



UITF Abstract 48
Accounting implications of the replacement of the
retail prices index with the consumer prices index for
retirement benefits

(Issued 17 December 2010)

The Issue

On 8 July 2010¹, the Minister for Pensions announced the Government's intention to move to using the Consumer Prices Index (CPI) rather than the Retail Prices Index (RPI) as the inflation measure for determining the minimum pension increases to be applied to the statutory index-linked features of retirement benefits. The Government announced the next such annual inflation measure in December 2010. In general annual CPI increases have been lower than annual RPI increases and therefore the change has the potential to reduce pension Scheme liabilities. 1

The UITF has been requested to provide guidance on the accounting treatment of this change. The UITF agreed the Abstract should address three matters: 2

- (i) whether there is a reduction in Scheme liabilities;
- (ii) how the effect of a reduction in Scheme liabilities should be presented; and
- (iii) when the effect of a reduction in Scheme liabilities should be recognised.

Scope

This Abstract applies to retirement benefits within the scope of FRS 17 'Retirement Benefits'. 3

Consensus

Whether there is a reduction in Scheme liabilities

The Government's announcement to replace RPI with CPI for the statutory minimum increase in pensions in defined benefit schemes has the potential to reduce Scheme liabilities. Whether there is a reduction in Scheme liabilities depends on facts and circumstances. 4

¹ For public sector schemes the announcement was made on 22 June 2010 as part of the Emergency Budget.

UITF CONSENSUS PRONOUNCEMENTS

How the effect of a reduction in Scheme liabilities should be presented

- 5 In accordance with FRS 17 a change in the Scheme liabilities arising from a change in benefit is part of non-periodic pension costs and is recognised in the profit and loss account. In contrast a change in the Scheme liabilities arising from a change in an assumption is part of actuarial gains and losses and is recognised in the statement of total recognised gains and losses.
- 6 The UITF reached a consensus that the presentation of a reduction in Scheme liabilities is dependent on whether the obligation is to pay benefits with increases based on RPI, or more generally with inflation-linked increases. Paragraph 20 of FRS 17 states that Scheme liabilities comprise benefits promised under the formal terms of the scheme and any constructive obligation for further benefits where a public statement or past practice by the employer has created a valid expectation in the employees that such benefits will be granted. An employer's public statement or past practice gives rise to a constructive obligation where the entity has created a valid expectation that it will pay certain employee benefits.
- 7 Where the obligation is to pay benefit increases based on RPI the UITF reached a consensus that the change in Scheme liabilities is a change in benefit and gives rise to a past service cost in accordance with FRS 17. An entity may need to apply judgement in determining if it has an obligation to pay benefits based on RPI in accordance with the provisions of paragraph 20 of FRS 17.
- 8 The UITF reached a consensus that if there is no obligation to pay benefit increases based on RPI then a change to CPI is a change in the financial assumption about inflation used to measure the Scheme liabilities and represents an actuarial gain or loss in accordance with FRS 17.

When the effects of a reduction in Scheme liabilities should be recognised

- 9 The UITF reached a consensus that where the obligation is to pay benefit increases based on RPI the past service cost should be recognised in the accounting period when any necessary consultations have been concluded or employees' valid expectations have been changed. An entity may need to apply judgement in determining when employees' expectations have been changed.
- 10 The UITF reached a consensus that if there is no obligation to pay benefit increases based on RPI an entity should use financial assumptions to measure Scheme liabilities that reflect market expectations at the balance sheet date, in accordance

ABSTRACT 48

with paragraph 23 of FRS 17. A ministerial announcement, as, for example, that made in July 2010², will form a reasonable basis for a change in market expectations regarding inflation to be assumed in calculating pension obligations under FRS 17.

Disclosure

The UITF reached a consensus that an entity should provide disclosures that explain the effect of changes in the Scheme liabilities arising from the replacement of RPI with CPI, consistent with objective of FRS 17 of ensuring that the financial statements contain adequate disclosure of the cost of providing retirement benefits and the related gains, losses, assets and liabilities. 11

Date from which effective

The accounting treatment required by this consensus should be adopted with immediate effect. 12

Reference Literature

FRS 17 'Retirement Benefits'

² For public sector schemes the announcement was made on 22 June 2010 as part of the Emergency Budget.

Appendix: Development of the Abstract: Accounting implications of the replacement of the retail prices index with the consumer prices index for retirement benefits

The Development of the Abstract accompanies, but is not part of Abstract 48.

Introduction

- A1 This Appendix sets out the UITF's considerations in developing the Abstract: 'Accounting implications of the replacement of the Retail Prices Index with the Consumer Prices Index for Retirement Benefits'.
- A2 The UITF received a request to provide guidance on the implications of the Government's announced intention to replace the Retail Prices Index (RPI) with the Consumer Prices Index (CPI) for the minimum increase in pensions in defined benefit schemes. The minimum increase in pensions in defined benefit schemes is set annually by the Government in a Statutory Instrument. The Government has announced that the calculation of that number (previously based on RPI) would in future be based on CPI. In general annual CPI increases have been lower than annual RPI increases. The change therefore has the potential to reduce pension Scheme liabilities.

Is an Abstract needed?

- A3 The UITF reached agreement that an Abstract could provide useful guidance to preparers and auditors and bring consistency in application for users. The UITF noted that whilst there is an urgent need for guidance it must adhere to UITF due process. Adherence to due process would have the effect that definitive guidance could not be published until near the end of 2010. As part of its due process the UITF issued a draft Abstract for comment, as an Information Sheet, placing the UITF's provisional thinking into the public domain in October 2010.

Scope

- A4 In developing the Abstract the UITF considered its scope. It noted that the issue related to the application of FRS 17 'Retirement Benefits'. It was, however, noted that entities preparing financial statements in accordance with international accounting standards may also need guidance.
- A5 The UITF considered whether to refer the issue to the IFRS Interpretations Committee (IFRS IC) but decided the issue is specific to the UK and consequently is unlikely to meet the IFRS IC agenda criteria. In addition the IFRS IC may be unable to respond to the urgent need for guidance in the UK. The UITF is, however, mindful not to interpret international accounting standards.

ABSTRACT 48

The UITF noted that entities applying paragraphs 10 to 12 of International Accounting Standard 8 'Accounting Policies, Changes in Accounting Estimates and Errors' may refer to the Abstract as a source of guidance in developing an accounting policy. A6

Some respondents to the draft Abstract noted that in 2007 the IFRS IC (then known as the International Financial Reporting Interpretations Committee (IFRIC)) considered the question of how a change made by a Government should be accounted for. The IFRS IC did not take the matter on to its agenda but noted that the accounting for changes caused by Government should be the same as for changes made by an employer. It further noted 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. The UITF noted that this agenda decision is also a source of guidance for entities applying international accounting standards in developing an accounting policy. A7

During consideration of comments received to its draft Abstract the UITF noted that some respondents requested clarification as to whether the Abstract applies to both public and private sector retirement benefit schemes. The UITF noted that FRS 17 does not make a distinction between these schemes but agreed to clarify that the Abstract applies to all retirement benefits within the scope of FRS 17. A8

Whether there is a change in Scheme liabilities

The Government announcement to replace RPI with CPI for the minimum increase in pensions in defined benefit schemes has the potential to reduce Scheme liabilities. Whether there is a reduction in Scheme liabilities depends on facts and circumstances. A9

How the effect of a reduction in Scheme liabilities should be presented

In relation to the presentation of the reduction in Scheme liabilities the UITF noted a distinction between changes in benefits when the benefits are based on RPI compared to changes in benefits linked more generally to inflation. The UITF noted that where the benefit is based on RPI (i.e. there is a specific link to RPI) a change in the benefit entitlement may require amendment to the formal terms of the scheme or a change in the expectations of members, for example by some form of communication. In contrast, where there is an unspecified measure of inflation the CPI measure can be applied without further action. A10

The UITF noted that the distinction between changes in benefits arising when an obligation is based on RPI, compared to changes in benefits linked more generally to inflation, should be considered in terms of whether the obligation to the member is being changed. A11

- A12 The UITF reached a consensus that where there is a change in the obligation to the member, there is a benefit change. Where the obligation to the member is not changed, any change in the Scheme liabilities arises from a change in assumptions applied in measuring the liability arising from the unchanged benefit. The key to the accounting is whether there is a change in the obligation to the members.
- A13 The UITF noted that paragraph 20 of FRS 17 provides that Scheme liabilities comprise both any benefits promised under the formal terms of the scheme and any constructive obligation for further benefits where a public statement or past practice by the employer has created a valid expectation in the employees that such benefit will be granted. The UITF noted that an entity may need to apply judgement in determining if it has an obligation to pay benefits based on RPI. An obligation may exist where RPI is not embedded into the formal terms of the scheme but where associated literature makes reference to RPI or where the general understanding of scheme members is that increases would be calculated using RPI. The nature of any obligation to members may vary and will depend on a number of factors, including the nature and content of the employer's communications with members.
- A14 In its draft Abstract the UITF noted that the replacement of RPI with CPI as the inflation measure for determining minimum pension increases could give rise to a reduction in Scheme liabilities. Respondents to the draft Abstract noted that FRS 17 discusses a past service cost only in relation to an increase in Scheme liabilities; that is FRS 17 does not specifically address the circumstance of a negative past service cost. The UITF accepted this point but could see no reason why a negative past service cost should be treated differently from the provision set out in FRS 17 for a past service cost.

When the effect of a reduction in Scheme liabilities should be recognised

- A15 The UITF noted that the nature of the change determines the period in which the effect of the reduction in Scheme liabilities is recognised.
- A16 Where there is a change in benefit this is a past service cost and should be presented in the period in which the change occurs. It was agreed that changes in benefits could not be anticipated and could only be recognised when the benefit obligation was altered.
- A17 Where a trust deed specifies that the obligation to pay benefits is linked to RPI the obligation cannot be reduced or amended to be linked to CPI without the agreement of members. Such a change gives rise to a past service cost in accordance with FRS 17 and the effect of the reduction in Scheme liabilities is recognised in the period agreement is reached.
- A18 Where the entity has a constructive obligation to pay benefits linked to RPI this also gives rise to a past service cost in accordance with FRS 17. The effect of the reduction in Scheme liabilities is recognised in the period the obligation is altered, that is when employee's valid expectations have been changed.

ABSTRACT 48

Where there is a change in a financial assumption, in accordance with paragraph 23 of A19 FRS 17, the assumptions should reflect market expectations at the balance sheet date. Accordingly the change should be reported in the period in which the Government announcement was made.

Disclosures

In its draft Abstract the UITF did not discuss the need to make specific disclosures, A20 however, some respondents to the draft Abstract noted that in view of the level of judgement required it is important for entities to make clear disclosures about the accounting treatment they have adopted and how they have applied the changes in the financial statements. The UITF agreed and noted that one of the objectives of FRS 17 is that financial statements contain adequate disclosure of the cost of providing retirement benefits and the related gains, losses, assets and liabilities. The UITF decided to specify in the Abstract that an entity should disclose the effect of changes in Scheme liabilities of the change arising from replacing the RPI with CPI.