Exposure Draft

Financial Reporting Council

August 2014

FRED 55

Draft Amendments to FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*

Pension obligations

The FRC is responsible for promoting high quality corporate governance and reporting to foster investment. We set the UK Corporate Governance and Stewardship Codes as well as UK standards for accounting, auditing and actuarial work. We represent UK interests in international standard-setting. We also monitor and take action to promote the quality of corporate reporting and auditing. We operate independent disciplinary arrangements for accountants and actuaries; and oversee the regulatory activities of the accountancy and actuarial professional bodies.

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Contents

Introduction

(i) In 2012, 2013 and 2014 the Financial Reporting Council (FRC) revised financial reporting standards in the United Kingdom and Republic of Ireland. The revisions fundamentally reformed financial reporting, replacing the extant standards with four Financial Reporting Standards:

(a) FRS 100 *Application of Financial Reporting Requirements*;

(b) FRS 101 *Reduced Disclosure Framework*;

(c) FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*; and

(d) FRS 103 *Insurance Contracts*.

This Exposure Draft proposes limited amendments to FRS 102 in respect of pension obligations.

(ii) The FRC's overriding objective in setting accounting standards is to enable users of accounts to receive high-quality understandable financial reporting proportionate to the size and complexity of the entity and users' information needs.

(iii) In meeting this objective, the FRC aims to provide succinct financial reporting standards that:

(a) have consistency with international accounting standards through the application of an IFRS-based solution unless an alternative clearly better meets the overriding objective;

(b) reflect up-to-date thinking and developments in the way entities operate and the transactions they undertake;

(c) balance consistent principles for accounting by all UK and Republic of Ireland entities with practical solutions, based on size, complexity, public interest and users' information needs;

(d) promote efficiency within groups; and

(e) are cost-effective to apply.

Draft amendments to FRS 102 – pension obligations

(iv) After the publication of FRS 102 in March 2013 the FRC issued, in October 2013, a Press Notice[1] addressing the accounting in accordance with EU-adopted IFRS for a 'schedule of contributions' payable by an entity to a defined benefit pension plan. Subsequently the FRC received enquiries about the accounting for similar circumstances by entities applying FRS 102.

(v) The issue concerns whether or not an entity applying FRS 102 should have regard to the principles of IFRIC 14 *IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* where it might be relevant to their circumstances. There appeared to be a diversity of views on the matter, and because the potential implications for an entity's financial statements could be significant the FRC decided to address the matter outside the intended three-yearly review cycle for FRS 102.

(vi) The draft amendments set out in this Financial Reporting Exposure Draft (FRED) propose to clarify that, for entities already recognising assets or liabilities for defined benefit plans

[1] FRC PN 089 *Findings of the FRC in respect of the accounts of WH Smith Plc for the year ended 31 August 2012.*

in accordance with FRS 102, no additional liabilities need be recognised in respect of a 'schedule of contributions', even if such an agreement would otherwise be considered onerous.

(vii) The draft amendments set out in this FRED also clarify that the effect of restricting the recognition of a surplus in a defined benefit plan, where the surplus is not recoverable, shall be recognised in other comprehensive income, rather than profit or loss.

Invitation to comment

1. The FRC is requesting comments on FRED 55 by 21 November 2014. The FRC is committed to developing standards based on evidence from consultation with users, preparers and others. Comments are invited in writing on all aspects of the draft standard. In particular, comments are sought in relation to the questions below.

> **Question 1**
>
> Do you agree that FRS 102 should be amended to clarify that an entity is not required to recognise any additional liabilities to reflect an agreement with a defined benefit plan to fund a deficit, where the entity has already measured and recognised its defined benefit obligation/asset in accordance with paragraphs 28.15 and 28.18 (and additionally for assets, paragraph 28.22) of FRS 102, even though this may differ from the accounting required by entities applying EU-adopted IFRS? If not, why not?
>
> **Question 2**
>
> Do you agree with the proposed new paragraph 28.15A of FRS 102 and the other proposed amendments to FRS 102? If not, why not?

2. Information on how to submit comments and the FRC's policy in relation to responses is set out on page 12.

[Draft] Amendments to FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*

Pension obligations

[Draft] Amendments to Section 28 *Employee Benefits*

1 The following paragraphs set out the [draft] amendments to Section 28 *Employee Benefits* (deleted text is struck through, inserted text is underlined).

2 Paragraph 28.15A is inserted as follows:

28.15A Where an entity has measured its defined benefit obligation using the **projected unit credit method** (including the use of appropriate **actuarial assumptions**), as set out in paragraph 28.18, it shall not recognise any additional liabilities to reflect differences between these assumptions and those used for the most recent actuarial valuation of the plan for funding purposes. For the avoidance of doubt, no additional liabilities shall be recognised in respect of an agreement with the defined benefit plan to fund a deficit (such as a schedule of contributions).

3 In paragraph 28.16 'actuarial assumptions' will no longer be shown in bold type.

4 In paragraph 28.18 'projected unit credit method' will no longer be shown in bold type.

5 Paragraph 28.25 is amended as follows:

28.25 Remeasurement of the net defined benefit liability comprises:

(a) **actuarial gains and losses**;~~ and~~

(b) the return on plan assets, excluding amounts included in net interest on the net defined benefit liability~~.~~; and

(c) any change in the amount of a defined benefit plan surplus that is not recoverable (see paragraph 28.22), excluding amounts included in net interest on the net defined benefit liability.

The Accounting Council's Advice to the FRC to issue FRED 55: Draft Amendments to FRS 102 – Pension obligations

Introduction

1 This report provides an overview of the main issues that have been considered by the Accounting Council in advising the Financial Reporting Council (FRC) to issue FRED 55 *Draft Amendments to FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland – Pension obligations*.

2 The FRC, in accordance with the *Statutory Auditors (Amendment of Companies Act 2006 and Delegation of Functions etc) Order 2012* (SI 2012/1741), is a prescribed body for issuing accounting standards in the UK. The Foreword to Accounting Standards sets out the application of accounting standards in the Republic of Ireland.

3 In accordance with the *FRC Codes and Standards: procedures*, any proposal to issue, amend or withdraw a code or standard is put to the FRC Board with the full advice of the relevant Councils and/or the Codes & Standards Committee. Ordinarily, the FRC Board will only reject the advice put to it where:

(a) it is apparent that a significant group of stakeholders has not been adequately consulted;

(b) the necessary assessment of the impact of the proposal has not been completed, including an analysis of costs and benefits;

(c) insufficient consideration has been given to the timing or cost of implementation; or

(d) the cumulative impact of a number of proposals would make the adoption of an otherwise satisfactory proposal inappropriate.

4 The FRC has established the Accounting Council as the relevant Council to assist it in the setting of accounting standards.

Advice

5 The Accounting Council is advising the FRC to issue FRED 55 *Draft Amendments to FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland – Pension obligations.*

6 The amendments set out in FRED 55 will resolve an issue of uncertainty over the requirements of FRS 102 in relation to a commitment to make payments under a 'schedule of contributions' to a defined benefit pension plan which the entity accounts for on a defined benefit basis, and therefore reduce potential diversity in practice and the cost of compliance with FRS 102.

7 The Accounting Council's Advice to the FRC to issue FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* was set out in that standard. When these amendments are finalised, the Accounting Council's Advice to the FRC on these amendments will be included in the revised FRS 102.

Background

8 After the publication of FRS 102 in March 2013 the FRC issued, in October 2013, a Press Notice[2] addressing the accounting in accordance with EU-adopted IFRS for a 'schedule of contributions' payable by an entity to a defined benefit pension plan. Subsequently the

[2] FRC PN 089 *Findings of the FRC in respect of the accounts of WH Smith Plc for the year ended 31 August 2012.*

FRC received enquiries about the accounting for similar circumstances by entities applying FRS 102.

9 The issue concerns whether or not an entity applying FRS 102 should have regard to the principles of IFRIC 14 *IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* where it might be relevant to their circumstances. There appeared to be a diversity of views on the matter, and because the potential implications for an entity's financial statements could be significant the FRC decided to address the matter outside the intended three-yearly review cycle for FRS 102.

Objective

10 In developing its advice to the FRC, the Accounting Council was guided by the following overriding objective:

> To enable users of accounts to receive high-quality understandable financial reporting proportionate to the size and complexity of the entity and users' information needs.

11 In meeting this objective, the FRC aims to provide succinct financial reporting standards that:

(a) have consistency with international accounting standards through the application of an IFRS-based solution unless an alternative clearly better meets the overriding objective;

(b) reflect up-to-date thinking and developments in the way entities operate and the transactions they undertake;

(c) balance consistent principles for accounting by all UK and Republic of Ireland entities with practical solutions, based on size, complexity, public interest and users' information needs;

(d) promote efficiency within groups; and

(e) are cost-effective to apply.

Proportionate measurement of the net defined benefit liability for a defined benefit plan

12 The Accounting Council considered whether FRS 102 required an entity with a defined benefit plan to consider the principles of IFRIC 14 in interpreting its requirements to measure the net defined benefit liability. The Accounting Council noted that there appeared to be uncertainty over this issue and that there was the possibility of significant diversity arising in accounting practice, particularly because the amounts that might be recognised (or not) could be very significant.

13 The Accounting Council considers that for entities applying FRS 102, the recognition of the net defined benefit liability or asset (which may be limited by paragraph 28.22) for a defined benefit pension plan as the net total of the present value of the obligations under the plan and the fair value of the plan assets is a proportionate way to measure the present obligation to employees as a result of service rendered. It noted that in some circumstances IFRIC 14 would result in an additional liability being recognised in relation to a schedule of contributions that had been agreed with the defined benefit plan in order to address a deficit that had arisen on the basis of the funding assumptions. It further noted that the measurement of the present value of the obligations under the plan for funding purposes differs from the measurement for accounting purposes, but they are different measurements of the same obligation, not separate obligations.

14 Therefore the Accounting Council advises that, as a practical and proportionate solution, in measuring its defined benefit obligation an entity need not include the present value of

contributions payable that arise from an agreement with the defined benefit plan to fund a deficit. The Accounting Council also advises that Section 28 *Employee Benefits* explicitly states that, in applying FRS 102, no additional liabilities shall be recognised in respect of an agreement with the defined benefit plan to fund a deficit (such as a schedule of contributions). This should ensure there are no divergent interpretations of the scope of Section 21 *Provisions and Contingencies* in relation to a schedule of contributions, because they are clearly within the scope of Section 28, and therefore outside the scope of Section 21.

15 The Accounting Council considered another potential solution to determining whether or not an additional obligation should be recognised in certain circumstances. It noted the interaction with the recognition of a defined benefit plan asset, and considered whether removing the restriction on recognising a defined benefit plan asset in some circumstances might be an alternative solution. However, the Accounting Council rejected this because it could have the unintended consequence of permitting an asset to be recognised where other factors would indicate the reporting entity was not able to recover the surplus.

16 These proposed amendments to FRS 102 do not affect the accounting for a schedule of contributions or other funding agreement between a reporting entity and a multi-employer plan, which is set out in paragraph 28.11A of FRS 102. Where an entity participates in a defined benefit plan that is a multi-employer plan accounted for as if it were a defined contribution plan, it shall recognise a liability for the contributions payable that arise from the agreement (to the extent that they relate to a deficit) because this is the most cost-effective way of recognising the entity's obligation to employees as a result of service rendered. This contrasts with the approach for defined benefit plans because the obligation has already been recognised as the net defined benefit liability.

Effect of a restriction on the recoverability of a plan surplus

17 The Accounting Council also noted that FRS 102 does not specify where an entity shall recognise the effects of a restriction on the recoverability of a plan surplus, and therefore FRS 102 would require it to be recognised in profit or loss. A plan surplus may be irrecoverable because the entity is not able to recover the surplus through reduced contributions in the future or through refunds from the plan (see paragraph 28.22 of FRS 102). The Accounting Council considers that, except for any amount included in net interest on the net defined benefit liability, the effect of any such restriction should be recognised in other comprehensive income and advises that paragraph 28.25 is amended so that any such amounts are part of remeasurements, and therefore recognised in other comprehensive income. This is consistent with IAS 19 *Employee Benefits*.

Effective date

18 The Accounting Council advises that the amendments set out in this FRED should be effective from the effective date of FRS 102 (ie accounting periods beginning on or after 1 January 2015), and therefore no amendment to the effective date of FRS 102 is required.

19 The Accounting Council notes that the final amendments may be issued during 2015 which will be after the effective date of FRS 102, but this will still be prior to the preparation of financial statements for accounting periods beginning on or after 1 January 2015.

Consultation Stage Impact Assessment

Introduction

1 The Financial Reporting Council (FRC) is committed to a proportionate approach to the use of its powers, making effective use of impact assessments and having regard to the impact of regulation on small enterprises.

2 The draft amendments to FRS 102 are intended to reduce the potential cost of compliance with FRS 102, by reducing diversity in practice and eliminating the need for entities with defined benefit plans to consider whether payments that will be made under a 'schedule of contributions' will be recoverable from the plan. This can be a time-consuming and judgemental issue. The draft amendments will continue to ensure that a net defined benefit liability is recognised, where relevant, for an entity's obligation to employees as a result of service rendered.

3 The FRC believes that the amendments to FRS 102 will have a positive impact on financial reporting.

This draft is issued by the Financial Reporting Council for comment. It should be noted that the draft may be modified in the light of comments received before being issued in final form.

For ease of handling, we prefer comments to be sent by e-mail to:

ukfrs@frc.org.uk

Comments may also be sent in hard copy to:

Jenny Carter
Financial Reporting Council
8th Floor
125 London Wall
London
EC2Y 5AS

Comments should be despatched so as to be received no later than 21 November 2014.

The FRC's policy is to publish on its website all responses to formal consultations issued by the FRC unless the respondent explicitly requests otherwise. A standard confidentiality statement in an e-mail message will not be regarded as a request for non-disclosure. The FRC does not edit personal information (such as telephone numbers or postal or e-mail addresses) from submissions; therefore, only information that you wish to be published should be submitted.

The FRC aims to publish responses within 10 working days of receipt.

The FRC will publish a summary of the consultation responses, either as part of, or alongside, its final decision.

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