

COMMENTS ON EFRAG/PAINÉ PAPER ON 'THE FINANCIAL REPORTING OF PENSIONS'

GENERAL

The paper is well written and argued and raises a number of sensible points about current practice.

Some concerns are:-

1. The paper suggests a number of disclosures regarding expected future performance. It is questionable whether these are appropriate in financial statements which are reporting on past performance.
2. The paper seems to suggest that in some instances the accounting should follow conservative or prudent policies, which seems to run contrary to the underlying concept of neutrality of freedom from bias.

SPECIFIC QUESTIONS RAISED

Q1. Should a liability to pay benefits that is recognized be based on expectations of employees' pensionable salaries when they leave service, or on current salaries (including non-discretionary increases)?

It should be based on current salaries, since the expected future salaries can not be calculated with reasonable accuracy and depend on decisions made by an entity in future years.

Q2. Should financial reporting be based on the premise that a liability is owed to an individual employee or to the workforce as a whole? What consequences do you consider your view has for the recognition and measurement of pension obligations?

This seems not to be an issue and it is unclear how the calculations would be different.

Q3. Do you agree that recognition should be based on the principle of reflecting only present obligations as liabilities?

Yes. There is no clear principle in spreading costs.

Q4. Do you agree that the consolidation of pension plans should be subject to the same principles as are usually applied in determining whether consolidation is appropriate?

Yes, in principle. However there are problems such as when pension funds are larger than their sponsoring employer (such as ICI or Invensys) where consolidation might be considered as misleading. Also it might be considered as a problem to consolidate funds where the funds are separate legal entities and the trustees have a legal obligation to act independently of their sponsoring entities, which may well result in differences of opinion.

Q5. Do you agree that changes in assets and liabilities related to pension plans should be recognized immediately, rather than deferred and recognised over a number of accounting periods or left unrecognized provided they are within certain limits (a corridor approach)?

In principle immediate recognition must be correct. However the effect of changes in market valuations and discount rates produces results which are misleading given the long-term nature of pension funds and has forced some funds into short-term and possibly unsatisfactory solutions. There still is room for further thinking on this subject.

Q6. Do you agree with the paper's views in the measurement of liabilities to pay benefits? In particular, do you agree that:

1. *Regulatory measures should not replace measures derived from general accounting principles?*
2. *The discount rate should reflect the time value of money only, and therefore be a risk-free rate?*
3. *Information about the riskiness of a liability (ie the risk that the amount of pension benefits will differ from today's expectations) is best conveyed by disclosure rather than by adjusting the amount of the reported liability?*
4. *The liability should not be reduced to reflect its credit risk?*
5. *Expenses of administering the plan's accrued benefits should be reflected in the liability?*

1. Agree, but where possible efforts should be made to minimize differences between the two.
2. No. In principle the discount rate should match the expected return from assets. Long-term liabilities are discounted because an entity has the use of the asset/money over the period and the accounting should reflect this.
3. Agree.
4. This section is very hard to follow, in particular the meaning of credit risk. It appears that the use of a risk-free rate has the effect of increasing liabilities whereas the extent of risk is already taken care of in the calculation of liabilities and the valuation of assets. Question whether the concept of neutrality is being applied here.
5. Disagree. It would be contrary to accounting principles to accrue for expenses for which there is no present obligation and which can hardly be calculated with reasonable accuracy. Such expenses should be considered in actuarial valuations.

Q7. Where employees have options to receive benefits in different ways, should the liability reported at the highest amount or at an amount that reflects the probability of different outcomes?

At the probable amount, as otherwise accounting would not be in accordance with concept of neutrality.

Q8. Do you agree that assets held to provide benefits should be reported at current values.

Agree, in the absence of any better method which would better reflect underlying values and future returns.

Q9. Do you agree that a 'net' asset or liability should be based on the difference between the amounts at which the assets and liabilities would be measured if they were measured directly?

Agree.

Q10. Do you agree that different components of changes in liabilities and/or assets should be presented separately?

Agree.

Q11. Do you agree that the financial performance of an entity should reflect the actual return on assets, rather the expected return, and that the expected return should be disclosed?

Yes, definitely agree that actual return should be included and do not understand reasoning behind previous practice. See no good reason for disclosure of expected return which seems contrary to the purpose of financial statements, however interesting it may be.

Q12. Do you agree with the objectives of disclosure that are identified in this Chapter? Are there specific disclosure requirements that should be added to or deleted from those proposed?

Concerned at the proposed levels of disclosure which will tend to dominate the financial statements and about the quantity of forward-looking information which is in contrast to the remainder of the statements. In particular the information on projected cash flows, investment strategy (is this not clear from a description of investment categories?), expected returns on assets (for how many years?), assessment of how liabilities will be met (if only this was known) seems excessive? Use of the word 'rewards' in the phrase 'risks and rewards' also seems meaningless in the context of pensions.

Q13. Do you agree that multi-employer plans should be reflected in an employer's financial statements using the same principles at those that apply to a single employer plan? How, in your view, should an accounting standard require that this be implemented in practice?

Agreed. Any standard should require application of a proportionate basis with appropriate examples.

Q14. Do you agree that a pension plan's general purpose financial statements should include its liabilities to pay benefits in the future? Do you agree that the plan's liabilities for future benefits should be quantified using the same principles as an employer's liability?

Agreed. The present situation is untenable given the pension fund's primary responsibility to meet liabilities.

Q15. Do you agree that a pension plan's statement of financial position should reflect an asset in respect of amounts potentially receivable under an employer's covenant, and that this should reflect the employer's credit risk?

Disagree. The 'employer's covenant' is a term used to describe the informal relationship between employer and pension fund. Unless there is a formal agreement for the employer to make good specific or general deficits it would be inappropriate to recognize a receivable.

Q16 and Q17. No matters to raise.

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