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Our ref: ICAEW Rep 123/10

Your ref: Information Sheet 90

Michelle Sansom
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Dear Michelle

DRAFT UITF ABSTRACT: ACCOUNTING IMPLICATIONS OF THE REPLACEMENT OF THE RETAIL PRICES INDEX WITH THE CONSUMER PRICES INDEX FOR RETIREMENT BENEFITS

1. The ICAEW is pleased to respond to your request for comments on the Exposure Draft *Accounting Implications of the Replacement of the Retail Prices Index with the Consumer Prices Index for Retirement Benefits.*

2. The ICAEW operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, we provide leadership and practical support to over 134,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. We are a founding member of the Global Accounting Alliance with over 775,000 members worldwide.

Support for the draft abstract

3. We applaud the UITF's rapid response to this material issue and we agree that guidance is essential in this area. We support the principle underpinning the UITF's draft consensus that the effect of a change in benefits should be presented in profit or loss, while a change in assumptions should be taken to the Statement of Total Recognised Gains and Losses as an actuarial gain.

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4. We support the distinction that we believe the draft Abstract is attempting to draw; namely, that changes to assumptions can be distinguished because, prima-facie, they relate to underlying conditions that will change without any involvement of the entity, whereas changes to benefits require an action to be taken before they are effective.

5. For legal obligations the distinction is straightforward and unambiguous to apply as it can be readily determined from the scheme trust deed and rules whether such an obligation exists. We agree that formal consultation will be required before an RPI obligation “hard-wired” into the trust deed can be changed to a CPI obligation and that P&L recognition of the resultant gain should be precluded until a formal term change has received the necessary agreement

Constructive obligations

6. We welcome the inclusion of constructive obligations in the draft Abstract. A series of judgements will be necessary in determining whether such an obligation exists and, given the likely materiality of the numbers involved, it is essential that adequate consideration is given to these judgements. By highlighting the need for judgement in the draft Abstract the Task Force helps to ensure that this area receives the attention it deserves.

7. We also support the phrasing of the draft Abstract in terms of high-level principles; we would not support rules in this area due to the necessity for individual judgement. In considering the responses received to this consultation we urge the Board not to risk preventing these judgements properly being taken by increasing the level of prescription.

8. However, there is one area in which we disagree with the draft Abstract; we do not believe that agreement is generally necessary before a constructive obligation may be changed. Paragraph 6 of the draft Abstract implies that any obligation (including a constructive one) explicitly referencing RPI must require trustee / member agreement before it can be changed. A10 confirms this implication; ‘a feature of a constructive obligation would be that the agreement of scheme trustees and / or members would generally be needed before any change could be made’. We do not agree with this assessment, nor the implication that any change that can be made without agreement necessarily is a change of assumption. In order for there to be a constructive obligation, the members must have a valid expectation of a specifically RPI-linked pension, which now is being disappointed; and, to pick up the IAS 19 language in this regard, the entity will be badly damaging its relationship with its employees to change to CPI but nevertheless is able to do so. We believe that the final sentence of paragraph A10 should be removed. Formal agreement is unlikely to be required for a constructive obligation; by its very name such an obligation, if documented at all, will be recorded in documents that by themselves do not legally constitute scheme terms. Even if documents of this type do exist it is unlikely that they would require agreement before they could be changed. The same would be true also of any constructive obligation arising under FRS 12 ‘Provisions, Contingent Liabilities and Contingent Assets’.

9. This point is particularly relevant for public sector unfunded schemes, for which we understand that the government believes that it can change from RPI to CPI without any approval or further action being required. Under the Abstract as currently drafted, this would make the change a change in actuarial assumption. Nevertheless, since the “entity” has in this case been involved directly in making the change (see our paragraph 4 above) it might instead be viewed as a change in benefit. Since the final Abstract will be applicable also to any private sector entity participating in a public sector scheme, we believe that the UITF should address in the final document the analysis to be undertaken for such schemes.

10. We do agree that, for other schemes, members’ valid expectations must be changed, however. This will be a further area in which judgements will be necessary in order to determine when this has occurred.

Approval of benefit level change by members alone is unlikely to be permitted

11. Paragraph 6 of the draft Abstract uses the term 'the agreement of either the retirement benefit scheme trustees and/or members of the scheme'. We are surprised at the suggestion that the members alone are able to agree a change to the trust deed. Therefore the term 'and/or' could be misleading and may in any case be redundant; if the UITF wishes to retain it, we believe its application should be explained in the appendix.

Disclosure

12. Whether the effect of the change is classified inside or outside profit or loss, disclosure of the amount recognised is essential. Where the amount is material to the accounts we believe that the notes should show not only any amounts recognised as a result of the change but also narrative sufficient to give an understanding of how the item has arisen.

Extra consideration for IFRS reporters

13. Paragraph A6 acknowledges that UK IFRS preparers may find the draft Abstract useful as guidance in considering how to present the effects of the change. We welcome the inclusion of this explicit reference in the draft Abstract; judgement in this area will be just as necessary for those reporting under IFRS as under UK GAAP. However, we note that some guidance relevant to this topic does already exist under IFRS in the form of the IFRIC agenda decision (IAS 19-6) published in the November 2007 IFRIC Update. This agenda decision considered the effects of a change to plan terms resulting from government action and concluded that the accounting for changes caused by government should be the same as for changes made by an employer. (It noted also that, in some circumstances, it might be difficult to determine whether the change is a benefit change or revised actuarial assumption and that judgement is required.) We believe that this additional material is likely to be useful to IFRS preparers and therefore we would recommend the inclusion of a summary and reference to it as a footnote to the draft Abstract.

14. Although we feel strongly that the draft Abstract will be useful to IFRS preparers we do not believe that they can be *required* to apply it. Therefore we would suggest that the phrase 'should refer' in paragraph A6 be replaced with 'may refer'.

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

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