



ACCOUNTING  
STANDARDS  
BOARD



# URGENT ISSUES TASK FORCE

## INFORMATION SHEET No 90

13 October 2010

This Information Sheet sets out a proposed UITF Abstract 'Accounting implications of the replacement of the Retail Prices Index with the Consumer Prices Index for Retirement Benefits'.

On 8 July 2010, 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 to use in determining the minimum pension increases to be applied to the statutory index-linked features of retirement benefits. The government is expected to announce the next such annual inflation measure in November 2010. The UITF received a request to provide guidance on the accounting implications of the government decision.

The UITF is issuing this draft as it considers an Abstract can provide useful guidance to preparers and auditors and bring consistency in application for users.

The draft Abstract proposes that where there is a change in the obligation to the member, there is a benefit change which is accounted for as a past service cost. Where the obligation to the member is not changed, any change in the Scheme liabilities arises from a change in assumptions applied to measure those liabilities. The key to the accounting is whether there is a change in the members' obligation.

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

The UITF invites comments on any aspect of the proposed Abstract. For ease of handling, we prefer comments to be sent by email to:

[asbcommentletters@frc-asb.org.uk](mailto:asbcommentletters@frc-asb.org.uk)

Comments may also be sent to Michelle Sansom, UITF Technical Director.

Comments should reach us by **10 November 2010**. All replies will be regarded as on the public record unless the writer asks for confidentiality.

## **UITF DRAFT ABSTRACT:**

### **ACCOUNTING IMPLICATIONS OF THE REPLACEMENT OF THE RETAIL PRICES INDEX WITH THE CONSUMER PRICES INDEX FOR RETIREMENT BENEFITS**

#### **The Issue**

1. On 8 July 2010, 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 is expected to announce the next such annual inflation measure in November 2010.
2. The UITF has been requested to provide guidance on the accounting treatment of this change. The issue is whether this change gives rise to a different benefit (a change in benefit) or whether a different assumption is being applied to an unchanged benefit (a change in assumption).
3. In accordance with FRS 17 'Retirement Benefits' a change in the Scheme liabilities arising from a change in benefit is part of non-periodic pension costs and 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 recognised in the statement of total recognised gains and losses.

#### **Scope**

4. This [draft] Abstract applies to all financial statements that are intended to give a true and fair view of a reporting employer's financial position and profit or loss (income and expenditure) for a period.

#### **Consensus**

5. The UITF reached a [draft] consensus that recognition of the change is dependent on whether the obligation is to pay pensions with increases based on at least the 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.
6. Where the Scheme liabilities are linked to at least RPI any change to these liabilities will generally require the agreement of either the retirement benefit scheme trustees and/or the members of the scheme. In these circumstances the UITF reached a [draft] consensus that the change is a change in benefit and gives rise to a past service cost in accordance with FRS 17.

7. The UITF reached a [draft] consensus that if Scheme liabilities are not linked to at least RPI then a change to CPI is a change in the assumption about inflation used to measure the liabilities and represents an actuarial gain or loss in accordance with FRS 17.
8. The UITF reached a [draft] consensus that where Scheme liabilities are linked to at least RPI the past service cost should be recognised in the accounting period when necessary consultations have been concluded. Consultations are concluded when the change has been agreed and announced (i.e. so that the members' expectations have been modified).
9. The UITF reached a [draft] consensus that where Scheme liabilities are not linked to at least RPI an entity should use assumptions that reflect market expectations at the balance sheet date, in accordance with paragraph 23 of FRS 17. The ministerial announcements in July 2010,<sup>\*</sup> will form a reasonable basis for a change in market expectations regarding inflation to be assumed in calculating pension obligations under FRS 17.

#### **Date from which effective**

10. The accounting treatment required by this [draft] consensus should be adopted with immediate effect.

#### **Reference Literature**

FRS 17 Retirement Benefits

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\* for public sector schemes the announcement has 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

#### *Introduction*

- A1. This Appendix sets out the UITF considerations in developing the draft 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 which sets out a number. 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 has 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. Early publication of an Information Sheet covering a draft Abstract would, however, place the UITF's provisional thinking into the public domain.

#### *Scope*

- A4. In considering the scope of the draft Abstract the UITF 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 it does not 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.

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

*Is there a change in benefit or change in assumptions?*

- A7. In relation to the issue of where the changes in liabilities should be recognised the UITF considered whether the change should be treated as a change in benefits (a past service cost) or as change in assumptions.
- A8. The UITF noted a distinction between changes in benefits arising when a trust deed is specifically linked to RPI compared to changes in benefits based on an unspecified measure of inflation. The UITF members noted that where there is a specific link to RPI, trustees generally must agree changes to the retirement benefit scheme before benefits can be reduced. In contrast, where there is an unspecified measure of inflation the CPI measure can be applied without further action.
- A9. The UITF noted that the distinction between changes in benefits arising when a trust deed is specifically linked to RPI, compared to changes in benefits with an unspecified measure of inflation, should be considered in terms of whether the obligation to the member is being changed.
- A10. The UITF noted that a constructive obligation to the member for pensions linked to RPI could exist where the RPI is not embedded into the trust deed but where associated literature made reference to the RPI or where the general understanding of scheme members was that increases would be calculated using the RPI. The nature of any constructive obligation to members could vary and would depend on a number of factors, including the nature and content of the communications with members. Consideration would need to be given to whether any associated literature made reference to the RPI or whether the general understanding of scheme members was that increases would be calculated using the RPI. However, 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.
- A11. The UITF reached a consensus agreement 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 to those liabilities. The key to the accounting is whether there is a change in the obligation to the members.

*In which period should the change be recognised?*

- A12. In relation to the issue of the period in which the change should be recognised the UITF considers that the period in which the change should be recognised follows whether there is a benefit change or a change in assumptions. Where there is a change in a benefit this is a past service cost and should be presented in the period in which the change occurs. Where there is a change in assumptions; in accordance with

paragraph 23 of FRS 17 assumptions should reflect market expectations at the balance sheet date and accordingly the change should be reported in the period in which the government announcement was made.

- A13. It was agreed that changes in benefits could not be anticipated and could only be recognised when trustees and/or members agreed to the change. There could be no recognition of the effects of the benefit change until agreement to the change had been reached and communicated.
- A14. In contrast, where a retirement benefit scheme has an unspecified measure of inflation this is a change in assumptions effective from the date of the government announcement so no further action is required.