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Our ref blp/815

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10 November 2010

Dear Ms Sansom

**UITF Draft Abstract: Accounting implications of the replacement of the Retail Prices Index with the Consumer Prices Index for Retirement Benefits**

We are grateful for the opportunity to comment on the above draft Abstract. We concur with the view expressed in Information Sheet 90 that an Abstract can provide useful guidance about the accounting for this change and reduce the diversity that might otherwise result although, as we explain below, we do not believe that there will be complete consistency of treatment.

We agree that the key issue is to determine whether a different *benefit* is now being given as a result of the change from RPI to CPI (i.e., the benefit is an RPI-linked pension) or whether a different *assumption* is being made about an unchanged benefit (i.e., the benefit is an inflation-linked pension). The gain resulting from changing a benefit will be recognised as (negative) past service cost in profit or loss; the gain resulting from changing the inflation assumption to be applied in measuring the obligation for an unchanged benefit will be an actuarial gain, to be recognised in the statement of total recognised gains and losses.

We agree also that an entity may have an obligation to pay an RPI-linked pension as a result either of a legal or of a constructive obligation.

However, we do not agree with the statement made in A10, and elsewhere, that “a feature of a constructive obligation would be that the agreement of scheme trustees and/or members would generally be needed before any change could be made”. Our understanding of a constructive obligation, whether arising within the context of FRS 17 or of FRS 12 (e.g., a constructive obligation to undertake a reorganisation), is that while the entity will have raised the counterparty’s expectations that it will fulfill its constructive obligation, it nevertheless can choose unilaterally not to do so and to suffer any adverse consequences this might bring. We therefore believe that an entity may have an obligation to pay an RPI-linked benefit not only when it could change that benefit only with the agreement of the trustees and/or members (paragraph 6) but also more widely when a public statement or past practice has raised

members' valid expectations of such a benefit, even if the entity could change the nature of that benefit unilaterally.

#### *Legal obligations*

We agree that when the trust deed makes specific reference to the pension increasing with RPI, the entity will have a legal obligation to pay an RPI-linked benefit and a change to CPI will therefore be a benefit change. In order to effect this change, the entity would have to follow the legally-required consultation procedures and we agree that the gain should be recognised when those procedures have been concluded.

#### *Constructive obligations*

We believe that it will be a matter for judgement by the directors whether an entity has a constructive obligation to pay an RPI-linked benefit, based on a review of communications with members and past practice. The nature and content of entity and scheme communications with members are likely to vary considerably between schemes; directors also may differ in their judgement as to whether a particular communication has led members to expect that the benefit they are receiving or will receive is a pension linked specifically to RPI. We therefore expect that there will be diversity in practice in this area but do not believe that the UITF should introduce detailed rules about what types of communication might or might not give rise to a constructive obligation.

With regard to the past practice of having given RPI increases for many years, in our view arguments could be made both for and against this giving rise to a constructive obligation. Some directors may believe that, as a result, members specifically expect RPI increases, whatever rate the government might set as the statutory minimum; others may believe that the constructive obligation is instead to pay whatever the government adopts as its inflation measure, absent any specific communication from the entity. We think that many may take the latter view and the UITF, if it supports this view, could assist in reducing diversity in practice by discussing this issue in the final Abstract or its appendix.

While we do not agree that agreement is required to change a constructive obligation, we do believe that members' expectations must be changed in order for the benefit to be changed. Again, it will be matter for judgement by the directors when this has occurred: some might believe that the government's announcement itself will have changed expectations; others might believe that a statement by the entity or the scheme to members would be required. Many may take the latter view. However, if the entity intended to pay only CPI increases from April 2011 but did not communicate with its members before its next financial year end following the government's announcement, it would seem that first paying the reduced level of increases might instead be the trigger to change expectations. It would be helpful in reducing diversity in practice of the recognition date if the UITF were to discuss this in the final Abstract or its appendix.

### *No obligation*

We agree that if the entity has neither a legal nor a constructive obligation to pay an RPI-linked pension, then it instead has an obligation to pay an inflation-linked pension, with an unspecified measure of inflation. We agree also that market expectations about the relevant inflation-linking to be assumed will have been changed by the government's announcement and that the resultant actuarial gain should be recognised in the financial period in which the announcement was made.

### *Public sector schemes*

The above comments are made primarily with private sector schemes in mind. Management's assessment as to whether the entity has an obligation to pay an RPI-linked or an inflation-linked benefit may well be different for a public sector scheme, since the government has a more direct role in setting the benefits. Many private sector entities participate in public sector schemes and the UITF could reduce diversity in practice by such entities if it provided guidance in the final Abstract as to the factors for management to consider in making this assessment.

We note that it is only in the footnote to paragraph 9 that public sector schemes are referred to. Participants in such schemes could mistakenly conclude that the Abstract is relevant only to participation in private sector schemes. It would be helpful if its scope were clarified by including a specific reference to public sector schemes, and the relevant announcement date for them, in the introductory paragraphs to the Abstract.

### *EU-adopted IFRSs*

In the context of entities preparing their accounts under EU-adopted IFRSs, we note that the (then-named) International Financial Reporting Interpretations Committee considered in 2007 the question of how a change made by government should be accounted for. It did not take the matter onto its agenda but noted in its rejection text that the accounting for changes caused by government should be the same as for changes made by an employer. It "acknowledged that, in some circumstances, it might be difficult to determine whether the change affects either actuarial assumptions or benefits payable and noted that judgement is required." We believe that paragraph A6 should draw attention to this agenda decision, since it would seem directly relevant to the assessment to be made by an entity preparing its accounts under EU-IFRSs. While we accept that the UITF cannot interpret IFRSs, discussion of this issue in a UK GAAP context in the appendix to the final Abstract might help directors in the sometimes difficult judgement as to the appropriate classification in their entity's case.

### *Disclosure*

In view of the likely diversity in practice in how the gain resulting from this change will be recognised, it would be helpful if the final Abstract encouraged disclosure of the amount of the gain and its treatment. While a past service credit recognised in profit or loss may be

sufficiently material to be covered by FRS 3's requirements for the disclosure of exceptional items, there is no requirement to disclose an exceptional element of actuarial gains and losses recognised in the statement of total recognised gains and losses.

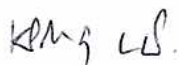
*Drafting comments*

Generally, we believe that much of the material currently included in the appendix should be included instead in the body of the Abstract, in order fully to explain the issue and the rationale for the UITF's consensus views. We also believe that the Consensus section of the Abstract could be redrafted more clearly to set out that (i) where there is an RPI-linked obligation, a change to CPI is a benefit change, recognised as negative past service cost in the profit and loss account; (ii) a change to a legal obligation is recognised [state when]; (iii) a change to a constructive obligation is recognised [state when]; (iv) where there is a more general inflation-linked obligation, a change to CPI is a change of actuarial assumption, recognised as an actuarial gain in the statement of total recognised gains and losses; and (v) a change to an actuarial assumption is recognised [state when].

The draft Abstract states in paragraph 6 (and elsewhere) that changing a benefit will generally require the agreement of "either the ... trustees and/or the members of the scheme". We comment above regarding constructive obligations. Regarding legal obligations we are surprised at the "and/or", which does not reflect our understanding of the position.

In paragraph A6 we believe that the phrase "should refer to" should instead be "may refer to", since the UITF has no authority to require a particular approach to be taken by those preparing their accounts under EU-IFRSs.

Yours faithfully



KPMG LLP