Pension Accounting

Pension accounting is a complex task. National pension accounting rules vary and comparing them is difficult. Glaum (2009) compares standards for accounting pensions in the US, the UK and six continental European countries.

While UK and Dutch pension accounting rules are similar to the International Accounting Standard (IAS) 19 and Financial Accounting Standard (FAS) 87, French, German, Italian, Spanish and Swiss rules are clearly different (Table). For example, in German accounting law, there are no explicit rules for the valuation of pension obligations, and French and Swiss accounting standards do not generally require the recognition of pension liabilities. Furthermore, disclosure rules also vary across countries, with requirements generally being much less extensive in continental Europe than in Anglo-Saxon countries, or in comparison to International Financial Report-

Table

National pension accounting rules: overview

	1. Specific standard for pension accounting	2. Recognition in the balance sheet		
		2.1. Recognition of liability mandatory	2.2. Smoothing mechanism for balance sheet	2.3. Presentation in balance sheet (gross/net)
France	No; recommendation, but no obligation to apply IAS 19 (however: application of SoRIE option not allowed).	Recognition of liability for pension obligations is not mandatory; if companies recognise a liability, application of IAS 19 is recommended (without SoRIE option); in case of voluntary recognition, IAS 19 defines minimum liability.	n.a. (see 2.1)	n.a. (see 2.1)
Germany	Currently only rudimentary rules in German Commercial Code (HGB), paragraph 249 and paragraph 253; reform of HGB in preparation, planned: market-based valuation of pension obligations.	Yes; if internally financed (except for pre-1985 liabilities); optional for funding deficits in case of external financing.	No	Gross (net in case of funding through separate legal units).
Italy	No; Codice Zivile, paragraph 21.20 applies only to severance payments (TFR); no specific rules for defined benefit obligations (which are uncommon in Italy).	n.a. (see 1.)	n.a. (see 1.)	n.a. (see 1.)
Netherlands	Dutch Accounting Standard (RJ 271); alternatively, companies may opt to apply IAS 19 or FAS 87; it is also allowed to adopt IFRS completely on a voluntary basis; DB pensions in multi-employer funds may be accounted for as DC plans; new Dutch standard 271 to be published in 2009.	Yes	Corridor approach (optional; SoRIE option not allowed under RJ 271).	Net
Spain	Yes; new rules to be applied as of January 2008; special rules for financial institutions.	Yes	Until 2007: same as IFRS, immediate recognition in P&L was common practice; since January 2008: only SoRIE-option allowed.	Net
United Kingdom	FRS17 “Retirement Benefits”.	Yes	No	Net in case of plan assets.
Switzerland	Yes; FER 16 and 26.	No; only, if pension fund is actuarially underfunded.	Yes; due to actuarial valuation.	Net
IFRS	IAS 19 “Employee Benefits”.	Yes	Corridor (optional).	Net in case of plan assets.
United States	FAS 87/158 “Employers’ Accounting for Pensions”.	Yes	No	Net in case of plan assets.

Table continued

	3. Valuation of liabilities					
	3.1. Specified method	3.2. Guidance on assumptions	3.3. Interest rate	3.4. Salary rate	3.5. Benefit rate	3.6. Mortality rate
France	n.a. (see 2.1)	n.a. (see 2.1)	n.a. (see 2.1)	n.a. (see 2.1)	n.a. (see 2.1)	n.a. (see 2.1)
Germany	No; mostly entry age normal cost method ("Teilwertverfahren") or projected unit credit method.	Yes	No explicit rule; traditionally adoption of interest rate specified in tax code 6% p.a..	No projections required.	No projections required.	No; actuarially determined.
Italy	n.a. (see 1.)	n.a. (see 1.)	n.a. (see 1.)	n.a. (see 1.)	n.a. (see 1.)	n.a. (see 1.)
Netherlands	Yes; projected unit credit method.	Yes	Yes; market based.	Yes	Yes	No; actuarially determined.
Spain	No; recommended: projected unit credit method.	No	No; actuarially determined.	No; actuarially determined.	No; actuarially determined.	No; actuarially determined.
United Kingdom	Yes; projected unit credit method.	Yes	Yes; market based, high quality corporate bonds.	Yes	Yes	No; actuarially determined.
Switzerland	No; actuarially determined.	No	No; actuarially determined.	No; actuarially determined.	No; actuarially determined.	No; actuarially determined.
IFRS	Yes; projected unit credit method.	Yes	Yes; market-based, high quality corporate bonds.	Yes	Yes	No; actuarially determined.
United States	Yes; projected unit credit method.	Yes	Yes; market-based, high quality corporate bonds.	Yes	Yes	No; actuarially determined.

	4. Valuation of assets	5. Pensions costs	
		5.1. Explicit rules	5.2. Smoothing mechanism
France	Same as IAS 19: fair value.	n.a. (see 2.1)	n.a. (see 2.1)
Germany	Cost; fair value or actuarial value in case of external financing.	No	Yes; implicit in traditional (tax-based) valuation practices.
Italy	n.a. (see 1.)	n.a. (see 1.)	n.a. (see 1.)
Netherlands	Fair value or allocated fair value for joint, multi-employer pension funds.	Yes	Corridor (optional).
Spain	Fair value.	Yes (but only SoRIE approach for actuarial gains and losses).	Only for prior service costs.
United Kingdom	Fair value.	Yes	No
Switzerland	Fair value.	No	Yes; implicit in actuarial valuation.
IFRS	Fair value.	Yes	Corridor (optional).
United States	Fair value.	Yes	Corridor (optional).

DB = Defined Benefit; – DC = Defined Contribution; – IAS = International Accounting Standard; – IFRS = International Financial Reporting Standards; – P&L = Profit & Loss; – SoRIE = Statement of Recognized Income and Expense.

Source: Glaum, M. (2009), 300-01.

ing Standards (IFRS). The lack of precise rules for the recognition and valuation of pension obligations and pension costs, combined with relatively lenient disclosure requirements, opens up wide scope for managerial discretion and earnings management. As a consequence, it is likely that both the relevance and the reliability of pension accounting information will vary across countries.

Following the European Union's IFRS Regulation of 19 July 2002, all publicly traded companies in the European Union are required, in most cases since 2005, to prepare their consolidated financial statements in accordance with IFRS. Hence, the above-discussed national accounting standards have lost their importance for stock-listed companies. Hence, since IAS 19 is very similar to FAS 87, one could expect pension accounting, in particular, to have become homogeneous, or at least very similar, for European and US stock-listed companies. However, there are serious reasons to expect that the very different institutional environments across Europe will continue to bring about country-specific accounting practices, despite the introduction of a single set of accounting standards.

Corporate pension systems differ across countries. This may affect how companies account for pension obligations, and it may have bearings on the way pension accounting information is processed. Glaum (2009) summarises important features of the occupational pension systems of the US, the UK, and of six continental European countries. Form the viewpoint of accounting, characteristics of occupational pension systems differ across countries. There are pronounced differences in funding practices. Variation in funding ratios is partly the result of differences in pension fund regulation. Another driving force is taxation. These institutional differences have consequences for how pension obligations are accounted.

W. O.

Reference

Glaum, M. (2009), "Pension Accounting and Research: A Review", *Accounting and Business Research* 39(3), Special Issue International Accounting Policy Forum, 273–311.