their close families, entities controlled by the scheme itself and entities owned or controlled by the trustees); and

- officers and managers (including the key managers of the scheme, their close families and entities owned or controlled by them). Entities engaged by the trustees to manage the pension scheme or its assets should be presumed to be related parties – this, therefore, includes the scheme administrator and investment manager.

Any material related-party transaction, which is defined as the transfer of assets or liabilities or the performance of services by, to or for a related party, should be disclosed in the accounts of a pension scheme. Disclosures should include:

- the names of the transacting parties and a description of the relationship between them;
- a description of the transaction, including the amounts involved; and
- any other details necessary for a full understanding of the financial statements.

Amounts owing to and from related parties at the year end should be disclosed in the accounts, together with details of any amounts written off or provided against such balances.

It is normally acceptable to disclose the following types of related-party transactions on an aggregated basis:

- the payment of contributions by the employer;
- the payment of benefits under the scheme to trustees; and
- the payment of fees and expenses, in the ordinary course of business, to trustees, scheme advisers and managers.

Where the employer bears the administrative and investment management costs of the scheme, that fact should be disclosed as a related-party transaction in the financial statements, but it is not necessary to disclose the amounts involved.

### 6.25 Stock lending

The SORP includes details of the disclosures required in respect of a scheme's stock lending transactions. In summary, disclosure should be made:

- if the scheme's custodian is authorised to loan the scheme's stock (even if they have not done so);
- of the major characteristics of the stock lending arrangements in place if material amounts of stock lending income have been earned in the year;
- the total value of securities out on loan at the year end, with analysis and detail of collateral.

### 6.26 Schemes in winding up

Schemes which are in the process of winding up are still subject to the requirements to produce an annual report and audited accounts. However, certain implications of a wind up may lead to the scheme qualifying for an exemption from this requirement. For example, at some stage during wind up the scheme's total membership will fall below two, and as noted in section 2.1 above, schemes with less than two members in total fall outside the requirement to prepare audited accounts. Trust law and best practice indicate that trustees should continue to prepare accounts which demonstrate their stewardship of the scheme up to the date that wind up is complete.

As such, on the completion of the winding up, final accounts should be prepared such that the trustees can demonstrate that all members' benefits have been secured and all scheme assets distributed in accordance with the scheme rules and relevant regulations. The final accounts should show net assets of zero.

In the event that a scheme commences winding up, it is no longer a going concern and as such the trustees should re-consider the bases of valuation of assets. The key consideration is to ensure that the valuation bases

used are consistent with the intended method and timescales for wind up and that the valuations applied can reasonably be expected to be achieved, with appropriate allowance for the costs of realisation.

Looking at specific types of investments:

- quoted investments would usually continue to be valued as described in 6.15 above, although the trustees should consider the need for an adjustment to ensure the investments are valued at net realisable value;
- unquoted investments, including properties should be valued at the trustees' estimate of net realisable value; and
- insurance policies should be valued using an appropriate method; surrender value may be the only reliable basis available at an acceptable cost, and would be consistent with the basis adopted for MFR purposes.

The bases of valuation should be disclosed. Certain other disclosures should also be made in the annual report:

- change in investment policy as a result of winding up;
- any claims and contingent assets;
- the amount of, and accounting treatment for, unpaid contributions;
- if an independent trustee has been appointed, an explanation of their role;
- any temporary embargo on benefit payments; and
- the likely timescale for the wind up, to the extent that this can be assessed.

For schemes that are subject to the MFR Regs (defined benefit, mixed benefit and hybrid schemes), the requirement for periodic MFR valuations continues throughout the period of winding up. However, the need for a schedule of contributions lapses as soon as wind up commences. In such cases the auditors' Statement about Contributions will refer to compliance with the schedule of contributions to the date that wind up commenced, and thereafter with the scheme rules and recommendations of the actuary.

For defined contributions schemes, the requirement for a payment schedule continues until wind up is complete. As such the trustees should revise the payment schedule to reflect that no contributions are payable.

### 6.27 Employer-related investments

Employer-related investments are defined in PA 1995 and include:

- shares issued by the employer (or a connected party);
- land or other property occupied or used by the employer; and
- loans to the employer (or a connected party).

There is a statutory limit on the maximum employer-related investment that a scheme can hold, which is currently 5% of the scheme's net assets. Loans by a scheme to the employer are illegal; however, there are certain exemptions from this rule, the most commonly encountered example being contributions owing by the employer to the scheme. Although, for accounting purposes, these fall to be treated as loans to the employer (disclosed separately within the current assets and liabilities note to the accounts), they do not count towards the 5% limit referred to above.

Any employer-related investment should be disclosed in the notes to the accounts, giving the details of the investments and the total percentage of the net assets of the scheme that they represent. If the total exceeds 5%, but some or all of the employer-related investments are exempt (such as overdue contributions), then the proportion of the exempt investments should be disclosed. If the net total is still greater than 5%, disclosure should be made of the steps that the scheme trustees propose to take to reduce the proportion to an acceptable level.

The SORP also recommends that any employer-related investments held at any time during the scheme year

(not just at the year end) should be disclosed. Where there has been no self-investment during the year, this fact should also be stated.

### 6.28 Current assets and liabilities

The notes to the accounts should include an analysis of current assets and liabilities, which should include separately any debtors for unpaid contributions and any creditors for unpaid benefits. It is often helpful to indicate when outstanding contributions were paid (see Example 9).

### 6.29 Subsequent events

Pension scheme accounts should contain disclosure of any material non-adjusting events occurring in the period between the scheme year end and the approval of the accounts. A significant fall in the market value of investments, which is due to fluctuations in stock markets, would not normally be classified as a non-adjusting event, whereas a fall caused by a permanent diminution in value should be disclosed.

### 6.30 Approval of the accounts

SSAP 17: *Accounting for post-balance sheet events* requires the date on which the accounts are approved by the trustees to be disclosed. This will usually be on the face of the net assets statement, accompanied by the signatures of at least two trustees, as evidence of the approval.

#### Example 9 – current assets and liabilities note

	2004	2003
	£'000	£'000
Contributions due from employer in respect of:		
Employer	1,205	1,195
Employees	600	590
Cash balances	750	690
Unpaid benefits	(235)	(200)
Accruals	(50)	(45)
	<u>2,270</u>	<u>2,230</u>

The contributions due at the year end, which relate to December 2004, were paid in full on 19 January 2005, the due date set out in the schedule of contributions.

## 7 The Audit report and statement about contributions

### 7.1 Payment of contributions – contribution schedules

Under PA 1995, pension schemes must have a schedule setting out the rates of contributions payable by the employer and by members and the dates on or before which the contributions must be paid. There are two types of schedule, depending on whether a scheme is defined benefit or defined contribution.

Defined benefit schemes must have a 'schedule of contributions'. This contains the rates of contributions agreed between the employer and the trustees that the employer and employees must pay in order that the scheme will meet the minimum funding requirement (MFR). Schemes must have their schedule of contributions in place within 12 weeks of each MFR valuation being signed by the actuary. As detailed in 3.5 above, the actuarial requirements are in a period of transition due to revised regulations in PA 2004. Regardless of this, schemes will still be required to have in place a schedule of contributions based upon the Statutory Funding Objective rather than the MFR basis.

Defined contribution schemes must have a 'payment schedule'. This is similar to the schedule of contributions, but there is no actuarial input, the schedule simply showing the rates of contributions agreed between the trustees and the employer, and the date by which they must be paid.

A scheme with both a defined benefit and a defined contribution section (or a 'mixed benefit scheme' – see 6.18 above) must have a schedule of contributions covering both sections of the scheme, rather than a separate payment schedule for the defined contribution section.

The contribution schedule is significant because the auditor expresses an opinion as to whether its provisions have been complied with – see below.

### 7.2 Statement of trustees' responsibilities

SAS 600: *Auditors' reports on financial statements* requires a statement of trustees' responsibilities. Examples of suitable wording are available in Practice Note 15, referred to above. In most cases this is included in the trustees' report, but if not included elsewhere in the annual report then it should be provided in the audit report.

### 7.3 Audit report and statement about contributions

Under the Audited Accounts Regs, the auditor is required to provide:

- the audit opinion, in which the auditor gives an opinion as to whether the accounts show a true and fair view of:
  - the financial transactions of the scheme during the scheme year;
  - the amount and disposition of the assets and liabilities (other than liabilities to pay pensions and benefits after the end of the scheme year); and
  - contain the information specified in the Schedule to the Audited Accounts Regs; and
- the statement about contributions, in which the auditor gives an opinion as to whether contributions have been paid in accordance with the payment schedule or schedule of contributions.

Historically these have been provided in one document – the audit report. However, the revised Practice Note 15 recommends that the auditors' statement about contributions is presented separately from the opinion on the financial statements. PN15 gives two reasons for this:

- for consistency between the various types of schemes, for example, for ear-marked schemes, there are no statutory financial statements;
- the statement about contributions is not an audit opinion and the work performed by the scheme auditor to provide the statement is different to that of an audit. Therefore, it is important for the reader not to confuse it with the audit opinion on the financial statements.

As such, two separate reports should be produced by the auditor – the audit report and the statement about contributions.

It is also important, to the reader and to the auditor, to be clear which contributions are covered by the statement and which are not, for example, some trustees may include AVCs on their contributions schedule whilst some do not. To assist in this the trustees may prepare a Summary of Contributions paid to the scheme under the contributions schedule and the auditors refer to this in their statement (see Appendix 2).

The audit report and statement about contributions must be addressed to the trustees of the scheme. If the trust deed so specifies, they may also be addressed to the members of the scheme.

## Appendix 1

### FUND ACCOUNT for the year ended 31 December 2004

	2004	2003
	£	£
<b>Contributions and benefits</b>		
Contributions receivable	x	x
Transfers in	x	x
Other income	x	x
	<u>x</u>	<u>x</u>
Benefits payable	(x)	(x)
Leavers	(x)	(x)
Other payments	(x)	(x)
Administrative expenses	(x)	(x)
	<u>(x)</u>	<u>(x)</u>
<b>Net additions from dealings with members</b>	<u>x</u>	<u>x</u>
<b>Returns on investments</b>		
Investment income	x	x
Change in market value of investments	x	x
Investment management expenses	(x)	(x)
	<u>(x)</u>	<u>(x)</u>
<b>Net returns on investments</b>	<u>x</u>	<u>x</u>
<b>Net increase in the fund during the year</b>	x	x
<b>Net assets of the scheme</b>		
At 1 January 2004	x	x
At 31 December 2004	x	x
	<u>x</u>	<u>x</u>

### NET ASSETS STATEMENT as at 31 December 2004

	2004	2004
	£	£
<b>Investments</b>	<u>x</u>	<u>x</u>
<b>Current assets and liabilities</b>	<u>x</u>	<u>x</u>
<b>Net assets of the scheme at 31 December 2004</b>	<u>x</u>	<u>x</u>

These financial statements were approved by the trustees on [date].

Signed on behalf of the trustees.

## Appendix 2

### XYZ Pension Scheme

#### Summary of Contributions paid in the year

During the year, the contributions paid to the Scheme by the Employer under the [Schedule of Contributions / Payment Schedule] were as follows:

	£
Employer normal contributions *	
Employer special contributions *	
Employer additional contributions *	
Employee normal contributions *	
Employee additional contributions *	
Employee additional voluntary contributions *	
Total contributions	<hr/> <hr/>

Signed on behalf of the Trustees:

Date:

*\* These descriptions of contributions which could be due under the schedules are for illustrative purposes only and should be replaced with the appropriate description of contributions for the scheme.*

## Appendix 3

### Glossary of abbreviations

AVC	Additional Voluntary Contribution
CEP	Contributions Equivalent Premium
DB	Defined benefit
DC	Defined contribution
FRS	Financial Reporting Standard
GPP	Group Personal Pension
HMRC	HM Revenue & Customs
MFR	Minimum Funding Requirement
OEIC	Open-ended Investment Company
Opra	Occupational Pensions Regulatory Authority
PRAG	Pensions Research Accountants Group
RES	Relevant Ear-marked Scheme
S2P	State Second Pension
SAS	Statement of Auditing Standard
SIP	Statement of Investment Principles
SORP	Statement of Recommended Practice
SSAP	Statement of Standard Accounting Practice (the forerunner of Financial Reporting Standard)
SSAS	Small Self-Administered Scheme
TPR	The Pensions Regulator

### Further reading

- *Pensions Terminology* – a glossary for pension schemes (6th edition), published by Pensions Research Accountants Group (PRAG) and the Pensions Management Institute
- *Tolley's Accounts and Audit of Pension Schemes*, 4th Edition
- *SORP: Financial Reports of Pension Schemes* (Revised November 2002), published by PRAG.

## Author Biography



Terri Jarvis ACA trained with Ernst & Young in London and qualified as a chartered accountant in 1998. Prior to, and since, qualification Terri specialised in pension scheme audit work, working alongside the Firm's Centre of Excellence in Reading, whilst helping to establish a pensions team in London.

After 11 years with Ernst & Young, Terri moved to Arthur Andersen in 2001 and then to Deloitte, as part of the transition of those firms. As well as focusing on pension scheme client work, Terri has been involved in the development and delivery of training courses to partners and staff across the UK in each of the above firms.

In December 2004, Terri left the 'Big Four' environment and became a partner in Ash Shaw LLP, a dynamic, independent firm which is dedicated to meeting the needs of the trustees of small- and medium-sized pension schemes. To find out more visit [www.ashshaw.com](http://www.ashshaw.com)

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