

# **GN17: Accounting for Pension Costs under Statement of Standard Accounting Practice No. 24**

## ***Classification***

Recommended Practice

## ***Legislation or Authority***

Institute of Chartered Accountants in England and Wales  
*Accounting for Pension Costs*. Statement of Standard  
Accounting Practice No. 24. 1988.

Auditing Practices Committee. *Practice Note 2. Accounting for pension costs under SSAP 24: Liaison between the actuary and the auditor*. 1990.

## ***Application***

Any actuary responsible for calculating pension costs and related disclosures which are to be stated in the company's accounts. In this Guidance note 'company' denotes any employing organisation which has to prepare accounts. The Guidance Note is applicable as required by SSAP 24 and must be read in conjunction with SSAP 24, relevant paragraph numbers of which are noted in the margin.

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## ***Status***

Approved prior to Due Process being introduced.

Version	Effective from
1.0	01.05.91

Adopted by BAS on 19.05.06

## **Ceased to apply from 30.11.08**

1. Statement of Standard Accounting Practice No. 24 applies to the accounting for pension costs in accounting periods starting on or after 1 July 1988. In relation to defined benefit pension schemes, whether funded or unfunded, the Statement requires that actuarial calculations of pension cost and of other figures to be disclosed should be made in accordance with the stated accounting principles.

## **Relationship with the Client**

2. The information presented in a company's accounts is the responsibility of the directors of the company. The role of the actuary in relation to SSAP 24 is to consult with the company, taking account of its circumstances and its

work-force, to settle the principles and assumptions to be followed and to calculate the required figures. The client in this respect is the company, not the scheme trustees.

3. The actuary should ensure that the client is given sufficient information to enable the expected future course of the pension cost to be appreciated, having regard to the method used for spreading variations in cost. The attention of the client should be directed to those assumptions to which the pension cost is sensitive.
4. The actuary should endeavour to ascertain any changes in benefits, membership and any other relevant factors affecting the scheme since the date of the last valuation and should take account of any expected changes in the future. All benefits are to be assessed, whether or not specifically referred to in SSAP 24. Any allowance for discretionary benefits should be agreed with the client. Administration expenses which are borne by the scheme should also be included. Actuaries should bear in mind the various users of company accounts and are referred to the article in the *Manual of Actuarial Practice* in relation to legal liability.
5. In some cases an actuary advises a subsidiary and its pension scheme within a group of companies but not the parent company, or vice versa. This situation can apply in particular with multinational groups with various actuaries advising foreign schemes which are to be accounted for in accordance with the Statement. Whatever the situation it is fundamental that all concerned are clear as to who is the client.

### **Relationship with the Auditor**

6. The auditor is required to satisfy himself that the actuary has worked within the framework laid down in the Statement. The auditor may require a full description of the approach taken including, for example, the method and assumptions adopted, the treatment of variations from regular cost and, if this is not clear, whether the method and assumptions taken as a whole lead to the actuary's best estimate of cost.
7. The actuary does not have a client relationship with the auditor but in practice communication between them will be helpful and the actuary can, with the consent of his client, provide information requested by the auditor. Practice Note 2 issued by the Auditing Practices Committee, copies of which are available from the Institute and Faculty, deals with the communication between the actuary and the auditor in relation to SSAP 24. That note indicates that the starting point for the auditor's work will often be to establish whether the latest actuarial valuation of a pension scheme is suitable for the purposes of SSAP 24.

## **Materiality**

8. The actuary is in a position to judge the significance of detail in his calculations relative to the results, but not to judge the materiality of pension costs and of the relevant disclosures under SSAP 24 relative to the company's accounts as a whole. Any materiality guidelines should therefore be agreed with the client. An actuarial method and assumptions which might otherwise be unsatisfactory for SSAP 24 may in fact be acceptable where the magnitude of the assessed pension cost, or the magnitude of the difference relative to a valid method, is not regarded by the company and auditor as material in the company's accounts.

## **Pension Cost**

9. SSAP 24 requires disclosure of the pension cost charge for the period. The basic requirements are:
  - (a) For defined benefit schemes the pension cost should be calculated using actuarial valuation methods which are consistent with the requirements of SSAP 24.
  - (b) The actuarial assumptions and method, taken as a whole, should be compatible and should lead to the actuary's best estimate of the cost of providing the pension benefits promised.
  - (c) The method of providing for expected pension costs over the service lives of employees in the scheme should be such that the regular pension cost is a substantially level percentage of the current and expected future pensionable payroll in the light of the current actuarial assumptions.
10. The regular cost is defined in the Statement as the consistent ongoing cost recognised under the actuarial method used. This should normally be equated to the standard contribution rate as defined in GN26, *Pension Fund Terminology*, which would be subject to recalculation at every actuarial valuation.
11. Companies may operate more than one pension scheme, or different pension arrangements (including different accrual scales) within the same scheme. If appropriate, pension cost should be assessed separately for each pension arrangement and, in these circumstances, different actuarial methods and assumptions may be used for the different arrangements.
12. The pension cost is the regular cost adjusted by any variation in cost and by interest on balance sheet prepayments and provisions where appropriate. Subject to exceptions stated in SSAP 24, variations in cost are to be spread over the expected remaining service lives of current employees in the scheme

or an equivalent average period. There are different methods of spreading variations, the essential requirement being that the cost of pensions is recognised on a systematic and rational basis. Several methods of spreading meet this requirement, notably by percentage of pensionable payroll, fixed annual charge, equal instalments of capital plus reducing interest, and instalments of capital reducing in proportion to expected future residual membership plus reducing interest. The method being used for the calculations should be settled between the actuary and his client.

13. The weightings used in calculating an average period of expected remaining service lives should be consistent with the assumptions used in the calculation of regular cost, disregarding new entrants. The method being used for spreading variations in cost should also be taken into account. For example, if the fixed annual charge method is used for spreading variations, it will normally be appropriate to exclude current and projected future pay levels from the weightings used in calculating the average period of expected remaining service lives.

#### **Validity of the Actuarial Methods**

14. A range of actuarial methods has been developed, primarily for funding purposes, in response to the varying circumstances of individual pension funds. The selection of the appropriate method for particular circumstances is an important area for the exercise of professional judgement. It is not the case that all possible methods are equally suitable for all situations and the following paragraphs set out certain combinations of method and situation which may not satisfy the basic requirements noted in paragraph 9.
15. **The Entry Age Method** is unlikely to be satisfactory if the standard contribution rate is based on a weighted average of rates applicable to existing members of the scheme and the weights are likely to change in respect of future entrants. A change might for example be foreseeable because:
  - (a) new entrants join at ages which are on average either higher or lower than the ages at which existing members joined; or
  - (b) new entrants are admitted on a pension scale which is materially different in cost from the scale applicable to current members. (But see paragraph 11 above).
16. **The Attained Age Method** is unlikely to be satisfactory in the following circumstances:
  - (a) where a scheme has a regular and significant flow of new entrants and the payment of the standard contribution rate in respect of the new entrants is expected to create material surpluses or deficits; or

- (b) where a scheme is or will be closed to new entrants and the standard contribution rate is expected to increase materially at each succeeding valuation. (However, the method can be satisfactory for a closed scheme where the regular cost is based throughout upon the standard contribution rate calculated in respect of the membership present at the time when the scheme was closed).
  
- 17. **The Projected Unit Method** is unlikely to be satisfactory if it is evident from the circumstances that the standard contribution rate is likely to change materially in future years. A change might for example be foreseeable because:
  - (a) the scheme is or will be closed to new entrants; or
  - (b) new entrants are admitted on a pension scale which is materially different in cost from the scale applicable to current members.
  
- 18. **The Current Unit Method** is unsatisfactory if used without a control period of adequate length as set out in paragraph 20, or if it is evident from the circumstances that the standard contribution rate is likely to change materially in future years. A change might for example be foreseeable:
  - (a) if the scheme is or will be closed to new entrants or if new entrants are admitted on a pension scale which is materially different in cost from the scale applicable to current members; or
  - (b) as an effect of future pay increases upon accrued pension rights.
  
- 19. **The Aggregate Method** has no standard contribution rate but is often perceived as a variant of the Entry Age Method or the Attained Age Method for the purposes of assessing pension cost and, as such, its validity is as described in paragraphs 15 or 16 respectively. Where the regular cost is required explicitly in terms of the standard contribution rate, it is appropriate to substitute either the Attained Age Method or the Entry Age Method, whichever may be considered suitable for the purpose, in place of the Aggregate Method. (The regular cost may not be required to be stated separately, and where this is so in relation to a scheme which is closed to new entrants the Aggregate Method may be suitable).
  
- 20. **Methods with control periods.** The above methods may be modified by the use of a control period. A method which uses a control period of adequate length consistently throughout the calculation of pension cost may be satisfactory for the purposes of SSAP 24 when, in the circumstances, the method would otherwise be unsatisfactory. A control period can be regarded as of adequate length if (a) the resulting standard contribution rate, which is to be used as the regular cost, is not altered materially by extending the control period and (b) the calculation of the pension cost makes specific provision for future increases in earnings not materially different from a full

provision for all future increases in earnings, including merit increases, and not solely those occurring up to the end of the control period.

21. **Other actuarial methods.** Guidance Note 26 does not list all possible actuarial methods. An actuary intending to use a method which is not listed should take special care to ensure that the method complies with the requirements of SSAP 24. Any actuary in doubt as to the validity of a proposed method should seek guidance from the Professional Body.

### **Actuarial Assumptions**

22. The selection of actuarial assumptions to be used in assessing pension cost for SSAP 24 purposes is a matter of judgement for the actuary in consultation with the client. The actuarial assumptions and the actuarial method taken as a whole should be compatible and lead to the actuary's best estimate of the cost of providing the benefits promised.
23. The method and assumptions used for SSAP 24 may well differ from those used for funding purposes because of factors which may be relevant to funding but which are not relevant to SSAP 24. The actuary should be prepared to explain to his client any difference between the approaches for funding and SSAP 24.
24. There can be no uniquely correct assumptions in most cases and SSAP 24 does not require the actuary to make best estimates of each of the financial and demographic factors taken separately. Nevertheless a notional yardstick against which a basis of assumptions could be judged is one in which each assumption is taken from a narrow range within which it satisfies the description of being a best estimate. It is not inappropriate to adopt assumptions which, taken together, are somewhat more likely to lead to surplus rather than deficiency at future valuations, this being in accordance with the accounting convention of prudence. However, it is not satisfactory to include significant margins which are likely to lead to future surpluses or deficits which are material in the sense of paragraph 8.
25. The financial and demographic assumptions should meet the requirement of providing a best estimate, in the sense described in paragraph 24, when considered in isolation from the actuarial method of costing. This is a more stringent condition than the one stated in SSAP 24; it follows from the requirement to disclose the level of funding using a standard method irrespective of the actuarial method which is used to derive the pension cost (see paragraph 30).

### **Prepayments and Provisions**

26. When calculating a variation in pension cost or a cumulative adjustment in respect of prior years, any pension prepayment already shown in the

company's balance sheet should be deducted from the value of the scheme assets to avoid double counting. Likewise any pension provision should be treated as an addition to the scheme assets. These adjustments to the value of scheme assets are not applicable to credit or debit positions between the company and the pension scheme to the extent that these positions are already recognised in the scheme's balance sheet. Nor are they applicable to the disclosures referred to below.

## **Disclosures**

27. SSAP 24 requires disclosure of any deficiency of assets to meet accrued benefits based, for members in pensionable service, on pensionable service to and pensionable earnings at the date of valuation including revaluation on the statutory basis or such higher basis as has been promised. Market-related investment assumptions may be used for the calculation if this is more appropriate than the assumptions used for calculating pension cost. If the result differs according to the rule under which the benefits are assumed to be payable (noting in particular the choice between early leaver and scheme termination rules) then the actuary should draw attention to the difference and provide the information for the alternative approaches.
28. The Statement requires disclosure of the actuarial method and main actuarial assumptions used at the most recent formal actuarial valuation or later formal review of the scheme on an ongoing basis for SSAP 24 purposes. When the method and assumptions used for SSAP 24 differ from those used for funding purposes (see paragraph 23) then the method and assumptions to be disclosed are those used for the calculation of the pension cost.
29. The degree of disclosure should be consistent with the requirements, in relation to funding, of the Disclosure Regulations and Guidance Note GN9. If a control period is used and is a significant factor in the calculations, then, in accordance with the approach of GN9, this should be disclosed as a part of the method and assumptions along with aspects such as the allowance made for new entrants.
30. The Statement requires disclosure of the level of funding in percentage terms, based on the most recent formal actuarial valuation or later formal review of the scheme on an ongoing basis. The appropriate values of the accrued liabilities and of the assets for this purpose are those obtained by the Projected Accrued Benefit Method, using the same assumptions as those used to derive the pension cost.
31. Unless either the Projected Unit or the Attained Age Method is being used for funding, part or all of any surplus or deficiency to be disclosed will be attributable to the use of the Projected Accrued Benefit Method for that disclosure. It would be appropriate to include a comment to this effect along with any other comments called for on material surplus or deficiency disclosed.

32. The responsibility for the disclosures required under SSAP 24 rests with the company. If an actuary is asked to produce draft wording he should ensure that the draft complies with the provisions of SSAP 24. The draft wording should aim to give the user of the financial statements a proper understanding of the impact of the pension arrangements on the company's financial statements. If the actuarial method for determining the pension cost is not precisely defined by reference to GN26, a clear and accurate description of the method should be given. Actuarial values of liabilities, surplus or deficiency should not be quoted in the disclosure unless either:
- (a) those values are properly to be compared with the market value of assets at the date of valuation; or
  - (b) the difference, if any, between market and actuarial value of assets is explained in the disclosures.