

Nadia Dabbagh-Hobrow
Secretary
SORP Working Party
c/o KPMG
One Snowhill
Snow Hill Queensway
Birmingham
B4 6GH

By email to: nadia.dabbagh-hobrow@kpmg.co.uk

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Dear Ms Dabbagh-Hobrow

Exposure Draft on the Statement of Recommended Practice: Financial Reports of Pension Schemes

Deloitte LLP is pleased to respond to the Exposure Draft on the Statement of Recommended Practice: Financial Reports of Pension Schemes ('ED'). We have set out our detailed responses to the consultation questions in the Appendix to this letter together with some additional comments on issues not covered by the specific questions.

Overall the draft SORP provides useful guidance on the application of FRS 102 requirements to Pension accounting. However, we have some concerns in relation to some of the proposals in the ED.

Our key comments, which we expand on in the appendix to this letter, are as follows:

- We believe the requirements for some of the additional disclosures and measurement information specified in the SORP may add significant cost in terms of obtaining information, preparing disclosures and engaging actuaries, investment managers and auditors as necessary, particularly for smaller schemes.
- We are concerned that the costs of the additional complexity and length of pension scheme accounts resulting from these proposals will outweigh the benefits to the key stakeholders (the members of the scheme) in areas such as requiring actuaries to value annuities and the requirement for much more detailed investment risk disclosures.

We have limited our responses to those relating directly to the additional requirements of the SORP. However, we also note that FRS 102 itself requires a number of additional disclosures and measurement requirements to current practice, and would recommend that the SORP working party review the appropriateness of such requirements and, where deemed necessary, work with the Financial Reporting

Council in the next revision of FRS 102 to ensure that the required disclosures are relevant to the users of the financial statements. We also suggest that a future update to Practice note 15 would benefit from additional guidance to auditors regarding the practical implications of auditing the new SORP and FRS 102 requirements.

We would be happy to discuss our letter and the draft proposals with you. If you have any questions, please contact Ken Rigelsford (+44 20 7007 0752 or krigelsford@deloitte.co.uk) or Mark Redfern (+44 20 7007 7022 or mredfern@deloitte.co.uk).

Yours sincerely

A handwritten signature in black ink, appearing to read 'V Poole', is positioned above the printed name.

Veronica Poole
National Head of Accounting and Corporate Reporting
Deloitte LLP

Appendix

Responses to detailed questions

Annuities

FRS 102 requires annuities to be reported at the amount of the related obligation. What practical issues do you see arising from this requirement? The draft SORP envisages the annuity value will be based on the trustee perspective of the related obligation and therefore most likely determined by the Scheme Actuary. Do you agree? (3.12.18 to 3.12.22)

We support the principle that annuities should be carried in the accounts at a fair value based on the valuation of the related liabilities, although we are aware of concerns on the part of trustees and preparers that it may be difficult for schemes to identify and value annuities where this has not been done previously.

We agree the valuation exercise could be carried out by an actuary, but in practical terms will lead to increased time and costs of both the actuary and auditors.

We believe that the cost of obtaining these valuations is potentially significant compared to the additional benefit to the members in terms of their understanding of the accounts. In extreme circumstances, this may lead to trustees not wanting to provide annuities to members, thus limiting the benefit options available to members.

We recommend that the SORP requires an actuarial valuation of annuities on, for example, a triennial basis with a roll forward adjustment in the intervening years as we believe that this will still provide useful information in the valuation of these policies but at less cost to the pension schemes.

Per 3.12.22, there is an exemption if obtaining the valuation is considered to be too costly or impractical to do, but only where the valuation concerned is 'not considered significant'. It would be more useful for the SORP to use the term 'immaterial' as it does elsewhere.

The SORP requires the total value of all annuities held to be taken into account, so the trustees need to have done a high level calculation or analysis to arrive at this decision. Therefore in the first year of application, a potentially costly valuation exercise would need to be carried out, just to determine whether future inclusion of annuity policies is necessary.

Investment risk disclosures

Has the draft SORP taken the right approach to risk disclosures? (Section 3.16). In particular is the approach to the pooled investment vehicles and the look through and asset class approaches considered appropriate? (Section 3.16.1 to 3.16.15) Is the approach to direct credit risk for pooled investment vehicles which recommends disclosing an analysis of types of pooled vehicles held, appropriate?(3.16.10 – 3.16.13) Are there alternative approaches that could be considered?

Whilst we generally agree with the proposed guidance and the concept of providing additional useful disclosure about investment risk, we believe that the proposed investment risk disclosures are not intuitive. The users of pension scheme accounts include the scheme members whose reasonable knowledge of pensions accounting and investment issues might not be as high as that of stakeholders in other sectors. Therefore, it would be helpful if the disclosure requirements of the SORP recognise this

and ensure that a user will be able to reconcile the disclosures to the figures reported in the investment note.

We are concerned about the length and understandability of the proposed additional investment disclosures, and the time and resources that will be needed to obtain information and generate them.

These additional investment risk disclosures may be seen, particularly by smaller schemes, as a compliance only type exercise that does not add significant value. Furthermore, quality of disclosures is likely to be significantly affected by the size of the scheme. Larger schemes with more resource and a more robust control environment for engaging with and monitoring the investment managers are more likely to be able to obtain the more detailed information and produce better quality disclosure.

To improve quality and consistency of reporting between schemes, we would suggest that more clarity and practical examples are required around quantifying investment risk versus more narrative style disclosures.

We would welcome more guidance in the SORP of how far to drill-down into investments, recognising that for example, a standard equity pooled investment vehicle is much more readily understood by the users of accounts than say a delegated liability fund. The SORP should also ensure pension scheme accounts capture where possible all risks and rewards of holding an investment, for example we would recommend relevant risk disclosures where the involvement of a broker has a material impact on the performance of the fund.

We agree that the “Look Through” approach to pooled investment vehicles, is appropriate, as it will give users of the financial statements a clearer understanding of the nature and risk profile of the investments that the scheme holds. However we note that the required disclosures could be a significant burden on smaller schemes due to the additional costs and potential difficulties of obtaining and preparing the information required and thus detracting from member’s benefits. Obtaining and preparing this information may be more problematic where for example, the investments are held by overseas investment managers and the nature of the holding is opaque.

We believe that an unintended consequence of the SORP is that the investment mandates of the pension schemes may need to be rewritten, as they may not currently entitle them to the information they will need for the proposed risk disclosures. For example, trustees have noted that current mandates only give them access to the level of information required under the current reporting environment and will not provide the additional level of detailed information on credit risk that is proposed by the disclosure requirements of this SORP.

Fair value hierarchy

Is the distinction of investments valued using a valuation approach (category C) between those using market observable data (C i) and non-market observable data (C ii) considered helpful? (3.12.8 to 3.12.10)

FRS 102 sets out a fair value hierarchy for valuing financial instruments and requires new disclosures on the approach to determining their fair value. As noted in the ED, FRS 102 does not use the same three categories within its fair value hierarchy as full IFRSs. The draft SORP proposes additional analysis to divide category C assets between those valued using market observable data (those that would be

disclosed as level 2 under full IFRSs) and those valued using non-observable data (those that should be disclosed as level 3 under IFRS).

We believe FRS 102 should be aligned with IFRS in this area so as to ease the process of obtaining investment valuation information and also to improve the understandability of investment disclosures in accounts, as they would be prepared on a consistent basis with IFRS. As Drafted, this SORP would require a further level of detail being obtained from investment managers in order to meet the disclosure requirements.

A fair value hierarchy aligned to IFRS would be helpful as it will aid transparency of disclosures. We anticipate that this may be of more use to the trustees and to the employers who contribute to the scheme, than the members of the scheme. However, again, this is likely to increase costs to the scheme of getting the information required for the preparation of the financial statements. Furthermore, as noted above, it may be that the schemes investment mandates need to be rewritten in order to accommodate the additional requirements, as currently some mandates do not allow trustees access to underlying pricing information.

Trustees may not be able to access the best performing funds if they have to ensure that the investment manager will be able to provide information which will enable them to comply with the requirements of the SORP.

Financial statement presentation

Do the example financial statements provide sufficient practical guidance on the application of the Draft SORP's new disclosures? Is the alternative combined presentation of investment risk and derivative notes to the example financial statements helpful? Is having a choice of examples helpful? Are there better alternative approaches?

Yes, we think the Draft SORP provides some clear examples. However we note that the alternative presentation options, in particular for combining derivatives and investment risk may lead to less comparability across pension scheme financial statements.

Auto enrolment

Do you agree with the approach taken by the draft SORP in relation to accounting for the first contribution arising from employees who are auto enrolled? (section 3.8.2)

Yes, we think this is a practical approach and makes it easier for administrators to monitor rather than having an additional administrative burden of having to monitor many transactions for opt outs.

Legislative disclosure requirements

Do you agree with PRAG's view that the legislative disclosure requirements in relation to investment classifications as set out in the Audited Accounts Regulations are updated to come into line with FRS 102 and the Draft SORP? (Appendix 7)

Yes, we think it makes sense not to have conflicting classifications and the SORPs suggested methodology gives more meaningful disclosures.

Concentration of investments

In addition to the detailed investment classification disclosures referred to above, the Audited Accounts Regulations also require the disclosure of any investment (other than UK Government securities) in which more than 5% of the total value of the net assets of the scheme is invested. Do you think this disclosure is necessary in light of the risk disclosures required by FRS 102 and the separate requirement to disclose employer related investment? If you do think it is required should it apply to investments in pooled investment vehicles at the unit level or should investments held indirectly through pooled investment vehicles be taken into account (“the look through” approach)

Yes, we think this requirement continues to be useful. In particular, we believe that the financial reporting of concentration risk continues to be important in the current economic environment. If the “look through” approach is going to be taken to disclosing PIVs where the purpose of the vehicle is to get exposure to that asset class then we believe any indirect investments should be included in the 5% test.

Additional comments

We note that there will be a cost to pension schemes of providing administrators and trustees with training to ensure they are able to implement the requirements of the SORP.

More guidance, including practical examples, would be welcomed on the accounting and disclosure requirements of transfers between sections of hybrid schemes. We would recommend that this SORP encourages disclosure where transfers are made for a specific purpose, e.g. an amount transferred for the purpose of settling a normal contribution.