Understanding of pension fund transactions and annual financial statements.

Presentation by Hope T Mulilo CA (Z)
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Presenter’s Biography

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Manager in charge of the Pensions and Other Benefits Schemes: National Social Security Authority (NSSA)

Member of the Insurance and Pensions subcommittee at ICAZ

Assistant Manager: KPMG Chartered Accountants (ZW)

Articles of Clerkship: KPMG Chartered Accountants (ZW)

Expertise: Audit, IFRS, Pensions and Social Security.
Disclaimer

The information contained in this presentation is of a general nature and may not address specific situations. If you require assistance, please contact experienced organisations.
Course Objectives

By the end of this presentation we should be able to understand:

- What a pension fund is.
- Pension fund terminology.
- Pension fund types.
- Pension fund transactions.
- Pension fund financial statements.
Definitions

- According to the Wikipedia, a **pension fund**, also known as a **superannuation fund** in some countries, is any plan, fund, or scheme which provides **retirement income**.

- According to the **Pension and Provident Fund Act Chapter 24:09** “the Act”, a **pension Fund** means any fund the principal object of which is to provide for the payment of a pension to a person who is or has been a member of the fund on his retirement.

Pension funds principally invest in equities, properties and money markets.
Understanding of Pension funds

- There is no law that a company/employer should set up an occupation pension fund for its employees.
- A pension is a condition of service and once such conditions of service are put in place, an employer cannot withdraw without consent from employees.
- In the event that the employer does not have a pension fund, they should pay a gratuity to their employees.
- Government promulgated law, (NSSA Act, Chapter 17:04 of 1989) that gave birth to a mandatory pension scheme under social security principles, which is administered by the National Social Security Authority (NSSA).
- Every employed person is obliged to belong to this mandatory pension scheme, irrespective of the size of the enterprise of the employer.
Understanding of Pension funds

- A pension fund should be registered with the Insurance and Pensions Commission (IPEC)
- A pension fund is governed by fund rules which determine:
  - the membership of the fund;
  - the contributions to be paid to the fund, whether compulsorily or otherwise;
  - the benefits to be payable from the fund;
  - the commutation of any pension;
  - the appointment or election of trustees to administer the fund and their powers and duties;
  - the dissolution of the fund, including the appointment and powers of a liquidator;
  - the amendment or replacement of the rules.
- Trustees are important for the governance of the Pension fund.
Understanding of Pension funds (cont’d)

Types of pension funds

The industry is broadly divided into three categories:

- The first being **insured funds**, administered by the country’s five largest assurers, Old Mutual, First Mutual Life, Zimnat Life, ZB Life and Zb Life. Insured funds are those whose contributions are used to buy assets which are registered in the name of the insurer and not the fund.

- The second class is self-administered funds which **operate under administrators and insurers**, with their assets are registered in the Pension Fund’s names.

- Lastly there are, **stand alone pension funds**, which comprises self-administered funds which own and control their administration structures, including staff, to operate the fund. These represent **key economic sectors**, including construction, clothing, mining industries and local authorities.
In Zimbabwe, the employment pension funds are either a defined contribution scheme or a defined benefit scheme. The type of the schemes is derived from the Fund rules.

In order to change the type of scheme there is need to amend fund rules.

Change in scheme type affects the financial position of the Fund. The Act in paragraph 8 section 2c states that “if the amendment or replacement affects the financial position of the fund, a certificate in connection with the financial soundness thereof by the valuator or, if the fund has no valuator, by the auditor.”
**Understanding of pension funds cont’d**

Types of pension funds (cont’d)

According to Wikipedia:

- A **defined benefit pension plan** is a type of [pension plan](#) in which an employer/sponsor promises a specified pension payment, lump-sum (or combination thereof) on retirement that is predetermined by a [formula](#) based on the employee’s [earnings](#) history, tenure of service and [age](#), rather than depending directly on individual [investment](#) returns.

<table>
<thead>
<tr>
<th>Defined Benefit Pension Plans</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employer is committed to specified retirement benefits.</td>
</tr>
<tr>
<td>Retirement benefits are based on a formula that considers years of service, compensation level, and age.</td>
</tr>
<tr>
<td>Employer bears all risk of pension fund performance.</td>
</tr>
</tbody>
</table>

**Guaranteed retirement benefit**, despite good or bad performance of the fund

**Employer bears the risk**
Understanding of pension funds cont’d

Types of pension funds (cont’d)

According to Wikipedia:

- A **defined contribution scheme** is a type of [retirement plan](#) in which the employer, employee or both make contributions on a regular basis. Individual accounts are set up for participants and benefits are based on the amounts credited to these accounts (through employee contributions and, if applicable, employer contributions) plus any investment earnings on the money in the account. In defined contribution plans, future benefits fluctuate on the basis of investment earnings.

Guaranteed contributions, but not return on the contribution or retirement benefit. Pensioner bears the risk.
### Understanding of pension funds cont’d

Types of pension funds (cont’d)

<table>
<thead>
<tr>
<th>Defined Contribution</th>
<th>VS</th>
<th>Defined Benefit</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Employee contributes to plan</strong></td>
<td></td>
<td><strong>Employer contributes to plan</strong></td>
</tr>
<tr>
<td><strong>Sometimes employer makes a matching contribution</strong></td>
<td></td>
<td><strong>Sometimes employee also contributes</strong></td>
</tr>
<tr>
<td><strong>Mutual funds</strong></td>
<td></td>
<td><strong>Plan trustees choose where and how much to invest</strong></td>
</tr>
<tr>
<td><strong>Employee generally chooses where and how much to invest</strong></td>
<td></td>
<td><strong>Benefit defined by a set formula</strong></td>
</tr>
<tr>
<td></td>
<td></td>
<td><strong>Payout guaranteed based on payment formula</strong></td>
</tr>
<tr>
<td><strong>Benefit defined by gains and losses</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Payout based on how well investment performs</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Pension funds are not fully International Financial Reporting Standards (IFRS) compliant as reporting is guided by the Act.

Pension Funds are Public Interest entities which means that the audit report of the financial statements should be a long form, which includes key audit matters.

The opinion of the pension fund is different from that of normal companies because of the emphasis of matter that is placed which states that “The financial statements are prepared for regulatory purposes. Consequently, the financial statements and the related auditors’ report are not suitable for any another purpose” This is because the financial statements are not widely distributed.
Understanding the financial statements (cont’d)

Basis of Preparation (Deviations with IFRS)

- The financial statements are prepared for regulatory purposes in accordance with the Regulations of the Pension and Provident Funds Act [Chapter 24:09] of Zimbabwe.

- The regulations require that the basis of accounting applied by the Fund comprises generally accepted accounting practice as applied to retirement funds in Zimbabwe, which is International Financial Reporting Standards (IFRSs) excluding the requirements of:
  - IAS 1: Presentation of Financial Statements
  - IAS 7: Statement of Cash Flows
  - IAS 27: Consolidated and Separate Financial Statements
Understanding the financial statements

Basis of Preparation (Deviations with IFRS) (cont’d)

- The Pension and Provident Funds Act [Chapter 24:09] requires assets to be recognized at cost.

- There is a significant difference between the fair value of asset and the cost thereof as some assets were bought pre-dollarisation and adopted new cost values in 2009. These values do not fully reflect the performance of the fund.

- However, the basis of accounting applied by Pension Fund industry, is to fair value assets at year end, some pension funds are disclosing both the market value and the cost.
Risks affecting financial statements

- Unsound investment decisions/dealing with distressed asset managers.
- Poor Information Technology infrastructure to enable maintenance of data relating to pensioners and allocating of the contributions to individual pensioners.
- Data issues which affect calculation of benefits.
- Existence of pensioners – Normally an annual verification is being done. However, there is a risk of continuing to pay pensioners who are deceased for the whole year.
- High administration expenditure resulting in erosion of the balance of the Fund.
- High contribution arrears due to failure by employers to remit contributions.
- Poor economic environment affecting the viability of pension funds.
- Ownership and existence of investments.
PENSION AND PROVIDENT FUNDS ACT [CHAPTER 24:09]

XXX PENSION FUND

INCOME AND EXPENDITURE ACCOUNT FOR THE YEAR ENDED 31 DECEMBER 2017

<table>
<thead>
<tr>
<th>Description</th>
<th>December 2017</th>
<th>December 2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>I Balance of Fund</td>
<td>xxx</td>
<td>Xxx (deviation with IFRS)</td>
</tr>
<tr>
<td>II Contributions during the year</td>
<td></td>
<td></td>
</tr>
<tr>
<td>a) By members (split between current and voluntary)</td>
<td>xxx</td>
<td>xxx</td>
</tr>
<tr>
<td>b) By employers (split between normal and special)</td>
<td>xxx</td>
<td>xxx</td>
</tr>
<tr>
<td>III Amount received on transfer from other funds</td>
<td>xxx</td>
<td>xxx</td>
</tr>
</tbody>
</table>
### XXX PENSION FUND

**INCOME AND EXPENDITURE ACCOUNT FOR THE YEAR ENDED 31 DECEMBER 2017**

<table>
<thead>
<tr>
<th>Description</th>
<th>December 2017</th>
<th>December 2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>IV. Amounts received on life insurances</td>
<td>XXX</td>
<td>XXX</td>
</tr>
<tr>
<td>V Income from investments</td>
<td>XXX</td>
<td>XXX</td>
</tr>
<tr>
<td>VI Net surplus on sale/redemption of investments</td>
<td>XXX</td>
<td>XXX</td>
</tr>
<tr>
<td>VII. Amount by which investments were written up <em>(The Act accounts at cost)</em></td>
<td>XXX</td>
<td>XXX</td>
</tr>
<tr>
<td>VIII Other</td>
<td>XXX</td>
<td>XXX</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>XXX</strong></td>
<td><strong>XXX</strong></td>
</tr>
</tbody>
</table>
### Pension and Provident Funds Regulations, 1991

#### XXX PENSION FUND

#### INCOME AND EXPENDITURE ACCOUNT FOR THE YEAR ENDED 31 DECEMBER 2017

<table>
<thead>
<tr>
<th>EXPENDITURE</th>
<th>December 2017</th>
<th>December 2016</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>I Benefits</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(a) Pensions enhancements</td>
<td>XXX</td>
<td>XXX</td>
</tr>
<tr>
<td>(b) Lump sum awards on retirement</td>
<td>XXX</td>
<td>XXX</td>
</tr>
<tr>
<td>(c) Lump sum awards on death</td>
<td>XXX</td>
<td>XXX</td>
</tr>
<tr>
<td>(d) Lump sum awards on resignation, dismissal</td>
<td>XXX</td>
<td>XXX</td>
</tr>
<tr>
<td>(e) Annuities</td>
<td>XXX</td>
<td>XXX</td>
</tr>
<tr>
<td><strong>II Amounts transferred to other funds</strong></td>
<td>XXX</td>
<td>XXX</td>
</tr>
<tr>
<td><strong>III Premiums paid on life insurances</strong></td>
<td>XXX</td>
<td>XXX</td>
</tr>
<tr>
<td><strong>IV. Other expenditure</strong></td>
<td>XXX</td>
<td>XXX</td>
</tr>
<tr>
<td>EXPENDITURE (continued)</td>
<td>December 2017</td>
<td>December 2016</td>
</tr>
<tr>
<td>-------------------------------------------------------------</td>
<td>---------------</td>
<td>---------------</td>
</tr>
<tr>
<td>V Net loss on sale/redemption of investments</td>
<td>xxx</td>
<td>xxx</td>
</tr>
<tr>
<td>VI Amounts by which investments were written down</td>
<td>xxx</td>
<td>xxx</td>
</tr>
<tr>
<td>(this is to reflect assets at FV and not cost)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>VII. Gross administration expenditure (asset management fees)</td>
<td>xxx</td>
<td>xxx</td>
</tr>
<tr>
<td>VIII Provisions</td>
<td>xxx</td>
<td>xxx</td>
</tr>
<tr>
<td>BALANCE OF FUND</td>
<td>xxx</td>
<td>Xxx (deviation with IFRS)</td>
</tr>
</tbody>
</table>
### Pension and Provident Funds Act [Chapter 24:09]

#### XXX PENSION FUND

#### STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2017

<table>
<thead>
<tr>
<th></th>
<th>December 2017</th>
<th>December 2016</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>LIABILITIES</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>I Amount of Fund</td>
<td>XXX</td>
<td>XXX</td>
</tr>
<tr>
<td>II Reserves</td>
<td>XXX</td>
<td>XXX</td>
</tr>
<tr>
<td>III Provisions</td>
<td>XXX</td>
<td>XXX</td>
</tr>
<tr>
<td>IV. Sundry creditors (benefits payable, admin fees payable etc)</td>
<td>XXX</td>
<td>XXX</td>
</tr>
<tr>
<td><strong>Total Liabilities</strong></td>
<td>XXX</td>
<td>XXX</td>
</tr>
</tbody>
</table>
### Pension and Provident Funds Regulations, 1991

**PENSION AND PROVIDENT FUNDS ACT [CHAPTER 24:09]**

**XXX PENSION FUND**

**STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2017 (continued)**

<table>
<thead>
<tr>
<th>Classification</th>
<th>December 2017</th>
<th>December 2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>I Investments in Zimbabwe <em>(at cost) – deviation with IFRS</em></td>
<td>xxx</td>
<td>xxx</td>
</tr>
<tr>
<td>II. Office furniture and equipment at carrying amount</td>
<td>xxx</td>
<td>xxx</td>
</tr>
<tr>
<td>III Sundry debtors in Zimbabwe</td>
<td>xxx</td>
<td>xxx</td>
</tr>
<tr>
<td>IV Assets outside Zimbabwe</td>
<td>xxx</td>
<td>xxx</td>
</tr>
<tr>
<td>V Payments in advance in Zimbabwe</td>
<td>xxx</td>
<td>xxx</td>
</tr>
<tr>
<td>VI Other</td>
<td>xxx</td>
<td>xxx</td>
</tr>
<tr>
<td>VII. Cash at bank</td>
<td>xxx</td>
<td>xxx</td>
</tr>
<tr>
<td><strong>Total Assets</strong></td>
<td><strong>xxx</strong></td>
<td><strong>xxx</strong></td>
</tr>
</tbody>
</table>
Disclosures of the financial statements

1. Basis of preparation
2. Areas of significant judgement
   - Valuation of property
   - Valuation of unquoted equity investments
   - Valuation of debtors
   - Valuation of prescribed assets
3. Recognition of revenue (income)
4. Recognition of expenditure
5. Going concern
6. Impact of the changes from defined benefit scheme to defined contribution scheme
Key Upcoming Financial Reporting Standards

The pension funds are not fully compliant with IFRS and impact of the upcoming standards will be minimal as reporting is guided by the Act.

- **IFRS 15 – Revenue from contracts with customers effective** 31 December 2018.

Contracts have to be scrutinised closely before revenue is recognised. However, for most of the pension funds this standard does not have a material impact on the current revenue recognition criteria.
Key Upcoming Financial Reporting Standards


- Their investments are mostly: Investment in shares, money market investments, Cash, contribution arrears, prescribed assets (treasury bills)

- Pension funds will not be able to comply with classification requirements due to the nature of their financial statements.

- However, in the current economic environment, there is need to consider application of IFRS 9 in providing for contribution debtors.
Key Upcoming Financial Reporting Standards

- **IFRS 17 – Insurance contracts** effective date pushed to 2021 – No material impact is expected on pension funds except where there is a significant risk component of **group life assurance**.
Going Concern

- Going concern issues due to:
  - Poor economic environment which is resulting in
  - Poor investment returns which are not adequately covering claims being paid.
  - Defaults in payment of contributions.
  - Reduction of contribution percentages made by employer.
  - High exits/withdrawals due to retrenchments and closure of companies.
  - Liquidity issues due to asset concentration
  - High administration costs eroding fund balance.

There is need for pension funds to disclose if they are a going concern.
Commission of inquiry – potential impact on the financial statements

Extracts from the Executive Summary of the commission of inquiry

Inquiry on conversion of pension values from the Zimbabwe dollar to the United States Dollar

Reasons for the inquiry included

- Loss of value due to:
  - Pension contribution arrears
  - Hyper inflation
  - Intergenerational transfer of benefits
  - Conversion on dollarization
  - Forced commutation of the full pension
  - Demutualisation of Old Mutual and First Mutual
  - Conversion from defined benefit scheme to defined contributions
Commission of inquiry – potential impact on the financial statements

Extracts from the Executive Summary of the commission of inquiry (continued)

- Industry wide complaints of cheques or transfers allegedly transferred by pension funds that never reflected in the pensioners account etc

Zim$ pensions values set at Z$13m/US$1

HARARE – A commission of Inquiry set up to probe the process used to convert pensions and insurance benefits following dollarisation of the economy in 2009 has come up with a conversion ratio from Zimdollar to US dollars.

The nine-member commission chaired by retired judge Justice George Smith was set up after many Zimbabweans who saved for their old age were offered meagre sums as low as US$6 for their life savings and pensions by the country’s bankrupt government.

Zimbabwe’s central bank had paid the meagre amounts to all those who held Zimbabwe dollar bank accounts and pensions when it abandoned its domestic currency in 2009.
Commission of inquiry – potential impact on the financial statements

Recommendations from the Commission of Inquiry

- Page 12 item 47, Standardise asset and liability valuation and standardised disclosures for financial reporting.
- Page 12 item 48, Split of insurance asset from pension assets supporting pension obligations
- Page 12 item 48, Repealing of accounting of assets on a historical cost basis to align with international accounting standards.
- Page 13 item 51-52 Regulation of permissible expenses. Expense ratios predetermined.
Commission of inquiry – potential impact on the financial statements

Recommendations from the Commission of Inquiry (continued)

- Page 24 item 101, recommendation to revisit the conversion method to ensure fairness to pensioners. Pension funds may need to accrue a liability once this is passed.
- Page 28 item 114 Securitisation of property to meet rightful benefits (through unitisation to enable OTC trading).
- Page 39 item h, Empowering IPEC to accredit auditors and valuators of pension funds.
- Page 39 item i, enhance disclosures for auditors or valuators of pension funds.
- Page 39 item g, reduce timeframe of submission of financial statements from current 6 months to 3 months.
QUESTIONS?
SIYABONGA
TATENDA
THANK YOU
ASANTE SANA