

10 November 2010

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Sent electronically

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Dear Michelle

— **UITF Information Sheet 90: Accounting Implications of the Replacement of the Retail Price Index with the Consumer Price Index for Retirement Benefits.**

The Audit Commission welcomes the opportunity to comment on the draft UITF abstract: Accounting Implications of the Replacement of the Retail Price Index with the Consumer Price Index for Retirement Benefits.

The Audit Commission is an independent watchdog, driving economy, efficiency and effectiveness in local public services in England to deliver better outcomes for everyone. We appoint auditors to over 700 major public bodies that are moving to prepare accounts under IFRS. Our work across local government, health, housing, community safety and fire and rescue services means that we have a unique perspective. We promote value for money for taxpayers, auditing the £200 billion spent by 11,000 local public bodies. As a force for improvement, we work in partnership to assess local public services and make practical recommendations for promoting a better quality of life for local people.

The Commission's Response

It should be noted that many of the public sector bodies audited by auditors appointed by the Audit Commission prepare their accounts under International Financial Reporting Standards. However, as IAS 19, Employee Benefits, is substantially the same as FRS 17, the principles covered by the abstract will apply equally to the bodies we audit. The abstract would, therefore, be persuasive in any consideration of the appropriate accounting treatment under IAS 19.

We believe that the analysis of the accounting in situations where there is and is not a legal or constructive obligation is correct. The key issue on which accounts preparers requires guidance is whether a constructive obligation exists or not. We believe that there are four scenarios that should be explicitly addressed in the abstract:

1. a linkage to RPI in the trust deed;
2. a linkage to an unspecified measure of inflation in the trust deed;

3. a statutory linkage to the increase determined annually for the public sector. This is relevant to increases in the Guaranteed Minimum Pension for contracted out schemes and to certain bodies reporting under UK GAAP, such as further education colleges, with members of, for example, the statutory Local Government Pension Scheme;
4. a linkage in the Trust deed to an the increase determined annually for the public sector schemes (e.g. the Universities Superannuation Scheme).

Scenario 1: Hardwired RPI in the Trust deed

We concur with the analysis in the UITF as to the accounting treatment to be adopted in this instance.

Scenario 2: Unspecified inflation indexation in the Trust deed

We are concerned with the interpretation of constructive obligation contained in the last sentence of paragraph A10.

Paragraph 2 of FRS 12, defines a constructive obligation as:

An obligation that arises from an entity's actions where:

- (a) by an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; and*
- (b) as a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities.*

Paragraphs 20 and 28 of FRS 17 similarly refer to the creation of a valid expectation on the part of a recipient of the pension. A constructive obligation is by its nature unilateral and in our view the reference to agreement by scheme members is therefore not relevant.

The definition of a constructive obligation is not directly applicable as it relates to the actions or statements of the reporting entity and the Trustees of the pension scheme are not the reporting entity. However, by analogy we believe that the actions and statements of the Trustees should be treated as if they were the actions and statements of the reporting entity and this is implied by the wording of paragraphs 20 and 28 of FRS 17. Applying this principle we believe that a consistent pattern by the Trustees of linking increases to RPI and communicating to scheme members that they were doing so would in our view give rise to a constructive obligation. In such circumstances, the reduction in liability should in our view therefore be accounted for as a negative past service cost in accordance with paragraphs 60 and 61 of FRS 17.

Scenario 3: Public service pension schemes

This scenario is not addressed in the UITF. However, we believe that, applying the same analysis as for scenario 2, the actions and statements of government should be treated as if they were the actions and statements of the reporting entity.

In our view there was a constructive obligation:

- The consistent pattern of determination of the annual increase; and
- Government earlier this year communicated publically that RPI was the basis of indexation (http://www.hm-treasury.gov.uk/d/Pensionsinc10_note.pdf).

In our view it is therefore appropriate to account for the change in liability as a negative past service cost in accordance with paragraphs 60 and 61 of FRS 17.

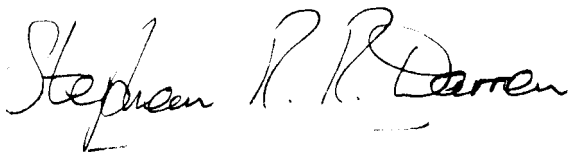
Scenario 4: Linkage to public service pension schemes

This scenario is not addressed in the UITF. However, we believe that, applying the same analysis as for scenarios 2 and 3, the actions and statements of government should be treated as if they were the actions and statements of the reporting entity. For the reasons given in scenario 3 above we believe that the conditions for a constructive obligation are satisfied and the change in liability should be accounted for as a negative past service cost in accordance with paragraphs 60 and 61 of FRS 17.

Conclusion

To maximise the value to preparers of financial statements, we believe that the UITF should focus on the application of the concept of 'constructive obligation' to different scenarios relating to both occupational and public service pension schemes.

Yours sincerely



Stephen Warren
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