Pensions - Follow-up of the 2014 review into compliance with the reporting standard

Audit & Reporting Quality

Publication date: 29 October 2015

The Netherlands Authority for the Financial Markets (AFM)

The AFM is a strong proponent of fairness and transparency in the financial markets.

As the independent conduct supervisor, we contribute to sustainable financial prosperity in the Netherlands.

Disclaimer
This is an English translation of the original Dutch text, furnished for convenience only. In the event of any conflict between this translation and the original Dutch text, the latter shall prevail.

Contents

1. Management summary 4

2. Rationale, objective, scope and methodology 5
    - 2.1 Rationale 5
    - 2.2 Objective 5
    - 2.3 Scope 5
    - 2.4 Methodology 5

3. Review findings 7
    - 3.1 Compliance with the disclosure requirements introduced in IAS 19 in 2013 has not improved 7
    - 3.2 Inconsistent classification of multi-employer pension plans has increased 10

1. Management summary

In view of the findings of its first review of application of new requirements in the reporting standard for pensions (IAS 19), the AFM announced last year in its report 'In Balance 2014' that it would repeat this review in 2015. The aim of the review is to establish the extent to which companies have taken note of the comments by the AFM and whether the quality of reporting on pensions in the Netherlands has improved as a result.

The main conclusions of the review are:

- Compliance with the disclosure requirements introduced in IAS 19 in 2013 has not improved in the financial reporting for 2014. There are virtually no differences in the findings of this year's review compared to last year's review.
- The same multi-employer pension plans are frequently classified differently by different companies, either as a defined benefit pension plan or as a defined contribution pension plan.

The AFM notes that the market has not independently achieved an improvement in its compliance with the provisions of IAS 19 as a result of its report in 2014. The AFM will accordingly take action against companies in the coming months with the worst compliance with the disclosure requirements in IAS 19, also taking account of the size of their pension obligations. Where necessary this requires adjustment. The AFM considers that there needs to be an improvement in the quality of the reporting on pensions in the financial reporting for 2015.

Regarding the inconsistency in classification of multi-employer pension plans, the AFM will contact both the companies concerned and the audit firms concerned to discuss how this can be removed.

2. Rationale, objective, scope and methodology

2.1 Rationale

Last year, the AFM conducted a review into the application of disclosure and other requirements of the then renewed standard IAS 19 (also referred to as a 0-measurement below). The main conclusions of the review are:

- Compliance with the new disclosure requirements in IAS 19 is poor.
- Multi-employer pension plans are not classified consistently.

Given the nature of the findings of last year's review and the social relevance of the issue, in its report 'In Balance 2015' the AFM announced that it would repeat this review in 2015 with respect to the financial reporting for 2014 (also referred to as a 1-measurement below).

2.2 Objective

The aim of the review is to establish the extent to which the market has taken note of the comments by the AFM and whether the quality of reporting on pensions in the Netherlands has improved as a result. The AFM has focused in this context on the correct application of the disclosure requirements. We also assessed the extent to which the quality of disclosures in the financial reporting for 2014 has changed in comparison to the financial reporting for 2013, distinguishing between the disclosure requirements that were mandatory prior to the 2013 financial year and the disclosure requirements that have been mandatory only since the 2013 financial year.

2.3 Scope

The review population concerns all listed companies with shares quoted on Euronext Amsterdam that fall under the supervision of the AFM pursuant to the Financial Reporting (Supervision) Act and that publish consolidated financial statements prepared in accordance with IFRS. We selected only those companies that in 2013 and 2014 had placed their defined benefit pension plan(s) with a company pension fund or a multi-employer pension fund. The selected population amounts to 61 companies.

2.4 Methodology

We compiled an assessment framework for the review on the basis of the disclosure requirements in IAS 19. We distinguished between provisions that applied prior to 2013 and new provisions that have applied with effect from 2013. For the determination of the non-compliance score, each disclosure requirement was assigned an equal weight and all disclosures not relevant to a company were removed[1]. The relevance of a disclosure was established on the basis of other information in the financial statements or other publicly available information, including from the Internet. The disclosures required for pension plans under other standards, such as IAS 24 and IAS 37, were not included in the non-compliance score. The so-called general provisions in IAS 19.135 were also not included in the non-compliance score.

[1] One example of this concerns the provisions relating to an asset ceiling. If the company has a net pension liability, the provisions relating to the asset ceiling were not included in the assessment. Another example concerns the separate reporting of changes as a result of business combinations. If the company in question did not make any acquisitions in the reporting year, these reporting standards were not included in the assessment for this company

3. Review findings

Our review findings are stated in the sections below.

3.1 Compliance with the disclosure requirements introduced in IAS 19 in 2013 has not improved

Compliance with the disclosure requirements in IAS 19 has not improved. There are virtually no differences in the findings of this year's review compared to last year's review.

Table 1: Percentage degree of non-compliance with disclosure requirements in the former IAS 19 and the new IAS 19 by companies that have placed their pension plans with a company pension fund

	Disclosure requirements IAS 19 former[2]		Disclosure requirements IAS 19 new[3]	
	2013	2014	2013	2014
Score at company pension fund	13%	12%	51%	47%

This table shows the average percentage of reporting provisions that were not complied with by the companies in their financial reporting for 2014, divided into the provisions of IAS 19 former and IAS 19 new

Table 1 shows that the quality of the disclosure for pension plans placed with company pension funds has shown little improvement. Apart from one single case, the companies that had to report on defined benefit pension plans placed with a company pension fund did not introduce any clear improvements in their disclosures of these plans.

Around half of the disclosures of defined benefit pension plans placed with a company pension fund did not include the mandatory disclosures newly introduced in 2013. As stated in the 'In Balance 2014' report with respect to 2013, these missing new disclosure requirements related mainly to:

- A description of the statutory framework for pensions and pension funds,
- A description of the governance of pension funds and the relationship with the company,
- Information on the degree of risk regarding the measurement of the pension investments by means of a classification analogous to that in IFRS 13[4],
- Information on the pension fund's risk appetite and the consequences of this for the company,

[2] The disclosure requirements in the former IAS 19 concern the requirements that applied prior to 2013.
[3] The disclosure requirements in the new IAS 19 concern the additional requirements that have applied with effect from 2013.
[4] IAS 19 requires further specification of the investments into listed and unlisted, comparable to the terms Level 1 and Level 2 and 3 respectively used in IFRS 13.

- the sensitivity of the pension liabilities to changes in the key assumptions,
- information on the average maturity and distribution of the pension liabilities over time ('duration').

The AFM considers that these disclosures are relevant to users, enabling them to make a better assessment of the risks associated with the company's pension plan. More specifically, these disclosures provide information on risks, future costs and outgoing cash flows at the company.

Regarding the pension plans placed with company pension funds, compliance by AEX stocks is better than by the non-AEX stocks. The table below shows the percentage of non-compliance per stock exchange segment.

Table 2: Percentage degree of non-compliance with disclosure requirements for company pension funds for IAS 19 former and IAS 19 new per stock exchange segment

	AEX	AMX	AScX	Other
Score IAS 19 former	9%	14%	11%	17%
Score IAS 19 new	33%	49%	50%	68%

This table shows the average percentage of reporting provisions that were not complied with by the companies in their financial reporting for 2014 per stock exchange segment, divided into the provisions of IAS 19 former and IAS 19 new

Table 3 shows that companies reporting defined benefit pension plans placed with a multi-employer pension plan score worse than the companies reporting defined benefit pension plans placed with company pension funds.

Table 3: Percentage degree of non-compliance with disclosure requirements in the former IAS 19 and the new IAS 19 by companies that have placed their pension plans with a multi-employer pension fund

	Disclosure requirements IAS 19 former[5]		Disclosure requirements IAS 19 new[6]	
	2013	2014	2013	2014
Score for multi-employer pension fund	23%	18%	74%	71%

This table shows the average percentage of reporting provisions that were not complied with by the companies in their financial reporting for 2014, divided into the provisions of IAS 19 former and IAS 19 new

Only around a quarter of the new provisions in IAS 19 are provided by the companies. The most important provisions that are not complied with concern:

- the funding agreement with the multi-employer pension fund and the extent to which the company will be liable for future shortfalls at the fund,
- the consequences for the company if the fund ceases to exist or the company wishes to place its liabilities elsewhere,
- the expected level of contributions to the fund,
- the company's share in the total size of the fund.

The AFM considers that these disclosure requirements are essential information for users. This is even more the case since the regular disclosure requirements applying to defined benefit plans do not apply here and are therefore not stated. This also means that the actual size of the pension liabilities for defined benefit pension plans placed with multi-employer pension funds is not included in the financial statements.

Regarding pension plans placed with multi-employer pension funds, the AFM notes that the AEX companies, and to a limited extent also the AScX companies, are more compliant than the companies not included in the AEX or the AScX. Here too, compliance with the old provisions of IAS 19 is better than compliance with the new provisions of IAS 19. The table below shows the percentage of non-compliance per stock exchange segment.

[5] The disclosure requirements in the former IAS 19 concern the requirements that applied prior to 2013.
[6] The disclosure requirements in the new IAS 19 concern the additional requirements that have applied with effect from 2013.

Table 4: Percentage non-compliance with disclosure requirements regarding multi-employer pension funds in IAS 19 former and IAS 19 new, per stock exchange segment

	AEX	AMX	AScX	Other
Score IAS 19 former	17%	33%	20%	29%
Score IAS 19 new	67%	75%	62%	85%

This table shows the average percentage of reporting provisions that were not complied with by the companies in their financial reporting for 2014 per stock exchange segment, divided into the provisions of IAS 19 former and IAS 19 new

The AFM notes that the market has not independently achieved an improvement in its compliance with the provisions of IAS 19 as a result of its report in 2014. In the coming months the AFM will accordingly take action against companies with the worst compliance with the disclosure requirements in IAS 19, also taking account of the size of their pension obligations. The AFM considers that there needs to be an improvement in the quality of the reporting on pensions in the financial reporting for 2015.

3.2 Inconsistent classification of multi-employer pension plans has increased

As was the case last year, the AFM's review focused on the way in which defined benefit pension plans placed with a multi-employer pension fund are presented in financial statements. Multi-employer pension funds state it is notpossible for the liabilities and in particular the assets of individual participating pension plans within the multi-employer fund to be identified. A provision for this has been introduced in IAS 19. If the information needed for the correct treatment of the defined benefit pension plan cannot be provided by the fund, the company may recognise the defined benefit pension plan as if it were a defined contribution plan. In this case, additional disclosures must be provided.

A total of 28 of the 61 companies reviewed have placed some or all or their pension plans with one or more multi-employer pension funds. In all cases, these pension plans are recognised as defined contribution plans. Table 5 shows how companies classify their pension plans.

Table 5: Classification of multi-employer pension plans[7]

	Number of companies
Plan is defined contribution	17
Plan is defined benefit	20

This table concerns the classification of multi-employer pension plans by 28 companies that have placed their pension plans with a multi-employer pension fund

Last year, we noted that some multi-employer pension plans were classified differently by different companies (as both defined benefit and defined contribution plans). This year, we established that:

- The number of multi-employer pension funds that are classified differently has increased,
- in a number of cases these different classifications were allowed by the same audit firm.

The AFM considers it unlikely that the same pension plan can be classified as both a defined contribution plan and a defined benefit plan. It is remarkable that the same multi-employer pension plan is classified differently at different companies that are audited by the same audit firm. This does not help transparency or clear classification. The review findings are summarised below.

[7] Some companies are affiliated to more than one multi-employer pension fund, and for this reason the total shown here is higher than the total number of companies.

Table 6: Inconsistent classification of multi-employer pension funds (MEPF)

MEPF:	Classification		Consistent classification at same audit firm		Inconsistent classification at same audit firm	
	DB	DC	DB	DC	DB	DC
PMT	3	5	2	2	1	3
PME	4	2	1	1	3	1
Construction	1	3	1	3	-	-
Railways	1	1	1	1	-	-
Other DB	11	-	11	-	-	-
Other DC	-	6	-	6	-	-
Total	20	17	16	13	4	4

This table shows the classification of multi-employer pension plans at the companies reviewed. The 'classification' column shows how the company classifies the pension plan. The 'consistent classification at audit firm' column shows how the company classifies the pension plan in cases where the classification at different companies audited by the same audit firm is consistent. The 'inconsistent classification at audit firm' column shows how the company classifies the pension plan in cases where the classification at different companies audited by the same audit firm is inconsistent. DB stands for a defined benefit pension plan, DC for a defined contribution pension plan.

The above table shows for instance that the pension plan of the multi-employer pension fund PMT is classified by three companies as a defined benefit plan, while five companies classify it as a defined contribution plan. The table also shows that the same audit firm is involved with four of the eight companies classifying the PMT plan as a defined benefit plan and with three other companies that classify it as a defined contribution plan.

Despite the fact that this difference in classification will not normally have any effect on the statement of financial position or the determination of the result of the reporting company, the classification does affect the disclosure that has to be provided. We have already reported on the quality of this disclosure in the preceding section. The AFM considers that the inconsistent qualification of the same pension plan with the same provider by different companies is not desirable, and can lead to uncertainty for users regarding the correct classification of the plan and the associated risks.

The AFM considers that clarity regarding the classification of multi-employer pension plans is important, as well as the quality of the disclosure.

Firstly, with reference to the broad public debate on the entitlements that employees can expect, which has become increasingly prominent in recent years.

Secondly, as part of the regularly recurring negotiations on setting the amounts of pension contributions, which in most cases take place every five years. Normally, these negotiations are part of collective employment agreement negotiations in a specific industry. The social partners in these negotiations will certainly include the amount of any surplus or shortfall in the multi-employer pension fund in their negotiating position. In situations where the multi-employer pension fund is - consistently - classified as a defined benefit pension plan, inclusion in the negotiations would seem to be appropriate. If however the multi-employer pension fund is classified as a defined contribution plan, the cumulative past results are no longer available to the negotiators; the setting of contributions should not be affected by compensation for a shortfall or reimbursement of a surplus.

Regarding the inconsistency in classification of multi-employer pension plans, the AFM will contact both the companies concerned and the audit firms concerned to discuss in consultation with the market how a suitable solution can be found so that the transparency and quality of reporting will be improved.

The Netherlands Authority for the Financial Markets (AFM)
T +31(0)20 797 2000 | F +31(0)20 797 3800
Postbus 112723 | 1001 GS Amsterdam
www.afm.nl