3 Robert Street
London
WC2N 6RL

Telephone: 020 7543 5600
Facsimile: 020 7543 5700
www.cipfa.org.uk

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Accounting Standards Board
Aldwych House
61-91, Aldwych
London WC2B 4HN

14 July 2008

By email to: asbcommentletters@frc-asb.org.uk

Dear Sir or Madam

**Discussion Paper: The Financial Reporting of Pensions**

CIPFA is pleased to present its comments on this Discussion Paper, on which the ASB has led development working in partnership with other EFRAG members as part of the Pro-Active Accounting Activities in Europe initiative.

As part of governance processes over public statements on technical and other matters, CIPFA responses are reviewed by panels of experts with relevant experience and knowledge. This response has been developed through consultation with CIPFA's Accounting and Auditing Standards Panel and CIPFA's Pensions Panel.

We were also very pleased to attend the ASB Round Table on these issues on 21 May 2008, which provided a helpful opportunity for UK stakeholders to discuss the proposals and to influence future developments.

In our view the two key issues in the paper are

- the definition and measurement of liabilities of uncertain amount; and

- the discount rate used to reflect the significant delay between the 'earning' of pension benefits and the stream of payments.

The paper provides very helpful discussion of these and other issues, while maintaining a clear and helpful separation between financing reporting of liabilities and related discussions on asset reporting and regulatory regimes for pensions. Answers to the questions raised by the invitation to comment are attached.

We hope that this will assist the development of this important discussion.

Yours faithfully

Chris Wobschall
Assistant Director Policy and Technical
CIPFA
3 Robert Street, London WC2N 6RL
Tel +44 (0)20 7543 5647
chris.wobschall@cipfa.org

**DISCUSSION PAPER: FINANCIAL REPORTING OF PENSIONS**
**RESPONSES TO QUESTIONS IN THE SUMMARY AND INVITATION TO COMMENT**

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

This question addresses one of the central issues of liability accounting, that is, when a specific measured portion of expected payment should, for the purposes of balance sheet recognition and measurement, be considered sufficiently committed or unavoidable in the light of past actions, or sufficiently 'earned' by the future recipient.

The question is more complicated in the pensions arena, because there is

- considerable delay between the provision of consideration (both in the form of contributions and work done as part of employment), and the subsequent return to the employee in the form of pension payments; and

- significant uncertainty about the value and incidence of the payments that will be made

We can see a case for the proposal made in the Discussion Paper, which suggests that although future increases in salary affect the amount of pensionable salaries when they leave service, those increases are *discretionary* and *avoidable*, and might be seen as being earned at the point in time at which they are formally confirmed or otherwise become unavoidable. We also agree that, prima facie, such an approach would be consistent with both the ASB Statement of Principles and the IASB Conceptual Framework.

However, especially at a time when the conceptual basis of financial reporting is being reconsidered, we also suggest that it would be sensible to exercise caution before moving away from the current treatment, which some would argue was also conceptually consistent and provides useful information to readers of financial statements. Supporters of the current approach might argue that, in order for a business to continue to operate as a going concern, it will have to observe the norms of the business sector within which it operates, which include expectations about career and salary progression. In this sense, expected increases in salary might be considered not to be avoidable.

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| 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? |

From a legal and operational perspective, it is clear that certain transactions and obligations are effected between the employer and individual employees, while certain negotiations, legal positions and other matters can more meaningfully related to the workforce as a whole.

We are inclined to see the underlying obligations as resting between the employer and individuals, but with a degree of interdependence between individual arrangements and the aggregate of arrangements. We are not sure this has much bearing on the determination of financial reporting liability.

More importantly, we would be sceptical of lines of reasoning which used a focus on the individual or aggregate workforce to significantly affect the question of whether a liability should be measured or recognised. In our view the main effect of considering the aggregate is to reduce the level of modelling and other uncertainty, but this should have no effect on the recognition or measurement of point estimates which are used to populate a liability balance.

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

Yes. But as noted in our answer to Question 1, there is still a question as to how the liability should be measured.

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| 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? |

We can see no compelling argument for excluding pension plans from group consolidations when they would otherwise be taken as part of the consolidated position.

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

We agree that changes in assets and liabilities relating to pension plans should be recognised immediately.

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

- Regulatory measures should not replace measures derived from general accounting principles?
- The discount rate should reflect the time value of money only, and therefore should be a risk-free rate?
- Information about the riskiness of a liability (i.e. 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?
- The liability should not be reduced to reflect its credit risk?
- Expenses of administering the plan’s accrued benefits should be reflected in the liability?

We agree generally with the paper’s views on the measurement of liabilities to pay benefits. In particular:

- Regulatory measures should not replace measures derived from general accounting principles (although if regulatory arrangements give rise to an asset or liability, this should be measured).
- The discount rate should reflect the time value of money but not risk. We note that there was support for a risk-free rate based on swaps at the ASB Round Table, and we consider that this should be explored. Whatever rate is used should be chosen in a standardised way which is not easily susceptible to manipulation. If a swap based rate is used it would be helpful if this reflected an economic rationale, rather than market preference for a lower liability figure.
- Information about the riskiness of a liability is best conveyed by disclosure rather than by adjusting the amount of the reported liability.
- Expenses of administering the plan’s accrued benefits should be reflected in the liability, where considered material to the liability.

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

In line with our answer to Question 6, the liability should be reported at an amount which reflects the probable aggregate outcome, and the potential variation should be a matter for disclosure rather than an adjustment to the valuation.

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| Q8 | Do you agree that assets held to pay benefits should be reported at current values? |

Yes

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| 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? |

Yes

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

The Discussion Paper proposes that changes should be disaggregated and separately presented as follows:

- Service cost—within operating activities
- Finance cost of pensions—within financing
- Effect of change in the discount rate—within financing
- Actual return on assets—within financing
- Actuarial gains and losses—in the profit and loss account, within other financial performance.

We agree that this separation usefully distinguishes between flows which have different drivers.

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

We agree with the proposals that

(a) financial statements should contain adequate disclosure of the cost of providing pension benefits and any related gains, losses, assets and liabilities;

(b) users of financial statements should be able to obtain a clear view of the risks and rewards arising from liabilities to pay pension benefits and the assets held to fund those benefits; and

(c) the funding obligations of the entity, in relation to liabilities to pay pension benefits, should be clearly identified.

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

We agree that it is right to consider whether multi-employer plans should be reported on using the same principles as those that apply to a single employer plan.

Accounting standards need to reflect cost benefit considerations, and we presume that these are what is being explored by this question. Using settlement value can be difficult or costly where systems are not designed to produce this information, and the discussion paper sets out the main alternative approaches to calculating a liability figure: we agree with the comments on the relative usefulness and cost of obtaining the information.

From a UK government perspective, it could be argued that risk is substantially shared, particularly in the central government sector, and this reduces the benefit from or need to accurately disaggregate employer pension liability. However, without more information on the cost-benefit arguments for private companies, the voluntary sector and other national jurisdictions, it is not clear whether this would justify a variant accounting treatment for public sector multi-employer schemes if the default was to use settlement value.

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| Q14 | Do you agree that a pension plan's general purpose financial report 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? |

We agree that a pension plan's general purpose financial report should include its liabilities to pay benefits in the future, in line with the reporting on defined benefit plans set out at paragraph 28 (a) of IAS 26 *Retirement Pension Plans.* We agree that this is to be preferred as a standardised disclosure, in preference to the current optional presentation in the notes (per IAS 26 paragraph 28 (b)) or in a separate actuarial report (per IAS 26 paragraph 28 (c)).

We also agree that the plan's liabilities for future benefits should be quantified using the same principles as an employer's liability (which is not compelled under IAS 26, where there is an option to use current salaries or expected salaries).

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| 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? |

We can see the logic of this proposal, but have no particular view as our main area of consideration is public sector pension schemes, where the nature of employer guarantees operates rather differently.

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| Q16 | Are there types of pension arrangements that require further consideration? Please identify the specific features of these arrangements and suggest how the principles of this paper would require development to secure appropriate financial reporting for them. |

We have not identified any such arrangements at this stage.

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| Q17 | Are there further specific issues relating to the cost and benefit of the proposals that should be taken account of in their further development? |

We have not identified any such issues at this stage.