The Pensions Management Institute

Achieving pensions excellence

VPL/SMW/EX07R/08

Accounting Standards Board
Aldwych House
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London
WC2B 4HN

28 July 2008

Dear Sirs

ASB Discussion Paper – The Financial Reporting of Pensions

I am pleased to attach our response to the above discussion paper.

If you have any queries about the content of the document please do not hesitate to contact me.

Yours faithfully

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Chief Executive

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ASB Discussion Paper:

The Financial Reporting of Pensions

Response from
The Pensions Management Institute

PMI response to ASB Discussion Paper: The Financial Reporting of Pensions

Introduction

The Pensions Management Institute (PMI) is the professional body for people working in the pensions sector. The PMI's members (currently over 4,200) work as pensions managers, consultants and technical specialists in consultancies and insurance companies. Many are also actuaries, pensions lawyers or company secretaries. Their experience is therefore wide ranging and has contributed to the thinking expressed in this response.

The PMI's Response

GENERAL

1. We welcome the ASB's initiative in undertaking a major review of the way in which pension costs are accounted for and reported. We note also that this review has been undertaken in an International context. Our members' interests and concerns are UK based, and our response is therefore in a UK context. We do however consider this is relevant because if the review's proposals are adopted, it could have major implications for UK accounting and reporting including reporting by pension schemes themselves.

2. Our response concentrates on Chapter 11 of the Discussion Paper as this is the area which most directly affects our members (see 5-9 below), but we also make some general comments first and give our response to the specific questions raised in the discussion paper in 10.

3. We note that the ASB believes "that a fundamental review is needed." We support this view, but are disappointed that in certain respects the thinking is not as fundamental as we would have wished. This is noticeable in three particular areas:

   - there has been no consideration as to whether information, particularly to pension scheme members, can be better provided by a format other than by general purpose financial statements;

   - there is a presumption that all liabilities including long term liabilities such as pension deficits are capable of being calculated with sufficient objectivity and accuracy to allow a single number to give meaningful information about these. In this respect we draw your attention to the paper published by the CASS Business School "An Unreal Number: How Company Pension Accounting Fosters an Illusion of Certainty";

- there is no consideration given to the responsibility which all standard setters (similar to legislators) should have to how they may influence behaviour. The influence which FRS 17 has had in influencing, as opposed to determining, the behaviour of Boards of companies should not be ignored.

4. There has already been much comment about the impact of using a risk free discount rate to calculate pension liabilities. We share these concerns particularly as most commentators believe that in current markets this would give a liability higher than the buy-out liability. This appears to give accounting theory precedence over common sense and ignores consequential behaviours.

CHAPTER 11

5. This Chapter asks two fundamental questions which are whether future pension liabilities should be included in pension scheme accounts and if so whether the employer's covenant should be reflected as an asset. It also makes certain proposals for pension scheme accounts to make further disclosures. We comment on each of these in turn.

6. The Paper concludes that pension scheme accounts should reflect the liability for future pensions. This, however, seems to be based on the premise that general purpose financial statements should be prepared and that general purpose financial statements are the most appropriate way of conveying information to members of pension schemes. In the UK members are given information about their scheme through a variety of means and not just by the accounts. The accounts are principally a stewardship document concerned with assets, liabilities (other than future pension liabilities) and financial transactions. The information regarding future pension liabilities is given in actuarial statements and more recently in the Summary Funding Statement (SSF). The present SORP encourages the inclusion of the SSF or relevant extracts in the annual report. Members are therefore already given the necessary relevant information. We believe the inclusion of yet another figure for the pension liability would serve no useful purpose and be even more confusing to members. We conclude that the present requirements meet the needs of scheme members and see no good reason for changing the net asset statement to a balance sheet.

7. The Discussion Paper contends that increases in costs would not be significant, but does not provide any evidence or conclusions of any research that cost increases would be insignificant. We are concerned that cost increases could be significant as these would include actuarial costs, audit costs and management time. We are even more concerned as these costs would be incurred, in our view, for no useful purpose.

8. This brings us to the question of whether the employer's covenant should be recognised as an asset. As a theoretical exercise and on the assumption that a liability is recognised, we agree that a corresponding asset should be recognised and that this asset should reflect the employer's credit risk. We stress "as a theoretical exercise" because we foresee many practical difficulties. Firstly, it will be an invidious task for Trustees to assess the credit risk and then to quantify the extent of any write downs. Trustees would have to use confidential information in making any such assessments and in the case of public companies such information may well be price sensitive. The assessment itself would be time consuming and the audit would incur still further costs. This reinforces our belief that the present requirements should not be changed.

9. The final point we wish to comment on is the suggestion for still further disclosures in the annual scheme accounts. These have already become far too complicated for members and we would have found it encouraging if what purports to be a fundamental review had considered ways of simplifying the accounts rather than making these even more complicated.

PMI Response to Specific Questions Raised in the Discussion Paper

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)?

PMI believes that current salaries plus any increases required by law including non-discretionary increases should be used.

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?

It should be based on the workforce as a whole.

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

We agree.

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 agree.

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 prefer the corridor approach due to the inherent uncertainties that exist.

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?*

  We do not agree. The cost of pensions is determined on an actuarial basis rather than an accounting basis. Regulatory measures could override general accounting principles.

- *The discount rate should reflect the time value of money only, and therefore should be a risk-free rate?*

  We disagree. A risk free return could lead to surpluses which would be misleading.

- *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?*

  We believe disclosure is the best method.

- *The liability should not be reduced to reflect its credit risk?*

  We agree.

- *Expenses of administering the plan's accrued benefits should be reflected in the liability?*

  Liabilities including future expenses should be set at a value set by the scheme actuary.

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?*

We believe that outcomes should be based on scheme experience.

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

We agree. This practice is widely accepted.

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?

The Company accounts should show the net position which reflects the corresponding position in the scheme accounts.

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

We disagree as this could lead to confusion.

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?

We agree.

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 believe that disclosures should be consistent with those made by the trustees as we can see no reason why they should be differ.

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. This could be implemented by equal and opposing entries.

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?

See our comments in paragraph 6.

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 disagree. The scheme's Recovery Plan should give sufficient information. See also our comments under paragraph 8.

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.

The DWP's consultation paper on Risk Sharing identifies different types of pension arrangements.

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 would encourage the ASB to take the opportunity to simplify scheme accounts which are intended for scheme members to understand.

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