Response No.14

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Dear Sirs

The financial reporting of pensions - a PAAinE Discussion Paper

Thank you for the opportunity to comment on the Pro-active Accounting in Europe Discussion Paper "The Financial Reporting of Pensions" ("the Discussion Paper")

We are responding to the views expressed in chapter 11 of the Discussion Paper which addresses Financial Reporting by Pension Plans.

Inclusion of liability to pay future pensions

The conceptual framework proposed by the Financial Accounting Standards Board ("FASB") indicates that general purpose financial reports should include information on solvency. For a pension scheme, in simple terms, this is the difference between the assets held and the actuarial valuation of the liabilities to pay pensions in the future. As the liability to pay pensions in the future is not currently included in the financial reports of pension plans, this is a change to current practice in the UK. We do not support this change as:

- The form of general purpose financial reports for not-for-profit entities do not need to be the same as other entities;
- The needs of the users of pension plan financial reports are different from other entities; and
- The inclusion of the liabilities to pay pensions in the future will give rise to unintended conflicts for trustees.

Not-for-profit entities

The FASB conceptual framework project is still to address not-for-profit entities. However, the Accounting Standards Board "(the ASB") has participated in a group monitoring the applicability of the conceptual framework project to not-for-profit entities in both the private and public sectors.

Following this participation, the ASB highlighted three issues on the objective of financial reporting by not-for-profit entities if the conceptual framework was to be applied:

- an insufficient emphasis on accountability/stewardship;
- a need to broaden the identified users and establish an alternative primary user group; and
- the inappropriateness of the pervasive cash flow focus.

The implication is that financial reports of pension plans could be on a different basis from commercial entities.

The Discussion Paper does not recognise that this phase of the conceptual framework project is incomplete and makes the broad statement that, to show a fair presentation of the financial position of the plan, the liability to pay benefits in the future must be included. However, this statement is being made on the basis that a pension plan needs to be reported in the same way as any other entity. There must be a fuller consideration of not-for-profit entities and this should focus on the needs of users and the other sources of information that are available to those users.

Users and other sources of information

The Discussion Paper does consider the users of the financial reports of pension schemes. We agree with the analysis and the conclusions, but there is no evidence put forward to suggest that any of the users identified would make better or different decisions if the liability to pay benefits in the future were to be included in the financial report.

The available evidence is the contrary view that the liability to pay pensions in the future should be excluded. This is based on consultations undertaken by the Pensions Research Accountants Group and the Pensions Regulator which both resulted in this conclusion.

Our view is, therefore, that the Financial Reports of Pension Plans should continue to be based on the principle of stewardship as the primary user group is different from that of other entities and relevant information on the liability is made available in other ways.

The members of pension schemes are not "equity investors, lenders, and other creditors" as identified in the conceptual framework. Their needs are different and there are other mechanisms by which these are satisfied.

Since 21 September 2006, members of defined benefit schemes have been sent Summary Funding Statements. These provide clear information on the solvency of the scheme.

In a defined benefit arrangement, the information provided on the Summary Funding Statement is based on Scheme Specific Funding basis and on a buy-out basis. The buy-out basis represents the "worst possible scenario". The scheme specific basis represents a reasoned assessment by the trustees of the liability and this has then been used to establish the contributions to the scheme from the employer. The agreement of the contribution rate does involve the employer and the trustees are obliged to assess the strength of the employer.

It must be recognised that, although it is not a strict accounting measure, the schedule of contributions agreed is a real cashflow formally agreed by the employer and the trustees and certified by the scheme actuary. The agreement for any deficit contributions (the recovery plan) is also subject to monitoring by the Pensions Regulator. The details of the recovery plan are included in the Summary Funding Statement. We consider this to be a suitable mechanism for providing relevant information to the primary user of pension plans.

From 6 April 2003 members of money purchase schemes have been provided with Statutory Money Purchase Illustrations. Members of defined contribution schemes will receive an annual statutory money purchase illustration. This indicates the pension that an individual will receive in the future based upon the current value of contributions and investment growth to date and a future projection. In a defined contribution scheme, the value of the assets accumulated to date determines the value of a pension and, therefore, by definition the asset will always meet the liability. We can see no benefit in the proposition that the existing practice is changed.

Trustee conflicts

If the liability to pay pensions in the future is recognised, then a debt from the employer must also be recognised. We agree with the proposal in the Discussion Paper that the debt from the employer should recognise credit risk.

In agreeing the funding principles for the scheme, the trustees have already made an assessment of the credit risk of the employer. This is a complex process that involves considerable input from the trustees and their advisers. In many cases the trustees are granted access to confidential information that may also be price sensitive. The Discussion Paper also proposes that included in the disclosures is a discussion about the strength of the employer covenant.

The basis of the recognition of the debt and the suggested discussion of the strength of the employer covenant could give contradictory information to the members to that given by the employer. The trustees are also in danger of placing confidential information into the public domain.

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

Yours sincerely

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