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UITF Information Sheet No 90

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Prepared Urgent Issues Task Force
for:
Prepared Association of Consulting Actuaries ;
by: The Actuarial Profession

Comments on draft Abstract "Accounting Implications of the replacement of the Retail Prices Index with the Consumer Prices Index for Retirement Benefits"

Introduction

Thank you for offering the Association of Consulting Actuaries (ACA) and the Actuarial Profession the opportunity to comment on the Draft Abstract.

About the ACA and the Actuarial Profession

This is a joint response from the Association of Consulting Actuaries (ACA) and the Actuarial Profession. The ACA is the representative body for consulting actuaries; the Actuarial Profession is governed by the Institute and Faculty of Actuaries, the chartered professional body for actuaries in the United Kingdom.

Summary

In June/July 2010, the UK Government announced that future statutory pension increases (both increases in payment and revaluation in deferment) would be based on the Consumer Prices Index compared with the historic approach of using the Retail Prices Index.

The Abstract aims to clarify the following issues arising from this announcement:

- In what circumstances the UK Government's proposals should be considered a benefit change (so recognised in P&L as a negative past service cost) and in what circumstances it should be considered as an assumption change (so recognised in the Statement of Total Recognised Gains and Losses).
- The timing of recognition of any change.

In our view, the draft Abstract achieves both these aims. However, in reaching a conclusion, the draft Abstract appears to use a different definition of constructive obligation from that contained in FRS 12 (and, indeed, from that in IAS 37). In our view, using the definition of constructive obligation contained in FRS 12 would lead to a different conclusion for many companies.

Definition of constructive obligation

The draft Abstract concludes that the change to pension scheme liabilities resulting from the Government's proposals is an assumption change if its adoption does not require the agreement of either the pension scheme trustees or members.

However, the requirement to obtain trustee or member agreement is not contained in the definition of constructive obligation in FRS 12:

"An obligation that derives from an entity's actions where:

(a) by an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; and

(b) as a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities."

Inclusion of this additional requirement to obtain consent from the other parties is likely to lead to a different conclusion in many cases compared with the FRS 12 definition which does not require such consent.

We understand the adding of this requirement to obtain consent may be intentional. If so, it would be helpful if the UITF would clarify why it has chosen to add this requirement which, in our view, for many companies is likely to alter the resulting accounting treatment of the Government's proposals. Such clarification would be helpful as it could affect the conclusion reached by companies and auditors for the correct treatment under other accounting standards (where, for example, the definition of a constructive obligation might be slightly different).

We do note that the draft Abstract says, "any change to these liabilities will **generally** require the agreement of either the retirement benefit scheme trustees and/or the members of the scheme" [our emphasis]. However, in our view, many users of the Abstract (including auditors) are likely to interpret this as a more definite requirement. Perhaps the UITF could provide guidance on identifying where a change to the liabilities does not require such agreement?

Examples of other benefits which form a constructive obligation

In our experience, various other benefits provided to pension scheme members have typically been treated as constructive obligations, and their introduction, amendment or removal recognised in P&L as benefit changes. Two examples are below, neither of which typically requires trustee or member consent.

- *Discretionary pension increases for pensions accrued in respect of pre-1997 service.* Such discretionary pension increases may have been removed altogether or changed to be, say, a fraction of RPI rather than 100% of RPI. This has not typically been treated as a change to the future inflation assumption but as a benefit change.
- *Early retirement on discretionary enhanced terms.* Where discretionary early retirement is no longer allowed, this is typically treated as a benefit change rather than a change to the assumed pattern of retirements.

Using the definition of a constructive obligation as used by the UITF in the draft Abstract, we would question whether companies should have been including an allowance in the scheme liabilities for the potential future exercise by the company of its discretion.

IFRIC Updates Autumn 2007

In September and November 2007, the IFRIC published updates which showed that they had considered whether the source of a change affected the accounting. More precisely, whether the accounting for a benefit change should be different if the change had been imposed by a government rather than an employer.

The IFRIC concluded in their meeting that the source of the change should not affect the accounting treatment.

Paragraph BC55 of IAS 19 also suggests that the IASB considers that the source of the change should not affect the accounting for that change.

We believe this is relevant here as we suspect there would be much less debate on this issue if, as illustrated in the previous section, companies rather than the Government had amended expectations around the terms on which revaluation was provided.

Timing of recognition

We agree with the conclusion that an appropriate date of recognition would be 8th July 2010 (for private sector pension schemes) or 22nd June 2010 (for public sector pension schemes) as this is the date at which the benefit obligation changed.

Where the change is deemed to be an assumption change, it seems reasonable that it is recognised at the next balance sheet date along with any other assumption changes.

Where the change is deemed to be a benefit change, it seems reasonable that it is recognised when the pension scheme rules are amended or the constructive obligation changed.

We feel it would be helpful if the UITF provided some guidance for companies which have already passed a balance sheet date since the Government's summer 2010 announcement. In many cases, these companies did not recognise the change at their balance sheet dates as they were awaiting guidance on recognition.

Disclosure of change

We note that the UITF does not specify a requirement to provide a narrative in the accounts explaining the change. In our view, such a narrative would be helpful to readers of accounts as it would enable them to reach their own view on the treatment. In particular, where the change to the inflation measure used is recognised as an assumption change, without a narrative explanation it would not be identifiable and would distort the total actuarial gain or loss on the scheme liabilities.

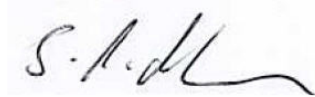
Negative past service costs under FRS 17

As a further point, we note that FRS 17 does not appear to allow for the concept of a negative past service cost – that is, the definition in paragraph 2 of FRS 17 only considers an "increase in the present value of scheme liabilities". This contrasts with IAS 19 and US GAAP which both explicitly consider the concept of a negative past service cost.

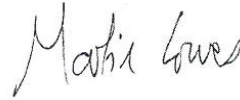
Similarly, paragraph 61 states that "Past service costs arise when the employer makes a commitment to provide a higher level of benefit than previously promised, ...". Again, this does not appear to allow for the option of a lower level of benefit than previously promised.

Given the subject matter considered by the draft Abstract, we wondered if the UITF would provide clarification that it is happy with the concept that negative past service costs can exist under FRS 17.

**Signed on behalf
of the Association
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