

## Accounting Q&As

### **My scheme's just entered an assessment period – what's the first accounting action I need to take?**

It depends where your scheme is in the annual cycle of accounts preparation and audit, so the first thing to do is find out where the scheme stands.

1. Have accounts at the last accounting date been audited and signed off?
2. Is the preparation and audit of accounts currently in progress?
3. Has the accounting date passed but work on accounts preparation and audit not yet commenced?

Establishing the schemes' position is crucial because the scheme remains subject to all of the regulations governing the production of trustee reports and audited accounts (e.g. the Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996 SI 1975) and no exemptions from the full force of these regulations are granted to schemes on the grounds of entering a PPF assessment period. You should talk to your auditor straight away – they obviously need to know that the scheme is in an assessment period, and will be able to provide invaluable advice on how to proceed in the most effective way. The PPF will also have assigned a caseworker to your scheme who will be happy to assist you in interpreting the regulations governing a PPF assessment period to your scheme's particular circumstances.

### **Does entering a PPF assessment period lead to any different accounting requirements?**

Almost certainly, yes. Regulations which came into force in April 2007 mean that schemes in assessment are required to complete an actuarial valuation, supported by audited accounts, for a period ending on the day before the assessment date (which is the date of the insolvency of the employer). This valuation is the one required under section 143 of the Pensions Act 2004. Scheme trustees need to consider whether it is possible to use this date as the new accounting date for the scheme, taking advantage of the provisions in the Disclosure Regulations governing changes to accounting periods. These regulations permit trustees to change accounting dates provided the first accounting period after the change is not less than 6, or not more than 18 months in length. Please note that the Regulator has also indicated that whilst it cannot waive compliance with legal requirements, in certain circumstances it will agree not to pursue a breach of the Disclosure Regulations relating to accounting periods in excess of 18 months, provided there is a robust business case for cost savings balanced with an assessment of the risks of permitting an extended period beyond 18 months without audit scrutiny.

So depending on where your scheme is in the annual cycle of accounts preparation and audit, you should think about whether to:

1. Change the scheme's formal accounting date to the assessment date and begin planning with your accountant and auditor to prepare an annual report and accounts for a period between 6 and 18 months long, ending with the assessment date; **or**
2. Plan to prepare a set of special purpose accounts (which would not be intended to comply with the Disclosure Regulations especially as regards the trustees' report) for a "short" period to the assessment date, solely for the purpose of supporting the s143 actuarial valuation; and then plan to prepare a full annual report and accounts at the usual accounting date.

**My investment manager claims to be able to produce valuations only at calendar month end, and my employer became insolvent in the middle of a month – what can I do to get investment values to incorporate into my accounts?**

It is true that most investment managers will routinely only produce valuations at calendar month ends. If you explain the unusual circumstances (of insolvency and assessment), your manager may well be able to cooperate with your request. This becomes more difficult if the request for additional information comes weeks or months after the event - investment managers are much more able to produce valuations at odd dates if you get your request in close to the required date.

If it proves to be absolutely impossible to get valuation information at this mid-month date, you will need to talk to your auditor and your actuary in order to determine how to proceed.

One consideration of course is how close the scheme is to being funded to meet its protected liabilities. If it is grossly over- or grossly under-funded, any possible fluctuation in value between the assessment date and available valuation dates may not affect whether the scheme transfers into the PPF.

**Does leaving a PPF assessment period to transfer into the PPF lead to any different accounting requirements?**

The statutory duties to keep proper books and records, and to obtain audited accounts should an Accounting Reference Date be reached, persist up to date of the Transfer Notice. However, as soon as the Transfer Notice is issued, the PPF takes over all of the assets and pension liabilities of the scheme, leaving the scheme with no members. The Disclosure Regulations do not apply to schemes with less than 2 members, so the requirement to obtain audited accounts will evaporate.

Some trustees may nevertheless consider it advisable to prepare and have audited a set of non-statutory accounts as at the Transfer Notice date, to prove that all assets and liabilities have been transferred out to the PPF and that the scheme is completely empty. It is not unusual for trustees whose scheme has completed wind up to produce accounts showing an empty balance sheet for similar reasons, to prove that all assets have been handed over to the buy-out insurer, for example, and that all non-pension liabilities (for fees etc) have been settled. If the PPF requires, for its own purposes, a closing set of accounts, this will have formed part of your scheme's project plan from a much earlier point. If neither the trustees nor the PPF require audit scrutiny of a closing set of accounts, you will nevertheless be asked to undertake some activities – providing cash book information, details of transactions on investment portfolios, for example - aimed at you providing the PPF (and its own auditors, the National Audit Office) with proper assurance that all of the scheme's assets and liabilities have been either dealt with by the trustees or transferred to the PPF in accordance with the Transfer Notice.

**My scheme is a group scheme, and only one of the participating employers has suffered an insolvency event. Does this cause complications?**

Yes. Depending on the structure of the pension scheme (assuming it is not a 'last man standing' scheme) this set of circumstances may trigger a sectionalisation of the scheme into the part which will enter an assessment period and be considered for entry into the PPF, and the part which will continue as a normal ongoing scheme. This will usually require the scheme actuary to operate the rules of the scheme applying to partial winding-up so that the actuarial liabilities associated with the members employed by the insolvent employer can be calculated. Subject to the exact provisions of the scheme rules, scheme assets will usually be apportioned to the segment in assessment in the same ratio as scheme liabilities. Accounts will be required to support the segment's s143 valuation and the methodology employed to apportion actuarial liabilities, and hence assets, will be fully within the scope of the audit so that trustees and the PPF can gain the required assurance over the outcome of the s143 valuation (that is, the PPF's decision to accept or reject the segment) based on the segment's funding position vis-à-vis its protected liabilities.

The Statement of Trustees' Responsibilities and the Auditor's Report will both have to be amended to cover the extension of the scope of the audit to cover this sectionalisation and apportionment process. Although this is strictly speaking a matter for the trustees and their auditors, the PPF can provide sample wordings which have proved acceptable to trustees, auditors and the PPF in these circumstances. Please contact your PPF caseworker.

This first set of sectionalised accounts will usually consist of a Fund Account for the whole scheme from the start of the accounting period to the assessment date, and of course a Net Assets Statement for the whole scheme as at the assessment date. This will be broken down into an analysis of the net assets of the whole scheme apportioned over the segment in assessment and the ongoing segment.

**What are the requirements for further sets of sectionalised accounts during the assessment period?**

Annual accounts for the scheme will continue to be required during the assessment period and trustees should consider presenting these accounts using principles similar to those set out in paragraphs 2.28 to 2.33 of the Statement of Recommended Practice "Financial Reports of Pension Schemes" (revised May 2007), headed "Schemes with multiple benefit structures". These principles suggest a columnar format, accounting separately for the ongoing segment and the segment in assessment, with a total showing the sum of the assets under the trustees' control.

Unless any provisions in the Trust Deed require otherwise, the transactions of the scheme will usually be analysed as follows:

- Contribution income: no contributions are payable in respect of the segment in assessment (except those due but unpaid at the assessment date).
- Benefit outgo: accounted for in the segment into which has been allocated the member in respect of whom the benefit is payable.

- General scheme expenses: accounted for in the ratio of the segments' assets.
- Specific expenses (for example, solely incurred in connection with the segment in assessment): accounted for in the segment incurring the expense.
- Investment return (assuming the scheme's investments have been only notionally rather than actually segregated over the segments): accounted for so as to ensure all segments share equally in the return on the scheme's investments.

Assuming the segment in assessment does eventually enter the PPF, the scheme's accounts covering that period will show the income, expenditure and investment return allocated to that segment up to the date of transfer into the PPF, and the transfer-out of the entirety of the segment's net assets to the PPF. This will give assurance to the PPF that all the segment's assets and liabilities have been properly transferred, and to the trustees that the ongoing segment has properly retained all of the assets and liabilities assigned to it

**My scheme (with the PPF acting as a creditor on the trustees' behalf) has a claim on the insolvent employer for its debt to the pension scheme. How should any dividend distribution be accounted for?**

Of course in many insolvency situations, there will be no realistic prospect of unsecured creditors such as the pension scheme receiving any dividend, so there is no accounting impact. Where there is a prospect of a dividend being paid (or other assets being recovered), trustees need to consider whether there is sufficient certainty about recovery and value to account for an asset on the scheme's Net Assets Statement, or to disclose a contingent asset in the notes to the accounts, in order to comply with FRS12 "Provisions, contingent liabilities and contingent assets". Of course, in complex insolvency situations, trustees may be virtually certain of receiving a specified level of dividend from the insolvency, and so disclose an asset. If the trustees are less certain of receiving a higher level of dividend, then they may disclose the additional dividend as a contingent asset.

**My scheme has been sectionalised because of the insolvency of one group company, and we have a claim on that insolvent employer which will pay out. How should the scheme account for this?**

Our current understanding of the legal position is that the debt on the insolvent employer operates for the scheme as a whole. This means that any recoverable asset belongs to the scheme as a whole and therefore needs to be apportioned over the segment in assessment and the ongoing segment in the same ratio as other scheme assets. This is the case even though the dividend derives from the insolvency of one employer for which a segment of the scheme is then created whose membership is identified directly by reference (usually) to employment with that employer.

**A number of employers in my group scheme have suffered insolvency events in the same day. Does this cause accounting complications?**

Definitely, yes, but only in the sense that a number of scheme segments are created on the same day, so that the accounts as at the common assessment date would usually consist of a Fund Account for the whole scheme from the start of the accounting period to the assessment date, and of course a Net Assets Statement for the whole scheme as at the assessment date,

with an analysis of the net assets of the whole scheme apportioned over the various segments in assessment and the ongoing segment (if any).

Depending on the length of the assessment period, and decisions made by the trustees about accounting reference dates, further sets of sectionalised accounts prepared during the assessment period may be required. These would be prepared in a columnar format similar to that recommended above for a two-segment scheme (one in assessment, one ongoing).

**A number of employers in my group scheme have suffered insolvency events, but all on different dates. Does this cause accounting complications?**

Most definitely, yes. Since s143 valuations will have to be prepared for each individual segment as at its own assessment date, audited accounts will be required as at each individual assessment date to support each valuation. A worked example might help illustrate the requirement:

Imagine the Conglomerate Holding Company Group Pension Scheme, accounting date 31 December 2006, audited accounts published 30 April 2007.

A participating employer, Company A, experiences an insolvency event on 15 May 2007 and begins a PPF assessment period. Company B follows on 1 June 2007 and Company C on 30 June 2007. The principal employer together with companies D, E and F continue, as solvent employers, to sponsor the scheme. There are no parent company guarantees or other arrangements in place to rescue the segments associated with the insolvent employers, and the scheme is not a "last man standing" scheme.

Special purpose accounts will be required for the whole scheme from 1 January 2007 to 15 May 2007, with the resulting net assets apportioned over Segment A (created by the insolvency of Company A) and the Rest of the scheme.

Then accounts will be required from 16 May to 1 June 2007 for the scheme, analysed in a SORP compliant format over Segment A and the Rest, with the resulting net assets of the Rest of the scheme then apportioned over Segment B and the Rest (which now only contains the Principal Employer and Companies C, D, E, and F).

Then accounts will be required from 1 June to 30 June 2007 for the scheme, analysed over Segment A, Segment B and the Rest, with the resulting net assets of the Rest then apportioned over Segment C and the Rest (which now only contains the Principal Employer and Companies D, E, and F).

It is virtually certain that a dividend will be declared from the insolvency of Companies B and C, but not from Company A. Until a segment has transferred into the PPF, it still exists as part of the scheme as a whole for the purposes of section 75 debt regulations and hence those dividends can benefit all segments of the scheme.

The trustees, their auditors and other advisors will work together to minimise the number of different documents that need to be produced for these purposes. They may, for example, consider if one consolidated document with a number of different appendices or analyses can be produced, all within the scope of one audit engagement letter and one audit report.

The annual report and accounts for the whole scheme will be required (assuming no other intervening events) as at the usual accounting date, that is, for the entire period 1 January to 31 December 2007, presenting the transactions and balances for the various Segments and the Rest of the scheme, in a SORP compliant format.

This worked example covers a scheme with both ongoing segments and segments likely to enter the PPF. In circumstances where all segments of a scheme are likely to enter the PPF, the accounting requirements are identical. If it is expected that the entire scheme will eventually enter the PPF, this will impact the assessment of risks around the processes for apportioning liabilities and assets over the various segments, so that the work associated with preparing and auditing accounts in these particular circumstances is minimised at a level consistent with the auditors' ability to give an unqualified opinion on the sectionalised accounts.