Year end 2024 accounting issues

ACA sessional meeting

The views expressed in this presentation are those of the authors at the date of this presentation.

28 November 2024
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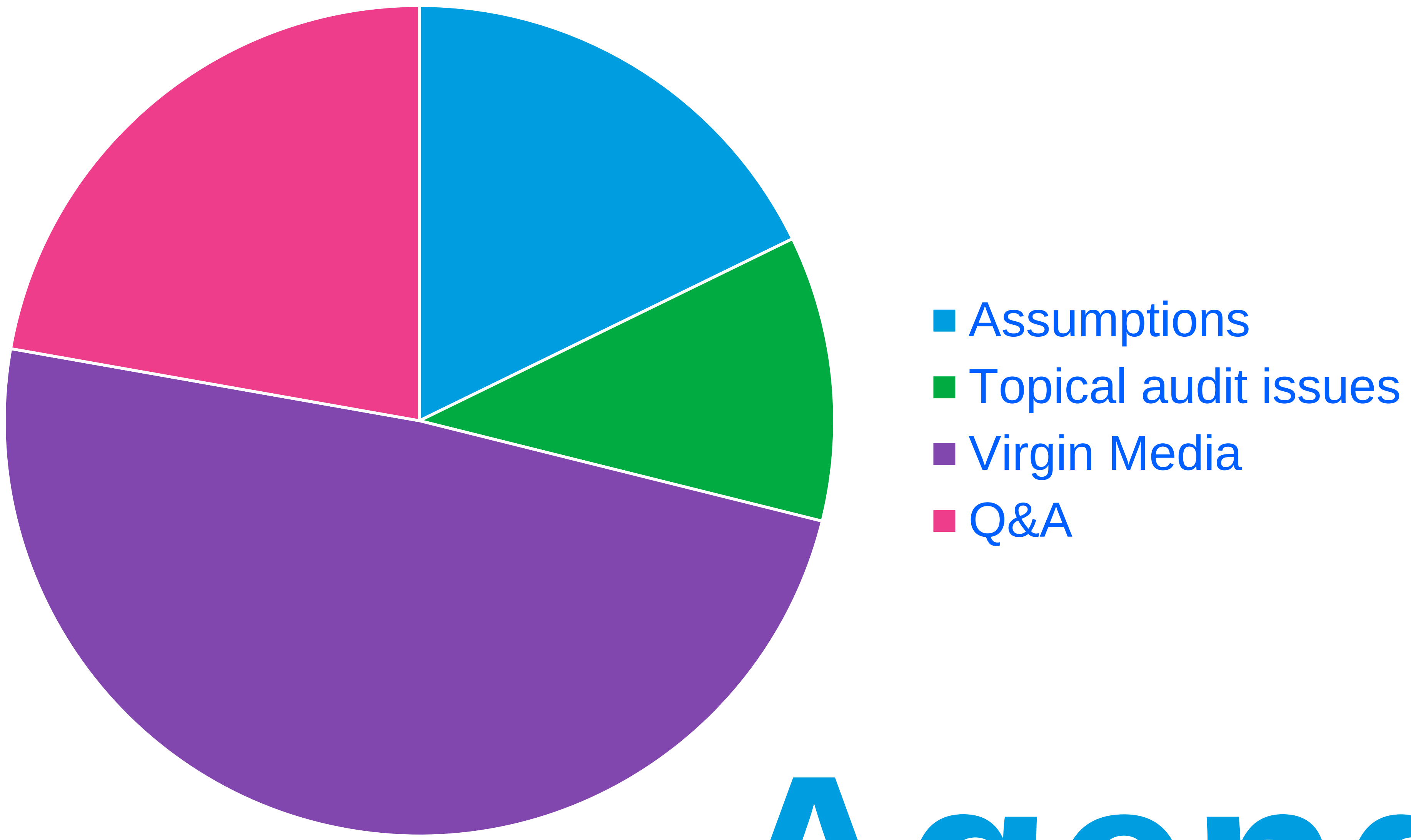

Agenda

Assumptions

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Assumptions

Trends in 2024

Market conditions

relatively stable in 2024 (compared with 2022!)

Accounting surpluses

=> more companies aiming to use “middle of the road” assumptions

Discount rate

range fairly narrow, with judgements around bond universe and extrapolation

Life expectancy

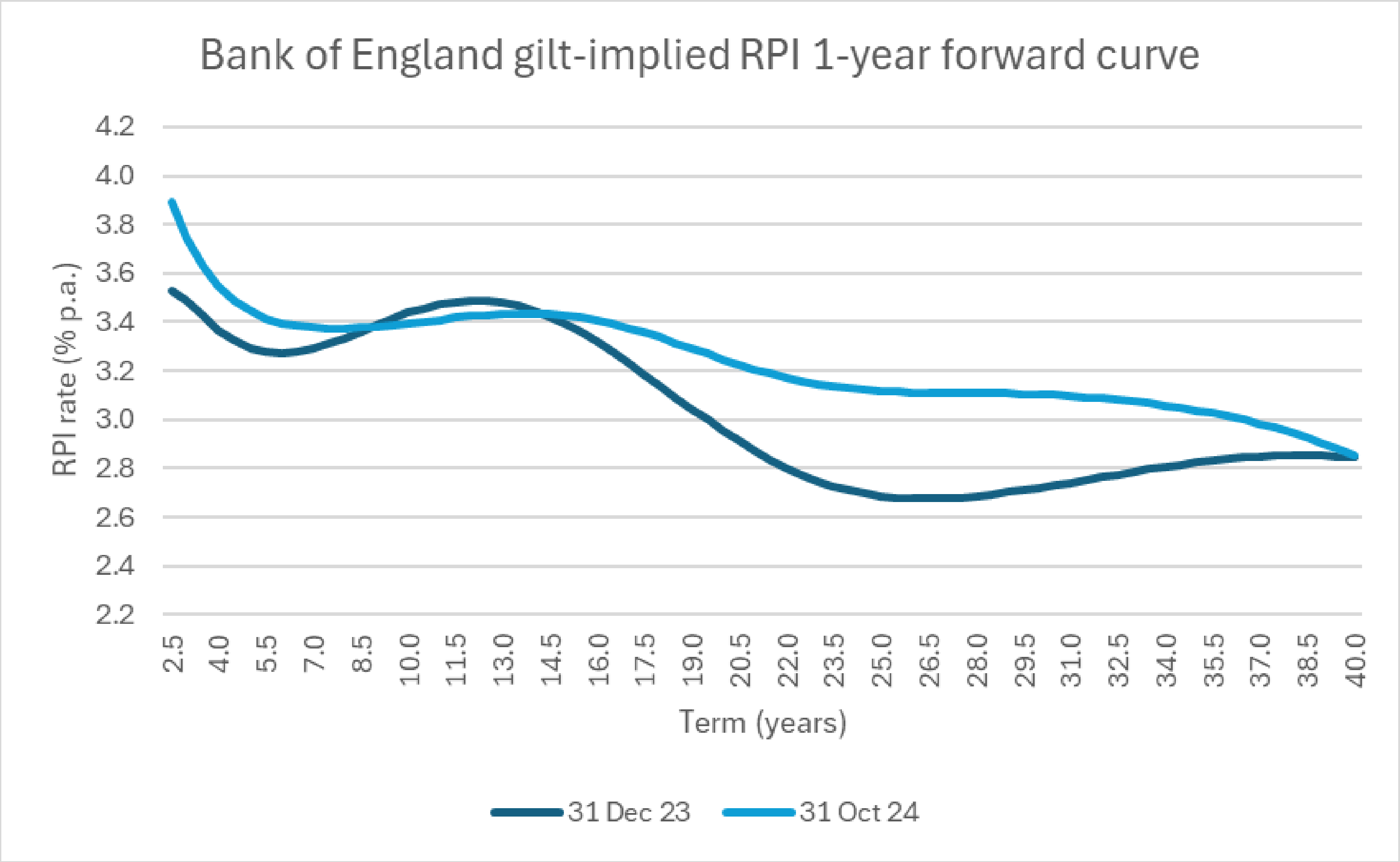
greater use of CMI core parameters, though scope to justify alternative approaches

Price inflation

expectations remain difficult to determine from market based evidence

Assumptions

Market-implied RPI inflation



Wisdom of crowds?

Broken?

Assumptions

How big is the inflation risk premium?

Bank of England Staff Working Paper No. 1,028 "The market for inflation risk" (2023)

- Inflation risk market is segmented – pension funds trade at long horizons, hedge funds at short horizons
- Prices absorb new information within three days
- Heteroskedasticity – releases of inflation data cause heightened volatility in the inflation swap market
- Fundamental shocks drive the long-horizon swap prices, while liquidity shocks drive the short-horizon prices
- "In 2020, the UK chancellor announced that RPI is to be aligned with CPIH "no earlier than Feb 2030", with no compensation for holders of index-linked gilts. However, the market is yet to price this transition in its entirety, likely due to expectations of a delay or possible compensation."

Inflation risk premium cannot be objectively disaggregated from market-based indicators

- IAS 19 assumptions have used a deduction to market implied RPI of between 0% and 0.55% for the inflation risk premium
- Is a greater inflation risk premium typically appropriate at longer durations?
- If so, how should "longer durations" be measured – post-2030 or something else?

Assumptions

How big is the CPIH/CPI wedge?

Office for Budget Responsibility provided a new forecast in October 2024 for the long term CPIH/CPI wedge of c. 0.4% p.a. based on CPI of 2%, CPIH of 2.4% and earnings growth (and rental inflation) of 3.8%:

- the owner-occupied housing component of CPIH (which has c. 16% weight) getting CPI + 1.8%; and
- the council tax component of CPIH (which has c. 3% weight) getting CPI + 2.8%,
- i.e. 16% x 1.8% + 3% x 2.8% ~= 0.4%.

Does this seem consistent with historical evidence?

- Historical evidence over various periods shows that the CPIH/CPI gap has generally remained significantly lower than 0.4%. The 1950-2024 gap was -0.3%, the 1983-2024 gap was 0.1%, the 1997 to 2024 gap was 0.0%.
- While the CPIH/CPI wedge in 2024 has been 0.7% on average (for the 10 months published), the average CPIH/CPI wedge was -0.6% in 2023 and -1.2% in 2022 (and -0.2% over the last 5 years to Oct 2024).
- ONS published council tax inflation data for the past 20 years shows it exceeded CPI on average by 0.3% (i.e. much lower than CPI + 2.8%).
- The ONS published an experimental measure of Private Housing Rental Prices from 2016 to 2024 which showed private rental inflation was lower than CPI by about 1.2% during this period (i.e. much lower than CPI + 1.8%).

Swap market-based CPI inflation curves have limited credibility due to the small size of the market but appear to support a long term CPIH/CPI wedge of close to 0% and no more than 0.2%

Topical audit issues

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Potential audit focus areas

- Lagged asset values
- Surplus recognition
- Group plan accounting
- Balance sheet presentation
- Legacy benefit issues

Surplus sharing: Accounting considerations

Surplus sharing options	Accounting considerations
Subsidising DB or DC accrual	• Cash saving • Still need to record IAS19 P&L cost • Potential for increased IFRIC14 headroom
Refund of surplus	• Akin to a negative contribution
Discretionary benefits – one-off	• Typically a Past Service Cost • Remeasure P&L under IAS19.123A

Discretionary benefits – series	• Typically a Past Service Cost
	• Remeasure P&L under IAS19.123A
	• Measuring future increases
	    • Automatic increases or periodic decision?
	    • Do relevant conditions exist?

Plan already provides for surplus sharing	Measure DBO in line with IAS19.88(b)

1. Consider accounting when agreeing surplus sharing frameworks
2. Assess interactions with surplus recognition / deferred tax
3. Agree treatments in principle with entity’s auditor

Virgin Media

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MACFARLANES

Virgin Media Limited v NTL Pension Trustees II Limited and Others

Legal perspective

Faye Jarvis

28 November 2024

Virgin Media Limited v NTL Pension Trustees II Limited and Others

A reminder

- Section 37 of PSA 93 and Regulation 42 Contracting-out Regulations 1996 provided that rules could not be amended in relation to section 9(2B) rights unless:
  - the trustees had informed the scheme actuary in writing of the proposed alteration;
  - the actuary had considered the proposed alteration and confirmed to the trustees in writing that they were satisfied the scheme would continue to satisfy the statutory standard in accordance with section 12A of the Act if the alteration was made (note, a formal certificate was not required); and
  - the alteration did not otherwise prevent the scheme from satisfying the conditions of section 9(2B) of the Act.
- Section 9(2B) rights were defined as *rights to the payment of pensions and accrued rights to pensions (other than rights attributable to voluntary contributions) under a contracted-out scheme so far as attributable to an earner's service in contracted-out employment on or after 6 April 1997*.
- **Courts held**:
  - the absence of the required actuarial confirmation when making amendments in relation to post-6 April 1997 benefits meant those amendments were void (meaning they did not take effect);
  - the amendments were void in respect of changes to both accrued benefits and future benefits; and
  - the voidness applied equally to amendments that were prejudicial to members and amendments that would (had they not been invalidated by the absence of the actuarial confirmation) have enhanced member benefits.

Virgin Media Limited v NTL Pension Trustees II Limited and Others

Practical issues

- Do trustees have a duty to investigate?
  - may be possible to argue that reasonable to presume what should have been done was done
  - BUT number of reasons why investigation may be necessary / sensible
- Circumstances that could force an investigation:
  - corporate transactions
  - de-risking transactions
  - desire to preserve professional negligence claim
  - auditors questions
- What evidence might be required?
  - recitals to the deed
  - correspondence with the actuary in relation to the deed
  - evidence that the actuary was at a meeting where the deed was discussed
  - evidence as to the documentation available from the relevant period
- Could amendments be saved from a later date?

Virgin Media Limited v NTL Pension Trustees II Limited and Others

Future developments

- Will the DWP take any action?
- Court case in February – understand will consider effect of subsequent actuarial confirmations on otherwise void amendments

Virgin Media: an audit perspective

Accounting requirement

IAS19 requires entities to account for their legal obligation under the formal terms of a defined benefit plan (IAS19.4 and IAS19.61)

Potential auditor expectations

1. Trustees/sponsor to obtain legal advice
2. Consider whether DBO needs adjusting for FY24 reporting
3. Document position on the implications of the case and next steps
4. Consider proportionate narrative disclosures

KPMG Current Issues document https://kpmg.com/uk/en/home/services/audit.html

Virgin Media: an audit perspective

1. Trustees/sponsor to obtain legal advice

- Validity of historical amendments is a legal matter
- DB schemes are unique in terms of trust deed and governance history
- Does not appear to be legal consensus on requirement to investigate
- In house reviews vs. external legal advice
- What about future DWP intervention / legal developments? “Wait and see” approach

Virgin Media: an audit perspective

2. Consider whether DBO needs adjusting for FY24 reporting

- These investigations can take time to conclude
- An adjustment to the DBO would require
    - A confirmed invalid historical amendment
    - Quantification of issue
- Accounting treatment would need to be agreed

Virgin Media: an audit perspective

3. Document position on the implications of the case and next steps

- Expect your auditor to request a copy of legal advice
- Summary of s37 confirmations for historical amending deeds
- Areas requiring further legal clarification
- Are there any other relevant facts and circumstances?
    - Buy-in/out transactions
    - Company indemnities in relation to section 37

Virgin Media: an audit perspective

4. Consider proportionate narrative disclosures

- Narrative disclosures may be expected if the position remains uncertain
- Even if position clear, expect interest from readers of the accounts
- Disclosures may include
  - Status of investigations
  - Legal advice received
  - The impact of the case on the scheme
  - Enhanced risk disclosures
  - Whether the DBO has been adjusted or not

Virgin Media

A consulting actuary's perspective

- **Fundamentally this is a legal issue**
  - An actuary can facilitate discussions between the employer, the trustees, the auditor and the legal adviser
  - But actuaries are not legal advisers
- **Quantifying the impact**
  - What benefit uncertainty?
  - Can an actuary determine the potential legal impact on the scheme benefit structure?
  - Is a reliable quantification possible?

Questions
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