ICAEW representation

ICAEW REP 50/06

RETIREMENT BENEFITS

Memorandum of comment submitted in July 2006 by the Institute of Chartered Accountants in England and Wales, in response to the Exposure Draft* Proposed Amendment to FRS 17 'Retirement Benefits' *and a draft Reporting Statement* 'Retirement Benefits - Disclosures', *published for comment by the Accounting Standards Board on 31 May 2006.

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INTRODUCTION

1. The Institute of Chartered Accountants in England and Wales ('the Institute') welcomes the opportunity to comment on the Exposure Draft *Proposed Amendment to FRS 17 'Retirement Benefits' and a draft Reporting Statement 'Retirement Benefits - Disclosures'*, published for comment by the Accounting Standards Board on 31 May 2006. We have reviewed the Exposure Draft and set out below our response to its proposals.

WHO WE ARE

2. The Institute is the largest accountancy body in Europe, with more than 127,000 members. Three thousand new members qualify each year. The prestigious qualifications offered by the Institute are recognised around the world and allow members to call themselves Chartered Accountants and to use the designatory letters ACA or FCA.

3. The Institute operates under a Royal Charter, working in the public interest. It is regulated by the Department of Trade and Industry through the Financial Reporting Council. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy.

MAJOR ISSUES

4. We support the Board's strategy of replacing the existing disclosure requirements of FRS 17 with those of International Accounting Standard (IAS) 19 *Employee benefits*, and at the same time promulgating an additional non-mandatory Reporting Statement of complementary disclosures. We applaud the Board's continuing to encourage good practice in pension disclosure, even though it no longer has any direct involvement in the financial statements of non-UK GAAP preparers.

5. Ideally, we would have liked the ASB to have taken this opportunity to improve on IAS 19. There are a number of aspects of FRS 17 that would represent such improvements (see paragraph 9 below). However, we accept that this would not have accorded with the ASB's strategy for convergence. The IASB has recently announced that it is to undertake a two-phase pensions project, phase one of which 'will consider revisions that would achieve significant improvements in the short term'. We believe that the ASB should draw to the IASB's attention for consideration as part of that project both the comments made in paragraph 9 below and the content of the Reporting Statement.

6. As we note in paragraph 4 above, the ASB no longer has direct involvement in the content of the financial statements of those UK entities that have adopted EU-endorsed IFRS. There is therefore a risk that they will not be aware of the Reporting Statement and its relevance to them. We believe it would be worth emphasising in the Reporting Statement (and accompanying press release

when it is finalised) that, as a non-mandatory formulation of best practice, it is equally applicable to companies reporting under IFRS or UK GAAP. If this is not done, notwithstanding the non-mandatory status of the proposed Reporting Standard we note that it has the potential to result in a greater degree of disclosure by unlisted UK entities than by large listed companies.

7. All entities, both listed and unlisted, will assess the extent to which they will make the disclosures recommended in the Reporting Statement in part on the basis of the materiality to them of their defined benefit arrangements. We are pleased to note the comment in paragraph (c) of the Summary to this effect. The other factor that will help determine the extent of their disclosure is cost-benefit considerations. For listed companies, one potential 'cost' might be failing to give disclosures that other similar companies have given. On the other hand, some listed companies might view the disclosure of information that is not being given by non-UK competitors as a 'cost', while still others might believe that voluntary disclosure will be viewed favourably by markets and therefore be a 'benefit'. We would welcome some discussion of these less tangible costs and benefits that might arise.

8. As noted in the Exposure Draft, there are a number of alternative measurement bases that can be applied to the liabilities of defined benefit schemes. FRS 17 requires measurement on an actuarial basis using the projected unit method and the draft Reporting Statement recommends additional disclosure of the liabilities on a buy-out basis. On balance, we do not support disclosure on a buy-out basis, for the reasons set out in paragraphs 12 - 14 below. However, we agree that additional disclosure would be helpful for users, and we support disclosure of the impact of changes in the various assumptions made in calculating the liability, as proposed in paragraph 12 of the draft Reporting Statement. Disclosure of the sensitivities in this way will provide users with a better understanding of the scale and impact of the liability.

Question 1 – Proposed amendment to FRS 17 'Retirement Benefits'

The proposals set out in the Exposure Draft propose to replace the existing disclosure requirements of FRS 17 with those of IAS 19 'Employee Benefits'. The ASB considers that, as part of its convergence programme of UK accounting standards with International Financial Reporting Standards (IFRS), it can replace the disclosure requirements set out in FRS 17 with those of IAS 19 and in doing so address some of the concerns expressed by commentators in relation to the disclosures of defined benefit schemes whilst achieving greater convergence with IFRS. Do you agree with the proposal to replace the existing disclosure requirements in FRS 17 with those of IAS 19? If not please identify your reasons for not supporting the proposal.

9. We agree with the proposal. However, we believe that there is a case for retaining as mandatory for UK GAAP preparers (as well as recommending for IFRS preparers) certain disclosures under FRS 17 that are not part of IAS 19:

(a) an analysis of the expected rate of return on assets by class of asset; and

(b) for closed schemes and those with a rising age profile, the fact that the current service cost will increase as members approach retirement.

10. We suggest that new paragraph 77(m)(ii) should be given a footnote to highlight that this requirement is for information as at the start of each period presented, as opposed to the other assumptions for which year end information is required. While this difference is noted in the Introduction, preparers will not be referring to that Introduction when pulling together their FRS 17 disclosures. (We note that there was a widespread lack of appreciation of this difference among those formulating this response.)

11. The expected rate of return on assets assumption has been omitted from the illustrative disclosures on page 31, although it is included in IAS 19's example. It should be included, with additional text (or a further footnote) to highlight the anomaly.

Question 2 – Scheme liabilities calculated on a buy-out basis

FRS 17 requires liabilities of defined benefit schemes to be measured on an actuarial basis using the projected unit method, there are however alternative measurement bases. One such alternative is the buy-out cost with an insurance entity. The ASB has considered alternative views on whether the financial statements of the reporting entity should include disclosure of scheme liabilities calculated on a buy-out basis, some of these views are set out above. The draft Reporting Statement includes the recommendation to disclose the scheme liabilities calculated on a buy-out basis. However, the ASB wishes to seek the views of constituents before finalising the Reporting Statement. Do you agree with the recommendation in the draft Reporting Statement to disclose the scheme liabilities as calculated on a buy-out basis? If not, please identify your reasons for not supporting the disclosure of the scheme liabilities calculated on a buy-out basis.

12. On balance, we do not agree that disclosure should be made of the scheme liabilities calculated on a buy-out basis. As set out in paragraph A31, such disclosure would be inconsistent in principle with the going concern basis, and there do not seem to be any grounds for singling out pension scheme liabilities in this way. For example, no such disclosure is required of the cost of potential early termination of lease obligations. We agree with the comment in A31 that the additional costs of obtaining the information (and auditing it) for non-UK schemes would outweigh any potential benefit.

13. We can see that a buy-out valuation could be regarded as a proxy for fair value, and thus to provide users with a 'better' measure of the economic obligation than an FRS 17 measure since it would reflect the cost of paying a third party to take over the entity's obligation. However, the buy-out value is unlikely to be a true fair value, particularly because of the illiquid buy-out market and the impact of transaction costs. We therefore question whether such disclosure would confer any particular benefit in practice. We believe that more relevant information would be provided by means of the sensitivity analysis recommended in paragraph 12 to the Reporting Statement (see paragraph 7 above) and the accrued benefit valuation referred to in Illustration 4. (We also wonder whether inclusion of a recommendation to disclose the

buy-out basis valuation might deter entities from making *any* of the disclosures recommended by the Statement, if they do not intend to make this one, whether for cost or other reasons.)

14. We do, however, believe that disclosure on a buy-out basis should be given where the Board has made a decision to wind up the scheme.

Question 3 – Pension Protection Fund (PPF) Levy

The Pensions Act 2004 established the Pension Protection Fund to pay compensation to members of eligible defined benefit schemes in the event of a qualifying insolvency event in relation to the employer. The compensation is, in part, funded by a levy on all UK defined benefit schemes. The ASB considers that the financial statements of the reporting entity should not be required to disclose the PPF levy. Do you agree that the PPF levy should not be disclosed in the financial statements of the reporting entity? If not, please explain why not.

15. We agree that the PPF levy should not generally need to be disclosed since it is just another administrative cost. However, the amount of the levy is determined by the company's credit rating and the PPF's need for cash and therefore might be volatile. If *any* disclosure were to be recommended, it might be of the existence of certain types of cost that are both material to the scheme and likely to be volatile; however, our preference is for there to be no such recommendation.

Question 4 – Regulatory Funding

The draft Reporting Statement aims to complement the disclosure requirements of draft FRS 17 by requiring additional disclosures. The additional disclosures include greater information about scheme funding. The ASB has not, however, recommended the disclosure of the level of compensation benefits that would be payable in the event of insolvency (section 179 of Pensions Act 2004). Do you agree that the financial statements should not require disclosure of this amount? If you would prefer disclosure please explain why?

16. We agree with the ASB that the liability is not a liability of the company and should not be disclosed. Furthermore, disclosure would be inconsistent with the going concern principle.

Question 5 – Effective Date

The ASB proposes the amendment to FRS 17 and the Reporting Statement be effective for accounting periods ending on or after 31 December 2006. This Exposure Draft proposes that corresponding amounts for the previous period are provided in accordance with FRS 28 'Corresponding Amounts'. Do you agree with the proposed effective date? Do you agree with the proposal to require corresponding amounts? If not, please explain your reasons why.

17. Given the likely publication date of the revised standard, we believe that the proposed effective date may pose difficulties, particularly for some medium-sized companies. While we welcome, for example, the new requirement (effectively) to disclose mortality rates, we do not believe that such disclosure

is of sufficient importance or urgency to warrant such haste in implementing the revision. We suggest that 31 March 2007 would be a more appropriate effective date (although, as usual, with early adoption encouraged). We agree with the proposal to require corresponding amounts in accordance with FRS 28.

18. The revised standard should clarify that FRSSE entities will not be required to provide the revised disclosures until such time as the FRSSE itself is revised. (The superseded disclosure requirements may need to be reproduced in the FRSSE to be finalised after the current FRSSE consultation period.) We propose an effective date for such entities of periods starting on or after either 1 January 2007 or 1 April 2007, whichever fits best with the next revision of the FRSSE.

Question 6 – Regulatory Impact

The ASB's view is that the proposals in this Exposure Draft will, in the main, lead to disclosure of information an entity already has available and as such additional costs incurred with the proposals set out in the Exposure Draft should be minimal. Do you agree? If not, can you identify and quantify costs resulting from the proposals? The ASB would also welcome views on whether the costs of providing the disclosures recommended in the Exposure Draft outweigh the benefits of disclosure.

19. The actuarial information required will generally be available, but it is not always routinely passed to the company, particularly in respect of overseas schemes. Actuarial work carried out between the triennial valuations will tend to add to the cost of compliance. If disclosure of the buy-out basis is recommended, we believe that disclosure in respect of overseas schemes might be at considerable cost to the company. The relevant factors are difficult to quantify, but we believe that (excluding cost in respect of the buy-out basis) the additional cost would not be substantial but would be more than 'minimal'. We fear also that such costs would be disproportionately burdensome for medium-sized companies.

OTHER MATTERS

20. Paragraph 3 of the draft FRS deletes paragraphs 76 to 93 of FRS 17 and paragraph 4 inserts new paragraphs 76 to 82. Paragraph 5 then deletes paragraphs 94 and 95, while paragraph 6 inserts 'new paragraphs 94 and 95'. The revised standard will need to state that paragraph numbers 83 to 93 are no longer used.

21. New paragraph 94 deals with the effective date of the new standard. We suggest that the corresponding amounts rules should not also be dealt with in this paragraph since they apply to all periods.

22. We note that in the illustrative disclosure of Employee Benefit Obligations, a deferred tax asset is deducted from the pension liability but not from the post-employment healthcare liability. This might be read as implying either that deferred tax cannot arise on the latter or that, if it does, it should be dealt with

in a different way. We suggest that it would be more consistent to deal with the healthcare liability in the same way by including a deferred tax asset, to cater for jurisdictions in which post-employment healthcare is deductible for tax on a cash basis. Alternatively, without changing the numbers a footnote might explain the position and why tax on the two is illustrated differently.

23. We do not believe it is necessary or desirable for the Reporting Statement to repeat definitions that are already established elsewhere. Preparers should simply cross-refer to the appropriate Framework. The only definition that appears to be necessary is for 'Duration of scheme liabilities'.

24. Illustration 4 defines the accumulated benefit obligation as including no assumption for future salary increases. However, we understand that the calculation may be performed either including or excluding statutory indexation in respect of the period between calculation date and assumed retirement date. We suggest that a footnote could indicate that the company should make clear in its disclosure which approach it has taken.

25. The draft Reporting Statement calls for disclosure of the relationship between the company and the trustees of defined benefit schemes. We support some disclosure in this area in principle, but fear that it will often take the form of unhelpful boilerplate. The Reporting Statement should extend the useful discussion in the draft to emphasise that the objective is to disclose any out-of-the-ordinary powers of or constraints on the trustees, or schemes for which the trustees' position differs significantly from that for a UK scheme.

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