KPMG

Pensions accounting focus areas 2023/24

Pensions Centre of Excellence

KPMG Audit, UK

As we approach the financial year ends of many companies across the market, our Pensions Centre of Excellence team have produced the following guide to help companies and their advisors to consider the pensions accounting and disclosure impacts of recent events when preparing upcoming financial statements in relation to defined benefit (DB) plans.

Focus area	Background	Key considerations
Virgin Media pensions case	In June 2023, the High Court handed down a decision in the case of *Virgin Media Limited v NTL Pension Trustees II Limited and others* relating to the validity of certain historical pension changes due to the lack of actuarial confirmation required by law. This case may have implications for other plans that were contracted-out and made changes between 1997 and 2016. The outcome is expected to be appealed, however, as the law currently stands, a plan amendment to a contracted-out scheme without appropriate actuarial confirmation could be void.	• As per ISA250A, auditors are expected to obtain sufficient appropriate audit evidence regarding compliance with relevant laws and regulations. • Management should document their position on the implications, if any, of the Virgin Media case and the steps proposed to clarify the position where there is uncertainty. • Expect auditors to request copies of any legal advice received by the corporate sponsor / pension trustees relating to the implications of this case.
IFRS17 impact on parent company guarantees	It is common for groups to have in place a parent company guarantee to provide additional protection to DB plan trustees. For example, where there is value elsewhere in the group, a guarantee can provide the trustees with legal protection that deficit funding will be met if the sponsor is unable to pay, or that a solvency deficit is covered if the sponsor becomes insolvent. Such guarantees have also been used as a way of managing Pensions Protection Fund levies. Parent company guarantees are considered "financial guarantee contracts" (FGCs). In the past these have generally been accounted for under IAS 37 as that was acceptable under IFRS4. With the introduction of IFRS17 *Insurance Contracts*, in our view parent company guarantees will need to be assessed under either IFRS17 or IFRS 9 *Financial Instruments*.	• For parent company guarantees issued intra-group, the new requirements may affect the individual entity accounts of the parent, but would be eliminated in the consolidated financial statements. • Following the introduction of IFRS17, there is a choice to apply either IFRS9 or IFRS17. • We anticipate that many entities will apply IFRS9 for such contracts, given the complexities in applying IFRS17. Under IFRS9, FGCs are measured initially at fair value rather than the transaction price • Further guidance can be found here.
Fair value measurement of illiquid assets	In July 2023 the FRC published its Thematic Review of IFRS13 Fair Value Measurement, highlighting that careful judgement is required when measuring the fair value of unquoted investments and where valuation adjustments are required. As schemes manage liquidity and seek to de-risk there has been an increase in sales of illiquid assets on secondary markets at a discount. This raises a question as to whether valuations reported by fund managers, often used as the basis for accounting, are representative of an "exit price" at the balance sheet date as per IFRS13. The Financial Conduct Authority has announced that it will commence a review into the valuation of illiquid asset funds by the end of 2023.	• Assessment as to whether reported valuations for illiquid assets are representative of fair value. • Increased scepticism over assets that have maintained their carrying value in the face of increased economic uncertainty. • Transparent disclosure on the valuation basis for illiquid investments and material judgements made by management in assessing the fair value as at the balance sheet date.
Covid 19 impact on longevity	The latest CMI Mortality Projections Model, CMI_2022, was published in June this year. The 2022 model produces lower life expectancies than the previous models. This model has been calibrated to England & Wales population mortality data up to 31 December 2022. For the Core version of CMI_2022, CMI use a weight of 0% for 2020 and 2021 data, a weight of 25% for 2022 data, and weights of 100% for other years.	• Where the core version of CMI_2022 has been adopted, entities should consider disclosure of its impact given the step change in implied life expectancies versus prior versions of the core CMI Model. • Consider disclosure where non-default weight parameters have been adopted, including the rationale.
Transfers between entities	We sometimes observe the use of Flexible Apportionment Arrangements (FAAs) to reapportion DB pension liabilities when an employer exits a scheme, often related to a group restructuring or in advance of business disposals. The accounting for these transactions can be complex and is dependent on the facts and circumstances in each case, for example, whether the transaction is at arm's length, the accounting and funding positions of the DB plan at the time of transfer and the current accounting policies in the relevant individual entity accounts. In addition, there may be Companies Act considerations for directors accepting obligations or transferring assets where the relevant entity does not have sufficient distributable reserves.	In order to mitigate potential issues relating to FAA transactions, entities should consider the following in addition to the usual legal and actuarial advice: • The accounting implications of transferring pension liabilities. • Directors' duties under the Companies Act, particularly where the entities involved have insufficient or negative distributable reserves. This may require corporate legal advice.

The Financial Reporting Council (FRC) published their Annual Review of Corporate Reporting 2022-23 in October 2023. In relation to pensions reporting, they identify a number of areas for companies to consider, including: recognition of surpluses, asset–liability matching strategies, sensitivities and the impact of the high interest rate and high inflation environment, though these areas are also interlinked. In meeting the FRC's expectations, entities should consider the below:

Focus area	IFRS Reference	Background	Key considerations
Recognition of surplus	IAS1.122 IAS1.125 IAS1.129 IAS19.64/65 IFRIC14 IAS19.131	With pension liabilities generally falling faster than asset values in the rising interest rate environment, more entities are now reporting IAS19 surplus positions, alongside seeing improvements in plan funding levels. The FRC have reiterated their message on appropriate disclosures for schemes in surplus "Companies should clearly explain their basis for the recognition of an asset and any judgement required." More specifically, to the extent that DB plans get closer to their strategic targets, some may be considering buy-in or buy-out transactions, or potentially agreeing uses of surplus with their sponsoring employers, such as DB contribution holidays where open to accrual, subsidising DC contributions in the same trust or DB benefit improvements.	• Disclosure of key judgements and estimations made in assessing recoverability of surplus. • Disclosure of any agreed uses of surplus where the entity may derive an economic benefit. • Consider the potential accounting impact of any strategic pension projects being considered. • Understand GAAP differences around surplus recognition.
Asset liability matching strategies	IAS19.146 IAS19.142 IAS19.139 (b)	IAS 19 requires and the FRC have highlighted that, "Companies should clearly explain their investment strategy and associated risks, including details of any asset-liability matching arrangements (such as liability driven investments)". This has come under greater focus since the well publicised liquidity challenges faced by plans in September/October 2022, through to the continued rising interest rate and inflation environment. For significant pension balances, investors may expect updated disclosure on how the asset-liability matching strategy has fared during the period. In some circumstances, investors may expect commentary on how plans manage liquidity, for example a mature plan with high benefit payments and no contributions.	• Disclosure of the risks the plan is exposed to, including the asset-liability matching strategy taken by the plan, where useful to readers of the accounts. • Consideration of plan specific factors, such as the impact of maturity and whether open or closed to accrual, on the entity's future cash-flows or risk exposure.
Sensitivity analysis	IAS19.145 (a) IAS19.145 (c) IAS1.125 IAS1.129	Accounting standards requires sensitivities both in respect of "changes in the relevant actuarial assumption that were reasonably possible" (IAS19) at the balance sheet date and where there is a "significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year" (IAS1). Given the increase in interest rates over 2022, for December 2022 reporters we saw an increase in entities disclosing higher sensitivities to key assumptions, in some cases multiple sensitivities and also an increase in sensitivity disclosures covering the impact on both the defined benefit obligation and on plan assets.	• Entities should consider both the disclosure requirements and emerging market practice in this area. • As pension plans de-risk, it may be helpful to readers of the accounts to show the impact of movements in key assumptions on the plan assets in addition to the defined benefit obligation.
Impact of the higher interest rate/ higher inflation environment	IAS19.135 IAS19.147 (c)	The above areas cover a number of the issues related to the higher interest rate and higher inflation environment. In this section we highlight other areas of the pension disclosures which may be impacted.	• Other impacted areas could include: - Liability duration - Profile of projected benefit payments - Detail on pension increases provided by the plan and their link to inflation - A description of any discretionary pension increase policy - Expected future employer contributions

Note: The above is one interpretation of IFRS disclosure requirements. The guidance does not cover all IAS19 disclosure requirements, only those relevant to recent market conditions in the UK, and therefore should be considered in the context of existing pension disclosures. Management should discuss their own circumstances with their auditor based on materiality.

Contact us

Naz Peralta
Partner, Pensions CoE
T: +44 (0)7825 845492
E: narayan.peralta@kpmg.co.uk

Chris Putman
Director, Pensions CoE
T: +44 (0)7268 750626
E: christopher.putman@kpmg.co.uk

kpmg.com/uk

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