FINANCIAL REPORTING

EXPOSURE DRAFT

PROPOSED AMENDMENT TO FRS 17 'RETIREMENT BENEFITS'

AND

REPORTING STATEMENT 'RETIREMENT BENEFITS - DISCLOSURES'

ASB
ACCOUNTING STANDARDS BOARD

For the convenience of respondents in compiling their responses, the text of the questions in the Invitation to Comment on which particular comments are invited (see pages 8 to 10) can be downloaded (in Word format) from the 'Pensions Disclosures Project' page in the Current Projects section of the ASB Website (www.frc.org.uk/asb).

For ease of handling, we prefer comments to be sent by email (in Word format) to

pensionsdisclosures@frc-asb.org.uk

Comments may also be sent in hard copy form to:

Michelle Crisp
ACCOUNTING STANDARDS BOARD
5th Floor, Aldwych House
71-91 Aldwych
London
WC2B 4HN

Comments should be despatched so as to be received no later than 11 September 2006. All replies will be regarded as on the public record, unless confidentiality is requested by the commentator.

FINANCIAL REPORTING
EXPOSURE DRAFT

PROPOSED AMENDMENT TO
FRS 17 'RETIREMENT BENEFITS'
AND
REPORTING STATEMENT
'RETIREMENT BENEFITS - DISCLOSURES'

ACCOUNTING
STANDARDS
BOARD

The draft is issued by the Accounting Standards Board for comment. It should be noted that the draft may be modified in the light of comment received before being issued in final form.

ISBN 1 84140 810 7

CONTENTS

PREFACE

Introduction

1 This Exposure Draft sets out for comment a proposed amendment to Financial Reporting Standard (FRS) 17 'Retirement Benefits' and a draft Reporting Statement: 'Retirement Benefits - Disclosures'.

Background

2 The Accounting Standards Board (ASB) published FRS 17 'Retirement Benefits' in November 2000, although its requirements have only become mandatory in full for accounting periods beginning on or after 1 January 2005.

3 The recent implementation of FRS 17 has given rise to a number of comments concerning the accounting and disclosures regarding defined benefit schemes. In addition to these comments there have been significant changes in the UK legal and regulatory environment for company pension schemes, particularly those arising from the Pensions Act 2004.

4 In view of comments received following the implementation of FRS 17 the ASB has taken on a review of disclosures for defined benefit schemes as set out in FRS 17. This review is distinct from the wider research project that the ASB announced on 14 October 2005.

Approach to the review

5 The ASB decided the review should have a narrow focus on how disclosures for defined benefit schemes can be improved in the short-term, giving particular consideration to the changes made in the UK legal and regulatory regime.

6 The ASB is conducting the wider research project with the assistance of a UK Advisory Panel and a Working Group from the European Financial Reporting Advisory Group (EFRAG). The ASB requested their assistance also in the short-term review.

7 The Accounting Standards Board received recommendations from the Panel and Working Group and considered how these recommendations could be implemented within the context of existing UK Financial Reporting Standards.

8 In making its proposals the ASB is conscious that any additional disclosure requirements, beyond those set out in draft FRS 17*, should address the needs of users whilst not being cumbersome. The ASB is of the view a Reporting Statement which sets out principles for disclosure, rather than specific requirements, allows entities the flexibility to provide disclosures that are appropriate to their exposure to risks and rewards arising from defined benefit schemes.

Summary of recommendations

9 This Exposure Draft proposes to amend FRS 17 by replacing the existing disclosure requirements set out in the FRS with those of International Accounting Standard (IAS) 19 'Employee Benefits'.

10 In addition the Exposure Draft sets out a draft Reporting Statement. The disclosures recommended in the draft Reporting Statement aim to provide users of financial statements with information to evaluate the risks and rewards arising from defined benefit schemes, including the funding obligations arising from defined benefit schemes.

---

* *Draft FRS 17 refers to FRS 17 as proposed to be amended by this Exposure Draft.*

11 The draft Reporting Statement sets out six principles to be considered when providing disclosures for defined benefit schemes in the financial statements. The six areas addressed by the principles are:

i the relationship between the entity and trustees (managers) of the defined benefit scheme;

ii the principal assumptions used to measure scheme liabilities;

iii the sensitivity of scheme liabilities to changes in the principal assumptions used to measure the scheme liabilities;

iv how the liabilities arising from defined benefit schemes are measured;

v the future funding requirements to the defined benefit scheme; and

vi the nature and extent of the risks arising from the assets held by the defined benefit scheme.

Specific proposals

Scheme liabilities calculated on a buy-out basis

12 The draft Reporting Statement recommends that the financial statements provide information that enables users to understand the method of measurement used to measure scheme liabilities. The ASB is aware that the UK actuarial profession requires scheme actuaries to provide, in valuation reports, the estimated buy-out cost of scheme liabilities with a suitable insurance entity.

13 The ASB has considered a number of points of view on whether financial statements should disclose the buy-out cost at the balance sheet date with a suitable insurance entity.

14 One view expressed is that the disclosure of the buy-out cost is not consistent with the going-concern concept. Those that support this view argue that the buy-out cost is a measurement of the amount required to settle the scheme liabilities rather than to continue the defined benefit scheme on an ongoing basis.

15 The ASB, however, notes that with the improved disclosures proposed in this Exposure Draft a user of financial statements may estimate the buy-out cost. The draft Reporting Statement includes a recommendation for disclosure of the buy-out cost but the ASB is specifically seeking the views of constituents on whether this disclosure should be included in the final Reporting Statement.

Other areas considered for disclosure

Pension Protection Fund (PPF) Levy

16 In developing the proposals in this Exposure Draft, the ASB has considered new regulations in the UK. The Pensions Act 2004 established the Pension Protection Fund (PPF). The PPF has been formed principally to pay compensation to members of defined benefit schemes, following an insolvency event of the sponsoring employer where there are insufficient assets to pay benefits at the PPF compensation level. The compensation payments are funded partly by the assets transferred from the schemes to the PPF and partly from an annual levy on other pension schemes. Although some commentators have suggested that the financial statements should disclose the amount of the PPF levy placed on a defined benefit scheme, the ASB considers that this is not a matter for the reporting entity to disclose. In reaching this conclusion, the ASB formed the view that the PPF levy was similar to other expenses of a defined benefit scheme, which did not require separate disclosure, and therefore could find no specific reason to disclose this expense.

Regulatory Funding

17 The ASB has also considered the new statutory regime in the UK for funding defined benefits schemes, including whether the financial statements should disclose certain "triggers" that The Pensions Regulator (TPR) proposes to introduce for monitoring the funding of defined benefit schemes. One of the pieces of information TPR proposes to use to monitor scheme funding is the amount of compensation that the Pension Protection Fund would be required to pay in the event of the sponsoring employer becoming insolvent. The ASB has given due consideration to the benefit of this disclosure but takes the view that the level of compensation payable, in the event of insolvency, is a matter between the members of the scheme and the scheme itself. The ASB notes that the amount of compensation payable in the event of insolvency does not represent a liability of the reporting entity and therefore the ASB is not proposing disclosure of this amount.

Regulatory Impact

18 In the ASB's view, the disclosures required and recommended in the Exposure Draft of the Proposed Amendment to FRS 17 and the draft Reporting Statement cover information that entities will already be preparing, either for management or regulatory purposes and as such there should be little extra cost involved in preparing additional information. The ASB believes that the users of financial statements will benefit from the proposals set out in this Exposure Draft through better understanding of the risks and rewards arising from defined benefit schemes. The ASB, however, would welcome views on whether there are any significant additional costs resulting from these proposals, and, if so, whether they can be quantified. The ASB would also welcome views on whether the benefits provided by the disclosures proposed in the Exposure Draft outweigh any costs involved.

INVITATION TO COMMENT

Question 1 – Proposed amendment to FRS 17 'Retirement Benefits'

19 The proposals set out in the Exposure Draft propose to replace the existing disclosure requirements of FRS 17 with those of IAS 19 'Employee Benefits'. The ASB considers that, as part of its convergence programme of UK accounting standards with International Financial Reporting Standards (IFRS), it can replace the disclosure requirements set out in FRS 17 with those of IAS 19 and in doing so address some of the concerns expressed by commentators in relation to the disclosures of defined benefit schemes whilst achieving greater convergence with IFRS. Do you agree with the proposal to replace the existing disclosure requirements in FRS 17 with those of IAS 19? If not please identify your reasons for not supporting the proposal.

Question 2 – Scheme liabilities calculated on a buy-out basis

20 FRS 17 requires liabilities of defined benefit schemes to be measured on an actuarial basis using the projected unit method, there are however alternative measurement bases. One such alternative is the buy-out cost with an insurance entity. The ASB has considered alternative views on whether the financial statements of the reporting entity should include disclosure of scheme liabilities calculated on a buy-out basis, some of these views are set out above. The draft Reporting Statement includes the recommendation to disclose the scheme liabilities calculated on a buy-out basis. However, the ASB wishes to seek the views of constituents before finalising the Reporting Statement. Do you agree with the recommendation in the draft Reporting Statement to disclose the scheme liabilities as calculated on a buy-out basis? If not, please identify your reasons for not

supporting the disclosure of the scheme liabilities calculated on a buy-out basis.

Question 3 – Pension Protection Fund (PPF) Levy

21 The Pensions Act 2004 established the Pension Protection Fund to pay compensation to members of eligible defined benefit schemes in the event of a qualifying insolvency event in relation to the employer. The compensation is, in part, funded by a levy on all UK defined benefit schemes. The ASB considers that the financial statements of the reporting entity should not be required to disclose the PPF levy. Do you agree that the PPF levy should not be disclosed in the financial statements of the reporting entity? If not, please explain why not.

Question 4 – Regulatory Funding

22 The draft Reporting Statement aims to complement the disclosure requirements of draft FRS 17 by requiring additional disclosures. The additional disclosures include greater information about scheme funding. The ASB has not, however, recommended the disclosure of the level of compensation benefits that would be payable in the event of insolvency (section 179 of Pensions Act 2004). Do you agree that the financial statements should not require disclosure of this amount? If you would prefer disclosure please explain why?

Question 5 – Effective Date

23 The ASB proposes the amendment to FRS 17 and the Reporting Statement be effective for accounting periods ending on or after 31 December 2006. This Exposure Draft proposes that corresponding amounts for the previous period are provided in accordance with FRS 28 'Corresponding Amounts'. Do you agree with the proposed effective date? Do you agree with the

proposal to require corresponding amounts? If not, please explain your reasons why.

Question 6 – Regulatory Impact

24 The ASB's view is that the proposals in this Exposure Draft will, in the main, lead to disclosure of information an entity already has available and as such additional costs incurred with the proposals set out in the Exposure Draft should be minimal. Do you agree? If not, can you identify and quantify costs resulting from the proposals? The ASB would also welcome views on whether the costs of providing the disclosures recommended in the Exposure Draft outweigh the benefits of disclosure.

Proposed Amendment to FRS 17 'Retirement benefits'

Introduction

1 This Exposure Draft sets out for comment a proposed amendment to FRS 17 'Retirement Benefits'. The amendment will converge the disclosure requirements set out in FRS 17 'Retirement Benefits' with those of IAS 19 'Employee Benefits'.

2 The Accounting Standards Board (ASB) published FRS 17 in November 2000, although its full requirements only became mandatory for accounting periods beginning on or after 1 January 2005. Following its implementation, some commentators have expressed a concern that financial statements do not contain sufficient information in relation to defined benefit schemes to allow users of the financial statements to obtain a clear view of the risks and rewards arising from such schemes.

3 The ASB has undertaken a review of the disclosure requirements of FRS 17. In doing so, the ASB has taken into account the fact that, in December 2004, the IASB amended the disclosure requirements of International Accounting Standard (IAS) 19 'Employee Benefits', following a review of national standards on accounting for post-employment benefits. The ASB is proposing that, as part of its convergence programme of UK accounting standards with International Financial Reporting Standards (IFRS), it can converge the disclosure requirements set out in FRS 17 with those of IAS 19 and in doing so address some of the concerns expressed by commentators.

4 In replacing the disclosure requirements of FRS 17 with those of IAS 19 the ASB has made changes where the accounting treatment of items differs between the two accounting standards or where necessary to make the terminology consistent.

Summary of Main Changes

5 The significant additional disclosures required by the proposed amendment to FRS 17 include:

- information that enables users of the financial statements to evaluate the nature of the entity's participation in defined benefit schemes and the financial effects of changes in those schemes. FRS 17 previously required the nature of schemes to be disclosed;

- the principal actuarial assumptions used as at the balance sheet date. FRS 17 currently only requires information regarding the main financial assumptions. The most significant change this is likely to bring is the requirement to disclose mortality rates – where it is considered to be a material assumption;

- an analysis of the opening and closing scheme liabilities and scheme assets showing separately if applicable the movements in scheme assets and scheme liabilities; and

- an analysis of scheme liabilities into amounts arising from schemes that are wholly unfunded and amounts arising from schemes that are wholly or partly funded.

6 The following disclosures will no longer be required:

- the date of the most recent full actuarial valuation and if the actuary is an employee or officer of the company;

- the effects of changes in the demographic and financial assumptions underlying the present value of the scheme liabilities;

- the financial assumptions at the beginning of the period; and

- an analysis of reserves in the notes to the financial statements distinguishing the amount relating to the defined benefit asset or liability net of the related deferred tax.

The ASB does not consider that the loss of these disclosures will seriously impede the needs of users of financial statements.

7 The ASB does, however, consider that for closed schemes and those in which the age profile of the active membership is rising significantly, the fact that under the projected unit method the current service cost will increase as the members of the scheme approach retirement will still provide useful information to users of financial statements. This disclosure is therefore recommended in the draft Reporting Statement.

8 FRS 17 requires an entity to disclose the fair value of scheme assets analysed into classes of assets together with the expected rate of return assumed for each class. In contrast IAS 19 does not specifically require disclosure of the expected rate of return assumed by class of asset. The ASB considers that this is a useful disclosure and has recommended in the draft Reporting Statement that disclosure of the expected rate of return by category of asset is disclosed.

9 FRS 17 requires an entity to disclose the main financial assumptions used at the beginning of the period and at the balance sheet date. In contrast IAS 19 requires assumptions used at the balance sheet date. As a consequence, an entity will no longer be required to disclose assumptions for a three year period. This change includes the expected rate of return which will no longer be required as at the balance sheet date.

10 An entity will no longer be required to disclose, for the accounting period and previous four periods, the difference between the expected and actual return on assets. In contrast, IAS 19 requires for the current annual period and previous four annual periods the present value of the defined benefit obligation, the fair value of the scheme assets and surplus or deficit arising in the scheme; and experience adjustments

arising on the assets and liabilities of the scheme expressed either as: (1) an amount; or (2) a percentage of the scheme assets at the balance sheet date. The ASB considers that the alternative information provided by draft FRS 17 is a suitable alternative disclosure.

11 Paragraph 82 of draft FRS 17 requires an entity to disclose information about contingent liabilities arising from retirement benefit obligations in accordance with FRS 12 'Provisions, Contingent Liabilities and Contingent Assets'. Similarly paragraph 94 of FRS 12 requires the nature of contingent assets, where an inflow of the economic benefits is probable, to be disclosed. In accordance with the provisions of FRS 12 an entity should therefore disclose contingent assets and contingent liabilities, including guarantees, arising from retirement benefit obligations.

[DRAFT] FINANCIAL REPORTING STANDARD

Amendment to FRS 17 'Retirement Benefits'

1 **In the summary, delete paragraph 'o' and replace with a new paragraph 'o':**

o The following disclosures are required:

(i) the principal assumptions underlying the scheme;

(ii) a reconciliation of the opening and closing balances of the fair value of scheme assets and the opening and closing balances of scheme liabilities showing effects during the period which give rise to the movement in the opening and closing balances;

(iii) for each major category of scheme assets the percentage or the amount that each major category constitutes of the fair value of the total scheme assets;

(iv) a narrative description of the basis used to determine the overall expected rate of return on assets; and

(v) the amounts for the current and previous four periods of the present value of the scheme liabilities, the fair value of the scheme assets and the surplus or deficit in the scheme.

2 **In paragraph 9(b) delete points (i) and (ii) and replace with:**

(i) the fact that the scheme is a defined benefit scheme; and

(ii) the reason why sufficient information is not available to enable the employer to account for the scheme as a defined benefit scheme; and

(c) to the extent that a surplus or deficit in the scheme may affect the amount of future contributions, disclose in addition:

(i) any available information about that surplus or deficit;

(ii) the basis used to determine that surplus or deficit; and

(iii) the implications, if any, for the employer.

3 **Delete paragraphs 76 to 93.**

4 **Insert new paragraphs 76 to 82 as follows:**

76 An employer shall disclose information that enables users of financial statements to evaluate the nature of its defined benefit schemes and the financial effects of changes in those schemes during the period.

77 An employer shall disclose the following information about defined benefit schemes:

(a) a general description of the type of scheme.

(b) a reconciliation of opening and closing balances of the scheme liabilities showing separately, if applicable, the effects during the period attributable to each of the following:

(i) current service cost,

(ii) interest cost,

(iii) contributions by scheme participants,

(iv) actuarial gains and losses,

(v) foreign currency exchange rate changes on schemes measured in a currency different from the entity's presentation currency,

(vi) benefits paid,

(vii) past service cost,

(viii) business combinations,

(ix) curtailments, and

(x) settlements.

(c) an analysis of scheme liabilities into amounts arising from schemes that are wholly unfunded and amounts arising from schemes that are wholly or partly funded.

(d) a reconciliation of the opening and closing balances of the fair value of scheme assets showing separately, if applicable, the effects during the period attributable to each of the following:

(i) expected rate of return on scheme assets,

(ii) actuarial gains and losses,

(iii) foreign currency exchange rate changes on schemes measured in a currency different from the entity's presentation currency,

(iv) contributions by the employer,

(v) contributions by scheme participants,

(vi) benefits paid,

(vii) business combinations and

(viii) settlements.

(e) a reconciliation of the scheme liabilities in (b) and the fair value of the scheme assets in (d) to the assets and liabilities recognised in the balance sheet, showing at least:

(i) any past service cost not recognised in the balance sheet (see paragraph 60);

(ii) any amount not recognised as an asset, because of the limit in paragraph 41; and

(iii) any other amounts recognised in the balance sheet.

(f) the total expense recognised in profit or loss for each of the following, and the line item(s) in which they are included:

(i) current service cost;

(ii) interest cost;

(iii) expected return on scheme assets;

(iv) past service cost;

(v) the effect of any curtailment or settlement; and

(vi) the effect of the limit in paragraph 41.

(g) the total amounts recognised in statement of total recognised gains and losses for each of the following:

(i) actuarial gains and losses; and

(ii) the effect of the limit in paragraph 41.

(h) the cumulative amount of actuarial gains and losses recognised in the statement of total recognised gains and losses.

(i) for each major category of scheme assets, which shall include, but is not limited to, equity instruments, debt instruments, property, and all other assets, the percentage or amount that each major category constitutes of the fair value of the total scheme assets.

(j) the amounts included in the fair value of scheme assets for:

(i) each category of the entity's own financial instruments; and

(ii) any property occupied by, or other assets used by, the entity.

(k) a narrative description of the basis used to determine the overall expected rate of return on assets, including the effect of the major categories of scheme assets.

(l) the actual return on scheme assets.

(m) the principal actuarial assumptions used as at the balance sheet date, including, when applicable:

(i) the discount rates;

(ii) the expected rates of return on any assets of the scheme for the periods presented in the financial statements;

(iii) the expected rates of salary increases (and of changes in an index or other variable specified in the formal or constructive terms of a scheme as the basis for future benefit increases);

(iv) retirement healthcare cost trend rates; and

(v) any other material actuarial assumptions used.

An employer shall disclose each actuarial assumption in absolute terms (for example, as an absolute percentage) and not just as a margin between different percentages or other variables.

(n) the effect of an increase of one percentage point and the effect of a decrease of one percentage point in the assumed retirement healthcare cost trend rates on:

(i) the aggregate of the current service cost and interest cost components of net periodic retirement healthcare costs; and

(ii) the accumulated retirement healthcare obligation for healthcare costs.

For the purposes of this disclosure, all other assumptions shall be held constant. For schemes operating in a high inflation environment, the disclosure shall be the

effect of a percentage increase or decrease in the assumed healthcare cost trend rate of a significance similar to one percentage point in a low inflation environment.

(o) the amounts for the current annual period and previous four annual periods of:

(i) the present value of the scheme liabilities, the fair value of the scheme assets and the surplus or deficit in the scheme; and

(ii) the experience adjustments arising on:

(A) the scheme liabilities expressed either as (1) an amount or (2) a percentage of the scheme liabilities at the balance sheet date and

(B) the assets of the scheme expressed either as (1) an amount or (2) a percentage of the assets of the scheme at the balance sheet date.

(p) the employer's best estimate, as soon as it can reasonably be determined, of contributions expected to be paid to the scheme during the annual period beginning after the balance sheet date.

78 Paragraph 77(a) requires a general description of the type of scheme. Such a description distinguishes, for example, flat salary pension schemes from final salary pension schemes and from retirement healthcare schemes. The description of the scheme shall include informal practices that give rise to constructive obligations included in the measurement of the scheme liabilities in accordance with paragraph 20(b). Further detail is not required.

79 When an entity has more than one defined benefit scheme, disclosures may be made in total, separately for each scheme, or in such groupings as are considered to be the most useful. It may be useful to distinguish groupings by criteria such as the following:

(a) the geographical location of the schemes, for example, by distinguishing domestic schemes from foreign schemes; or

(b) whether schemes are subject to materially different risks, for example, by distinguishing flat salary pension schemes from final salary pension schemes and from retirement healthcare schemes.

When an entity provides disclosures in total for a grouping of schemes, such disclosures are provided in the form of weighted averages or of relatively narrow ranges.

80 Paragraph 9(b) requires additional disclosures about multiemployer defined benefit schemes that are treated as if they were defined contribution schemes.

81 Where required by FRS 8 'Related Party Disclosures' an entity discloses information about related party transactions with retirement benefit schemes.

82 Where required by FRS 12 'Provisions, Contingent Liabilities and Contingent Assets' an entity discloses information about contingent liabilities arising from retirement benefit obligations.

5 **Delete paragraphs 94 and 95.**

6 **Insert new paragraphs 94 and 95 (including sub-headings):**

DATE FROM WHICH EFFECTIVE

94 **The requirements of the [draft] FRS become effective for financial statements covering periods ending on or after 31 December 2006. There is a general requirement in FRS 28 'Corresponding Amounts' to disclose corresponding amounts for the previous reported period. In accordance with FRS 28 this [draft] FRS requires corresponding amounts for amounts disclosed in accordance with paragraphs 9(b), 9(c) and paragraphs 76 to 82. Early adoption is encouraged.**

95 **Paragraph 77(h) of the [draft] FRS requires disclosure of the cumulative amount of actuarial gains and losses recognised in the statement of total recognised gains and losses. The amount to be disclosed should be the amount recognised in the statement of total recognised gains and losses since 22 June 2002 or since adoption of FRS 17 in accordance with paragraph 96 of the FRS.**

7 **Delete Appendix I – 'Disclosure Example' of the FRS and replace with the revised Appendix I set out at the end of this proposed amendment to FRS 17.**

8 **In Appendix III – 'Compliance with International Accounting Standards' delete the final sentence of paragraph 1.**

9 **Also in Appendix III delete paragraphs 2 to 4. Replace paragraph 2 with:**

2 The FRS requires actuarial gains and losses to be recognised, immediately they occur, in the statement of total recognised gains and losses. IAS 19 (revised) requires an entity to:

(i) recognise a specified portion of the net cumulative actuarial gains and losses in the profit and loss account to the extent that they exceed the greater of 10 per cent of fair value of the scheme assets and 10 per cent of the present value of the defined benefit obligation (before deducting scheme assets). The portion of the actuarial gains and losses to be recognised for each defined benefit plan is the excess that fell outside the 10 per cent 'corridor' spread forward over the remaining working lives of employees participating in the scheme; or

(ii) recognise immediately all actuarial gains and losses in the period in which they occur outside the profit and loss account in a statement of recognised income and expense; or

(iii) the Standard permits systematic methods of faster recognition, provided that the same basis is applied to both gains and losses and the basis is applied consistently from period to period. Such permitted methods include immediate recognition of gains and losses in the profit and loss.

10 **In Appendix IV – 'The development of the FRS' insert new paragraph 56A as follows**:

56A In 2006 the Accounting Standards Board decided to converge the disclosure requirements set out in FRS 17 'Retirement Benefits' with those of IAS 19 'Employee Benefits'. In converging the disclosure requirements of FRS 17 with those of IAS 19 the ASB sought to amend the text of IAS 19 only where UK terminology differed.

11 **Also in Appendix IV – 'The development of the FRS' insert new paragraph 57A as follows:**

57A In 2006 the Accounting Standards Board, following convergence of the disclosure requirements with those of IAS 19, required the new disclosure requirements to be effective for accounting periods ending on or after 31 December 2006.

APPENDIX I

ILLUSTRATIVE DISCLOSURES

ASB Note: These illustrative examples have been extracted from IAS 19 'Employee Benefits', amendments are shown in marked-up form.

This appendix accompanies, but is not part of, ~~IAS 19~~ [draft] FRS 17. Extracts from notes show how the required disclosures may be aggregated in the case of a large multi-national group that provides a variety of employee benefits. These extracts do not necessarily conform with all the disclosure and presentation requirements of ~~IAS 19~~ [draft] FRS 17 and other Standards. In particular, they do not illustrate the disclosure of:

~~(a)~~ ~~accounting policies for employee benefits (see IAS 1 Presentation of Financial Statements~~ FRS 18 Accounting Policies). ~~Paragraph 120A(a) of the Standard requires this disclosure to include the entity's accounting policy for recognising actuarial gains and losses.~~

~~(b)~~ (a) a general description of the type of plan (paragraph ~~120A(b)~~77(a)).

~~(c)~~ (b) a narrative description of the basis used to determine the overall expected rate of return on assets (paragraph ~~120A(l)~~77(k)).

~~(d)~~ ~~employee benefits granted to directors and key management personnel (see IAS 24 Related Party Disclosures).~~

~~(e)~~ ~~share-based employee benefits (see (IFRS 2) Share-based Payment~~).

Employee benefit obligations

The amounts recognised in the balance sheet are as follows:

	Defined benefit pension plans*		Post-employment ~~medical~~ healthcare benefits	
	20X2	*20X1*	*20X2*	*20X1*
Present value of funded obligations	20,300	17,400	–	–
Fair value of plan assets	(18,420)	(17,280)	–	–
	1,880	120	–	–
Present value of unfunded obligations	2,000	1,000	7,337	6,405
~~Unrecognised actuarial gains (losses)~~	~~(1,605)~~	~~840~~	~~(2,707)~~	~~(2,607)~~
~~Unrecognised past service cost~~	~~(450)~~	~~(650)~~	–	–
~~Net liability~~ Deficit	3,880 ~~1,825~~	1,120 ~~1,310~~	7,337 ~~4,630~~	6,405 ~~3,798~~
Related deferred tax asset†:	(1,164)	(336)	-	-
Net liability	2,716	784	7,337	6,405
Amounts in the balance sheet				
Liabilities	2,716~~1,825~~	874 ~~1,400~~	7,337 ~~4,630~~	6,405 ~~3,798~~
Assets	–	(90) –	–	–
Net liability	2,716~~1,825~~	784 ~~1,310~~	7,337 ~~4,630~~	6,405 ~~3,798~~

* *ASB Note: FRS 17 refers to defined benefit schemes whereas IAS 19 uses the term defined benefit plans.*

† *ASB Note: Paragraph 49 of FRS 17 requires the deferred tax relating to the defined benefit asset or liability to be offset against the defined benefit asset or liability and not included with other deferred tax assets or liabilities. Differences between the asset or liability in the balance sheet and the surplus or deficit in the scheme will arise because of the related deferred tax balance.*

The pension plan assets include ordinary shares issued by [name of reporting entity] with a fair value of 317 (20X1: 281). Plan assets also include property occupied by [name of reporting entity] with a fair value of 200 (20X1: 185).

> *ASB Note: FRS 17 sets out where changes in the defined benefit asset or liability (other than that arising from contributions to the scheme) should be reported in the performance statements.*

~~The amounts recognised in profit or loss are as follows:~~

	Defined benefit pension plans		Post-employment ~~medical~~ healthcare benefits	
	20X2	*20X1*	*20X2*	*20X1*
Current service cost	850	750	479	411
Interest on obligation	950	1,000	803	705
Expected return on plan assets	(900)	(650)		
~~Net actuarial losses (gains) recognised in year~~	~~(70)~~	~~(20)~~	~~150~~	~~140~~
Past service cost	200	200		
Losses (gains) on curtailments and settlements	175	(390)		
Total~~, included in 'employee benefits expense'~~	1,275 ~~1,205~~	910 ~~890~~	1,282 ~~1,432~~	1,116 ~~1,256~~
Actual return on plan assets	600	2,250	–	–

Changes in the present value of the defined benefit obligation are as follows:

	Defined benefit pension plans		Post-employment healthcare ~~medical~~ benefits	
	20X2	*20X1*	*20X2*	*20X1*
Opening defined benefit obligation	18,400	11,600	6,405	5,439
Service cost	850	750	479	411
Interest cost	950	1,000	803	705
Actuarial losses (gains)	2,350	950	250	400
Losses (gains) on curtailments	(500)	–		
Liabilities extinguished on settlements	–	(350)		
Liabilities assumed in a business combination	–	5,000		
Exchange differences on foreign plans	900	(150)		
Benefits paid	(650)	(400)	(600)	(550)
Closing defined benefit obligation	22,300	18,400	7,337	6,405

Changes in the fair value of plan assets are as follows:

	Defined benefit pension plans	
	20X2	*20X1*
Opening fair value of plan assets	17,280	9,200
Expected return	900	650
Actuarial gains and (losses)	(300)	1,600
Assets distributed on settlements	(400)	–
Contributions by employer	700	350
Assets acquired in a business combination	–	6,000
Exchange differences on foreign plans	890	(120)
Benefits paid	(650)	(400)
	18,420	17,280

The group expects to contribute 900 to its defined benefit pension plans in 20X3.

The major categories of plan assets as a percentage of total plan assets are as follows:

	20X2	*20X1*
European equities	30%	35%
North American equities	16%	15%
European bonds	31%	28%
North American bonds	18%	17%
Property	5%	5%

Principal actuarial assumptions at the balance sheet date (expressed as weighted averages):

	20X2	*20X1*
Discount rate at 31 December	5.0%	6.5%
Future salary increases	5%	4%
Future pension increases	3%	2%
Proportion of employees opting for early retirement	30%	30%
Annual increase in healthcare costs	8%	8%
Future changes in maximum state healthcare benefits	3%	2%

Assumed healthcare cost trend rates have a significant effect on the amounts recognised in profit or loss. A one percentage point change in assumed healthcare cost trend rates would have the following effects:

	One percentage point increase	One percentage point decrease
Effect on the aggregate of the service cost and interest cost	190	(150)
Effect on defined benefit obligation	1,000	(900)

Amounts for the current and previous four periods are as follows:

Defined benefit pension plans

	20X2	*20X1*	*20X0*	*20W9*	*20W8*
Defined benefit obligation	(22,300)	(18,400)	(11,600)	(10,582)	(9,144)
Plan assets	18,420	17,280	9,200	8,502	10,000
Surplus/(deficit)	(3,880)	(1,120)	(2,400)	(2,080)	856
Experience adjustments on plan liabilities	(1,111)	(768)	(69)	543	(642)
Experience adjustments on plan assets	(300)	1,600	(1,078)	(2,890)	2,777

Post-employment medical benefits

	20X2	*20X1*	*20X0*	*20W9*	*20W8*
Defined benefit obligation	7,337	6,405	5,439	4,923	4,221
Experience adjustments on plan liabilities	(232)	829	490	(174)	(103)

The group also participates in an industrywide defined benefit plan that provides pensions linked to final salaries and is funded on a pay-as-you-go basis. It is not practicable to determine the present value of the group's obligation or the related current service cost as the plan computes its obligations on a basis that differs materially from the basis used in [name of reporting entity's] financial statements. [describe basis] On that basis, the plan's financial statements to 30 June 20X0 show an unfunded liability of 27,525. The unfunded liability will result in future payments by participating employers. The plan has approximately 75,000 members, of whom approximately 5,000 are current or former employees of [name of reporting entity] or their dependants. The expense recognised in the income statement, which is equal to contributions due for the year, and is not included in the above amounts, was 230 (20X1: 215). The group's future contributions may be increased substantially if other entities withdraw from the plan.

[DRAFT]
Reporting Statement
'Retirement Benefits - Disclosures'

Introduction

1 This Exposure Draft sets out for comment a draft Reporting Statement 'Retirement Benefits – Disclosures'.

2 The Accounting Standards Board (ASB) published FRS 17 'Retirement Benefits' in November 2000, although its full requirements only became mandatory for accounting periods beginning on or after 1 January 2005. Following its implementation, some commentators expressed a concern that the financial statements do not contain sufficient information in relation to defined benefit schemes to allow users of the financial statements to obtain a clear view of the risks and rewards arising from defined benefit schemes.

3 The ASB has undertaken a review of the disclosure requirements of FRS 17. In doing so the ASB has taken into account the fact that, in December 2004, the IASB amended the disclosure requirements of IAS 19 'Employee Benefits', following a review of national standards on accounting for post-employment benefits. The ASB is proposing that, as part of its convergence programme for UK accounting standards with International Financial Reporting Standards (IFRS), it can converge the disclosure requirements set out in FRS 17 with those of IAS 19 and in so doing address some of the concerns expressed by commentators.

4 The ASB notes, however, that convergence alone will not address all of the areas of concern highlighted by commentators. The ASB is proposing to address those areas of concern not covered in the proposed amendment to FRS 17 in a Reporting Statement.

Proposals in the [draft] Reporting Statement

5 This Exposure Draft, which builds on the proposed amendment to FRS 17 'Retirement Benefits', sets out additional disclosures that complement the disclosure requirements of FRS 17.

6 The proposals set out in the [draft] Reporting Statement recommend the following complementary disclosures:

a. information that enables users of the financial statements to understand the relationship between the entity and trustees (managers) of the defined benefit scheme. This information would allow users to understand how an entity is able to manage its affairs with the scheme including any constraints placed on the entity through powers delegated to trustees (managers);

b. information about the principal assumptions such that users of financial statements can understand the inherent uncertainties affecting the measurement of scheme liabilities;

c. a sensitivity analysis for each of the principal assumptions used to measure the scheme liabilities;

d. information about the method of measurement used to measure scheme liabilities;

e. information that enables the users of the financial statements to evaluate the funding obligations an entity has for defined benefit scheme liabilities; and

f. information that enables users of financial statements to evaluate the nature and extent of the risks and rewards arising from the assets held by the defined benefit scheme.

[DRAFT] REPORTING STATEMENT 'RETIREMENT BENEFITS – DISCLOSURES'

SUMMARY

a The [draft] Reporting Statement is designed as a formulation of best practice; it is intended to have persuasive rather than mandatory force. The Reporting Statement is applicable for any entity that operates or sponsors a defined benefit scheme.

b The [draft] Reporting Statement sets out a number of areas where additional disclosures would benefit the users of financial statements in understanding the risks and rewards, and funding obligations, arising from defined benefit schemes. The disclosures aim to provide the users of the financial statements with information to evaluate the risks, and funding obligations, arising from defined benefit schemes.

c The [draft] Reporting Statement recommends that the directors provide disclosures in the notes to the financial statements. The disclosures set out in this Reporting Statement complement the disclosure requirements set out in [draft] FRS 17 'Retirement Benefits'. The extent of disclosure required depends on the significance to the entity of its participation in defined benefit schemes and of its exposure to risk arising from those schemes.

OBJECTIVE

1 The objective of this [draft] Reporting Statement is to specify disclosures for defined benefit schemes such that:

a. the financial statements contain adequate disclosure of the cost of providing retirement benefits and the related gains, losses, assets and liabilities;

b. the users of financial statements can obtain a clear view of the risks and rewards arising from defined benefit schemes; and

c. the funding obligations of the entity in relation to liabilities of defined benefit schemes are clearly identified.

SCOPE

2 This [draft] Reporting Statement may be applied to financial statements that are intended to give a true and fair view of a reporting entity's financial position and profit or loss (or income and expenditure) for a period the reporting entity operates or sponsors a defined benefit scheme.

DEFINITIONS

3 The following definitions shall apply in this [draft] Reporting Statement:

Actuarial gains and losses - Changes in actuarial deficits or surpluses that arise because:

(a) events have not coincided with the actuarial assumptions made for the last valuation (experience gains and losses); or

(b) the actuarial assumptions have changed.

Current service cost - The increase in the present value of the scheme liabilities expected to arise from employee service in the current period.

Defined benefit scheme - A pension or other retirement benefit scheme other than a defined contribution scheme.

Usually, the scheme rules define the benefits independently of the contributions payable, and the benefits are not directly related to the investments of the scheme. The scheme may be funded or unfunded.

Defined contribution scheme - A pension or other retirement benefit scheme into which an employer pays regular contributions fixed as an amount or as a percentage of pay and will have no legal or constructive obligation to pay further contributions if the scheme does not have sufficient assets to pay all employee benefits relating to employee service in the current and prior periods.

An individual member's benefits are determined by reference to contributions paid into the scheme in respect of that member, usually increased by an amount based on the investment return on those contributions.

Defined contribution schemes may also provide death-in-service benefits. For the purposes of this definition, death-in-service benefits are not deemed to relate to employee service in the current and prior periods.

Duration of scheme liabilities - The duration of the scheme liabilities is a measure of how long on average it is until the benefits of the scheme fall due. This is the weighted average time to payment of the cash flows, weighted by the present value of the cash flows (ie on a discounted basis).

Duration is calculated by adding the results of multiplying the present value of each cash flow by the time it is received (paid) and then dividing by the total present value of all the cash flows.

Derivative – Is a financial instrument with all three of the following characteristics:

(a) its value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract (sometimes called the 'underlying');

(b) it requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market forces; and

(c) it is settled at a future date.

Equity instrument – Is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities.

Expected rate of return on assets - The average rate of return, including both income and changes in fair value but net of scheme expenses, expected over the remaining life of the related obligation on the actual assets held by the scheme.

Financial instrument - Any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

Financial asset - Any asset that is:

(a) cash;

(b) an equity instrument of another entity;

(c) a contractual right:

  (i) to receive cash or another financial asset from another entity; or

  (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity; or

(d) a contract that will or may be settled in the entity's own equity instruments and is:

(i) a non-derivative for which the entity is or may be obliged to receive a variable number of the entity's own equity instruments; or

(ii) a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity's own equity instruments.

Financial liability - Any liability that is:

(a) a contractual obligation:

(i) to deliver cash or another financial asset to another entity; or

(ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; or

(b) a contract that will or may be settled in the entity's own equity instruments and is:

(i) a non-derivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments; or

(ii) a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity's own equity instruments

Interest cost - The expected increase during the period in the present value of the scheme liabilities because the benefits are one period closer to settlement.

Projected unit method - An accrued benefits valuation method in which the scheme liabilities make allowance for projected earnings. An accrued benefits valuation method is a valuation method in which the scheme liabilities at the valuation date relate to:

(a) the benefits for pensioners and deferred pensioners (ie individuals who have ceased to be active members but are entitled to benefits payable at a later date) and their dependants, allowing where appropriate for future increases, and

(b) the accrued benefits for members in service on the valuation date.

The accrued benefits are the benefits for service up to a given point in time, whether vested rights or not.

Guidance on the projected unit method is given in the Guidance Note GN26 as adopted by the Board for Actuarial Standards.

Retirement benefits - All forms of consideration given by an employer in exchange for services rendered by employees that are payable after the completion of employment.

Retirement benefits do not include termination benefits payable as a result of either

(i) an employer's decision to terminate an employee's employment before the normal retirement date or

(ii) an employee's decision to accept voluntary redundancy in exchange for those benefits, because these are not given in exchange for services rendered by employees.

Scheme liabilities – The liabilities of a defined benefit scheme for outgoings due after the valuation date.

Scheme liabilities measured using the projected unit method reflect the benefits that the employer is committed to provide for service up to the valuation date.

PRINCIPLES

4 **The financial statements should disclose information that enables the users of the financial statements to understand the relationship between the reporting entity and the trustees (managers) of defined benefit schemes.**

5 [Draft] FRS 17 'Retirement Benefits' requires the financial statements to disclose information that enables users of financial statements to evaluate the nature of the entity's participation in defined benefits schemes and the financial effects of changes in those schemes during the period.

6 Many retirement benefit schemes are established as trusts. The basis of trust law is that one group (the trustees) hold assets for the benefit of another group (the beneficiaries). The relationship between the entity and the trust is normally governed by a trust deed and/or trust rules. In addition to trust law itself the powers of trustees may be regulated by legislation. The powers conferred on trustees by regulation may enhance their authority compared to that of the trust deed and/or trust rules.

7 The relationship between the reporting entity and the trustees (managers) of the scheme will determine how an entity manages and arranges its affairs with regard to the defined benefit scheme, including: determination of the investment strategy for the assets held by the scheme, arrangements to determine principles for funding the scheme

including how contribution levels to the scheme are agreed. The management and arrangement of affairs may be affected by the powers vested in the trustees (managers). The financial statements should disclose the arrangements between the trustees (managers) of the scheme and the reporting entity setting out any significant powers of the trustees (managers).

8 **The financial statements should include sufficient information about the principal assumptions used to measure scheme liabilities to allow users to understand the inherent uncertainties affecting the measurement of scheme liabilities. These assumptions should include, where this is not otherwise required by [draft] FRS 17, mortality rates.**

9 [Draft] FRS 17 paragraph 77(m) requires the entity to disclose the principal assumptions used as at the balance sheet date. This [draft] Reporting Statement recommends, where otherwise not required, that the assumptions disclosed include mortality rates providing the number of years post retirement it is anticipated pensions will be paid to members of the scheme. Where the number of years assumed alters depending on geographical, demographical or other significant reasons, the rates should be separately disclosed.

10 Where it is anticipated a change in mortality rates could have a significant impact on the measurement of the scheme liabilities a sensitivity analysis, as required by paragraph 12 of this [draft] Reporting Statement, should be provided.

11 Where an entity has a closed scheme or a scheme in which the age profile of the active membership is rising significantly, the fact that under the projected unit method the current service cost will increase as the members of the scheme approach retirement should be disclosed.

12 **The financial statements should disclose a sensitivity analysis for the principal assumptions used to measure the scheme liabilities, showing how the measurement**

of scheme liabilities would have been affected by changes in the relevant assumption that were reasonably possible at that date.

For the purposes of this disclosure, all other assumptions shall be held constant.

13 The inherent uncertainties affecting the measurement of scheme liabilities require the liabilities to be measured on an actuarial basis. This involves estimating the future cash flows arising under the scheme liabilities based on a number of actuarial assumptions. The measurement of scheme liabilities can be materially affected by changes in assumptions. The financial statements should disclose how movements in the assumptions could affect the measurement of scheme liabilities.

14 **The financial statements should disclose information that enables users to understand the method of measurement used to measure the liabilities arising from defined benefit schemes.**

15 FRS 17 'Retirement Benefits' requires defined benefit scheme liabilities to be measured on an actuarial basis using the projected unit method. The scheme liabilities should be discounted at a rate that reflects the time value of money and the characteristics of the liability (assumed to be the current rate of return of a high quality corporate bond). There are, however, alternative approaches to the measurement of defined benefit scheme liabilities*

16 An alternative approach is the cost of buying out benefits at the balance sheet date with a suitable insurer. In certain jurisdictions there is a requirement for defined benefit schemes to consider this amount when determining contributions payable to the scheme. The financial

* *The measurement of defined benefit scheme liabilities is discussed in paragraphs 11 to 22 of The Development of the FRS to FRS 17 'Retirement Benefits'.*

statements should disclose the cost of buying out benefits at the balance sheet date with a suitable insurer.

17 **The financial statements should disclose information that enables the users of financial statements to understand the funding obligations (estimated where applicable) that the entity has in relation to defined benefit schemes.**

18 [Draft] FRS 17 'Retirement Benefits' requires the employer's best estimate, as soon as it can reasonably be determined, of contributions expected to be paid to the scheme during the annual period beginning after the balance sheet date. Scheme liabilities are, however, often of a long term nature and contributions expected to be paid in the next annual period may not provide sufficient information to allow the users of the financial statements to understand how the scheme liabilities affect the economic resources available to the entity, including its cash-flow.

19 The financial statements should disclose the rates of contributions which have been agreed with the trustees (managers) of the scheme and are payable to the scheme by or on behalf of the reporting entity.

20 The funding requirements for defined benefit schemes are often regulated by legislation, including where legislation sets a minimum funding requirement (or target). An entity may be required or may choose to agree principles for funding scheme liabilities with the trustees (managers) or the scheme. The financial statements should disclose the funding principles the entity has agreed or operates with regard to defined benefit schemes.

21 Where a defined benefit scheme is in deficit* and the entity has entered into an agreement with the trustees (managers) of

---

* *A deficit/surplus in a defined benefit scheme is the shortfall/excess of the value of the assets in the scheme below/over the present value of the scheme liabilities.*

the scheme to make additional contributions to reduce or recover the deficit, in addition to normal levels of funding, the financial statements should disclose separately the additional contributions. The financial statements should also disclose separately the number of years over which it is anticipated the additional contributions will be paid to the defined benefit scheme in order to recover or reduce the deficit.

22 In order to evaluate the economic resources available to the entity, users of financial statements are particularly interested in the period of time over which the liabilities of the defined benefit scheme mature. One measure of this is the duration of scheme liabilities, which should be disclosed in the financial statements.

23 The duration of the scheme's liabilities may not alone provide users with information as to how the defined benefit schemes cash flows are dispersed. The financial statements should also disclose information that allows users to understand the dispersion of cash flows.

24 **The financial statements should disclose information that enables users of financial statements to evaluate the nature and extent of the risks and rewards arising from the assets, including any financial instruments, held by defined benefits schemes at the balance sheet date.**

25 For each type of risk arising from assets, including financial instruments, held by retirement benefits schemes an entity shall disclose:

a. the exposures to risk and how they arise;

b. the objectives, policies and processes undertaken by the defined benefits scheme or the entity for managing the risk and the methods used to measure the risk; and

c. any changes in (a) or (b) from the previous period.

26 An entity may disclose a sensitivity analysis, such as value-at-risk, for types of risks to which the assets of the defined benefit scheme are exposed. Where an entity discloses such sensitivity analysis it should also disclose the method and assumptions used in preparing this analysis and any changes from the previous period in the methods and assumptions used.

27 [Draft] FRS 17 requires an entity to disclose for each major category of scheme assets the percentage or amount that each major category constitutes of the fair value of the total scheme assets. An entity should also disclose the expected rate of return assumed for each major category of scheme assets for the period presented.

28 The assumption made for the expected return on assets does not affect the valuation of the scheme assets because they are measured at fair value. It does, however, determine the amount to be recognised in the profit and loss account.

APPENDIX TO THE REPORTING STATEMENT: ILLUSTRATIVE DISCLOSURES

The following illustrations of possible disclosure examples for defined benefit schemes are provided for general guidance only and do not form part of the [draft] Reporting Statement. The disclosures provided should supplement those disclosures provided in accordance with [draft] FRS 17.

Illustration 1 – Explanation of the relationship between the reporting entity and the trustees (managers) of the defined benefit scheme
(Paragraphs 4 to 7)

The pension scheme assets are held in a separate Trustee-administered fund to meet long-term pension liabilities to past and present employees. The trustees of the fund are required to act in the best interest of the fund's beneficiaries. The appointment of trustees to the fund is determined by the scheme's trust documentation. The Group has a policy that one-third of all trustees should be nominated by members of the fund, including at least one member by current pensioners.

*In addition to its statutory duties the board of trustees has the power to 'call' for settlement of a pension fund deficit should funding of the scheme fall below the agreed funding level or if the Group makes a significant disposal.

* *This disclosure is provided in accordance with FRS 12 'Provisions, Contingent Liabilities and Contingent Assets'.*

Illustration 2 - Disclosure of mortality rates
(Paragraphs 8 to 11)

Investigations have been carried out within the past three years into the mortality experience of the Group's major schemes. These investigations concluded that the current mortality assumptions include sufficient allowance for future improvements in mortality rates. The current life expectancies underlying the value of the scheme liabilities for the Group's schemes are:

	2006 UK	2005 UK	2004 UK
Retiring today age 61			
Males	81.0	78.9	78.9
Females	85.3	82.1	82.1
Retiring in 10 years at age 63			
Males	81.9	79.9	79.9
Females	86.3	83.2	83.2>

Illustration 3 – Sensitivity analysis for each of the principal assumptions used to measure the scheme liabilities
(Paragraphs 12 and 13)

The sensitivities regarding the principal assumptions used to measure the scheme liabilities are set out below:

Assumption	*Change in assumption*	*Impact on scheme liabilities*
Discount rate	Increase/decrease by 0.5%	Decrease/increase by 9.5%
Rate of inflation	Increase/decrease by 0.5%	Decrease/increase by 5.5%
Rate of salary growth	Increase/decrease by 0.5%	Decrease/increase by 3%
Rate of mortality	Increase by 1 year	Increase by 4.5%

Illustration 4 – Understanding the method of measurement used to measure scheme liabilities
(Paragraphs 14 to 16)

The Group provides retirement benefits to some of its former and approximately 60% of current employees through a defined benefit scheme. The level of retirement benefit is principally based on salary earned in the last five years of employment.

The liabilities of the defined benefit scheme are measured by discounting the best estimate of future cash flows to be paid out by the scheme using the projected unit method. This amount is reflected in the deficit in the balance sheet*. The projected unit method is an accrued benefits valuation method which makes allowances for projected earnings. The accumulated benefit obligation is an actuarial measure of the present value of benefits for service already rendered but differs from the projected unit method in that it includes no assumption for future salary

* *An entity that prepares financial statements in accordance with IAS 19 'Employee Benefits' should explain the method of recognition for actuarial gains and losses.*

increases. At the balance sheet date the accumulated benefit obligation was £xm.

An alternative method of valuation would be on a solvency basis, often estimated using the cost of buying out benefits at the balance sheet date with a suitable insurer. This amount represents the amount that would be required to settle the scheme liabilities at the balance sheet date rather than the Group continuing to fund the on-going liabilities of the scheme. The Group estimates the amount required to settle the scheme's liabilities at the balance sheet date is £xm.

Illustration 5 - Funding obligations in relation to defined benefit schemes.
(Paragraph 17 to 23)

The most recently completed triennial actuarial valuation of the Group's main retirement benefits fund was performed by an independent actuary for the trustees of the scheme and was carried out as at 31 December 2004. Following the valuation the Group's ordinary contributions rate increased, with effect from 1 January 2005, from 12.9% of pensionable salaries to 13.4% representing regular contributions. In addition the Group contributed a further £8m to the scheme as a contribution towards the current deficit. The Group has agreed with the trustees it will aim to eliminate the deficit over the next 8 years. The Group will monitor funding levels on an annual basis. The next triennial valuation is due to be completed as at 31 December 2007. The Group considers that the contribution rates agreed with trustees at the last valuation date are sufficient to eliminate the deficit over the agreed period and that regular contributions, which are based on service costs, will not increase significantly.

The Group has agreed the following funding objectives with trustees:

1. To return the on-going funding level of the scheme to 100% of the projected past service liabilities within a period of 8 years measured in accordance with FRS 17;

2. Once the funding level of the scheme is 100% of the projected past service liabilities to maintain funding at least at this level; and

3. To meet the liabilities of the scheme in the event that the scheme is wound up.

The following overview comprises amounts paid to defined benefits schemes in the past two years and expected future payments for a ten year period:

	Total	*UK schemes*	*Foreign Schemes*
Contributions paid			
2004	29	19	10
2005	43	32	11
Contributions expected to be paid			
2006	46	35	11
2007	50	37	13
2008	51	38	13
2009	54	40	14
2010	55	41	14
2011	57	42	15
2012	59	43	16
2013	51	35	16

The Group estimates the present value of the duration of UK scheme liabilities on average fall due over Y years and foreign schemes over X years.

Illustration 6 – Risks and rewards arising from the assets
(Paragraphs 24 to 26)

At 31 December 2006 the scheme assets were invested in a diversified portfolio that consisted primarily of equity and debt securities. The fair value of the scheme assets as a percent of total scheme assets and target allocations are set out below:

	Planned 2007	**2006**	**2005**
(as a percentage of total scheme assets)			
Equity securities	60	62	65
Debt	25	22	19
Property	10	9	12
Other	5	7	4

In conjunction with the trustees the Group has recently conducted an asset-liability review for its major schemes. These studies are used to assist the trustees and the Group to determine the optimal long-term asset allocation with regard to the structure of liabilities within the scheme. The results of the study are used to assist the trustees in managing the volatility in the underlying investment performance and risk of a significant increase in the scheme deficit by providing information used to determine the pension schemes investment strategy.

The majority of the equities held by the scheme are in international blue chip entities. The aim is to hold a globally diversified portfolio of equities, with a target of 60% of equities being held in UK and Europe, 30% in US equities and the remainder in emerging markets. To maintain a wide range of diversification and to improve return opportunities, up to approximately 15% of equity assets are allocated to high risk markets such as Private Equity.

APPENDIX A: THE DEVELOPMENT OF THE EXPOSURE DRAFT

This development of the Exposure Draft accompanies, but is not part of, the proposed amendment to FRS 17 or the draft Reporting Statement.

Introduction

A1 This development of the Exposure Draft summarises the Accounting Standards Board's (ASB) considerations in reaching the conclusions in this Exposure Draft. The Exposure Draft proposes an amendment to FRS 17 'Retirement Benefits' and a draft Reporting Statement for 'Retirement Benefits - Disclosures'.

Background

A2 The Accounting Standards Board (ASB) published Financial Reporting Standard (FRS) 17 'Retirement Benefits' in November 2000, although its requirements have only become mandatory in full for accounting periods beginning on or after 1 January 2005.

A3 Following the implementation of FRS 17 a number of comments concerning the accounting for pensions have arisen. In particular, there has been a general concern that financial statements do not include sufficient information to allow users of the financial statements to obtain a clear view of the risks and rewards arising from defined benefit schemes.

A4 In addition the UK legal and regulatory environment for company pension schemes has changed significantly. Regulatory changes arising from the Pensions Act 2004 include the following:

- establishment of The Pensions Regulator (TPR), a new regulator with significant new powers;

- the establishment of the Pension Protection Fund (PPF) to pay compensation to members of eligible defined benefits schemes where there is a qualifying insolvency event in relation to the employer; and

- a new statutory obligation on solvent companies to meet their pension obligations.

A5 These changes could not have been anticipated when FRS 17 was developed and may have an effect on the relevant financial reporting.

A6 On 14 October 2005 the ASB announced a research project into the financial reporting of pensions. The project is wide ranging and is reconsidering the fundamental principles of accounting for retirement benefits. The ASB aims to issue a Discussion Paper outlining its findings by the end of 2006.

A7 In December 2005 the Financial Reporting Council (FRC) published its Regulatory Strategy (version 2) and its Plan & Budget 2006/07. As part of its objective to promote high quality corporate reporting, the FRC undertook to review best practice for the disclosure of pension liabilities by UK companies in the context of the regulatory regime for UK pension schemes.

A8 In view of comments received following the implementation of FRS 17 the ASB decided to undertake a review of disclosures for defined benefit schemes as set out in FRS 17. The review is distinct from the wider research project and has had a narrow focus on how disclosures for defined benefit schemes can be improved in the short-term giving particular consideration to the changes made in the UK regulatory regime.

Approach to the review

A9 To assist in its research project the ASB has formed a Pensions Advisory Panel in the UK, with members who can provide a variety of expert perspectives on pensions accounting, including those of actuaries, auditors, the preparers and users of financial statements and regulators. In addition the research project is supported by a Working Group from the European Financial Reporting Advisory Group (EFRAG). The role of the Panel and the Working Group is to ensure that a number of knowledgeable points of view are fully considered. The ASB wished to progress the short-term project as quickly as possibly and considered the Panel and the Working Group would provide a unique resource to assist the ASB in its short-term review. The Panel and Working Group agreed to assist the ASB in its short-term project. The ASB would like to thank the members of the Panel and Working Group for their contribution to the proposals set out in the Exposure Draft.

A10 Following research on possible improvements to disclosures for defined benefit schemes a number of recommendations were made to the ASB for its consideration. The Accounting Standards Board then considered how the Panel's recommendations could be implemented within the context of existing UK Financial Reporting Standards.

A11 The proposals set out in this Exposure Draft replace the existing disclosure requirements for defined benefit schemes set out in FRS 17 with those of IAS 19 'Employee Benefits.' In addition the Exposure Draft is proposing that additional disclosure recommendations, beyond the requirements set out in IAS 19, should be set out in a Reporting Statement.

A12 In making its proposals in the Exposure Draft the ASB is conscious that any additional disclosure requirements, beyond those set out in draft FRS 17, should address the needs of users whilst not being cumbersome to preparers. The Board is of the view that a Reporting Statement which sets out principles for disclosure, rather than specific requirements, allows entities the flexibility to provide disclosures that are appropriate to their exposure to risks arising from defined benefit schemes.

Summary of recommendations

Amendment to FRS 17 – 'Retirement Benefits'

A13 This Exposure Draft proposes to amend FRS 17 by replacing the existing disclosure requirements set out in the FRS with those of IAS 19 'Employee Benefits'. In making this decision the ASB has taken into account that, in December 2004, the IASB amended the disclosure requirements of IAS 19 'Employee Benefits', following a review of national standards on accounting for post-employment benefits. The ASB considers that, as part of its convergence programme of UK accounting standards with International Financial Reporting Standards (IFRS), it can converge the disclosure requirements set out in FRS 17 with those of IAS 19 and in doing so address some of the concerns expressed by commentators.

A14 The disclosures which will no longer be required on adoption of the proposed amendment to FRS 17 include:

- the date of the most recent full actuarial valuation and if the actuary is an employee or officer of the company;
- the effects of changes in the demographic and financial assumptions underlying the present value of the scheme liabilities;
- the financial assumptions at the beginning of the period; and
- an analysis of reserves in the notes to the financial statements distinguishing the amount relating to the defined benefit asset or liability net of the related deferred tax.

The ASB does not consider that the loss of these disclosures would seriously impede the needs of the users of financial statements.

A15 The ASB, however, decided that the disclosure required for closed schemes and those in which the age profile of the active membership is rising significantly, and the fact that under the projected unit method the current service cost will increase as the members of the scheme approach retirement would still provide useful information to users of financial statements. The ASB has decided to include this disclosure in its draft Reporting Statement.

A16 In accordance with draft FRS 17 an entity will no longer be required to disclose, for the accounting period and previous four periods, the difference between the expected and actual return on assets. In contrast, IAS 19 requires for the current annual period and previous four annual periods the present value of scheme liabilities, the fair value of the scheme assets and surplus or deficit arising in the scheme; and experience adjustments arising on the assets of the scheme expressed either as: (1) an amount; or (2) a percentage of the scheme assets at the balance sheet date. The ASB considers that the alternative information provided by draft FRS 17 provides a suitable alternative disclosure.

A17 The ASB notes that some commentators have raised the issue of disclosure of guarantees. The UITF included the following paragraph in its Information Sheet 69, published 25 November 2004:

Disclosure of the rights of pension fund trustees to 'call' a pension fund deficit

The UITF has considered a question on whether rights of pension fund trustees to 'call' a pension fund deficit should be disclosed in a sponsoring entity's accounts. The UITF noted that there could be situations, including a change in control of the sponsor, in which trustees have contingent rights to required revised contributions from the sponsoring entity. In certain circumstances this might give rise to a greater liability than the amount recorded in the balance sheet calculated in accordance with FRS 17 'Retirement Benefits'.

The UITF noted that FRS 17 requires any agreed contribution rates for future years to be disclosed and FRS 12 'Provisions, Contingent Liabilities and Contingent Assets' requires contingent liabilities to be disclosed, unless the possibility of a transfer of economic benefits is remote. If required by FRS 12, an entity should therefore disclose contingent liabilities arising from retirement benefit schemes. In the light of these requirements the UITF decided not to develop an Abstract.

A18 Paragraph 82 of the draft FRS 17 requires an entity to disclose information about contingent liabilities arising from retirement benefit obligations in accordance with FRS 12 'Provisions, Contingent Liabilities and Contingent Assets'. Similarly paragraph 94 of FRS 12 requires the nature of contingent assets, where an inflow of the economic benefits is probable, to be disclosed. In accordance with the provisions of FRS 12 an entity should therefore disclose contingent assets and contingent liabilities arising from retirement benefit schemes, including guarantees.

Reporting Statement

A19 The Exposure Draft also proposes a new Reporting Statement. The Reporting Statement is a formulation of best practice and is intended to have persuasive rather than mandatory force. It is applicable to all entities who have defined benefit schemes.

A20 The draft Reporting Statement recommends that the directors provide disclosures in the notes to the financial statements that complement the disclosures set out in draft FRS 17. The extent of the disclosures required depends on the significance of the entity's defined benefits schemes and its exposure to risks and rewards arising from those schemes.

A21 The objective of the draft Reporting Statement is to provide the users of financial statements with information, in addition to the disclosure required by draft FRS 17, which enables them to evaluate the risks and rewards arising from defined benefit schemes including the funding requirements placed on the entity by those schemes.

A22 The draft Reporting Statement proposes that the directors should disclose information that enables users of financial statements to understand the relationship between the entity (employer) and trustees (managers) of the defined benefit scheme. This information would allow users of financial statements to understand the extent to which an entity is able to influence arrangements with the scheme.

A23 In making this proposal the ASB is conscious of the importance of the independent role of trustees (managers) for many defined benefit schemes and how the extent of this independence might vary between individual schemes and between schemes in different legal jurisdictions. The ASB considers that the relationship between the trustees (managers) of defined benefit schemes and the reporting entity affects how an entity is able to manage its affairs with regard to the defined benefit scheme and that users of financial statements would benefit from having a greater understanding of this relationship.

A24 A particular concern highlighted by commentators in relation to FRS 17 is the absence of the requirement to disclose mortality rates used to calculate scheme liabilities. IAS 19 requires the principal assumptions of the scheme to be disclosed (and therefore requires disclosure of mortality rates where it is considered to be a principal assumption) whereas FRS 17 requires only the principal financial assumptions to be disclosed. The ASB considered whether to specify in the proposed amendment to FRS 17 the requirement to disclose mortality rates but took the view that this would not be consistent with its policy of convergence as it would require IFRS text to be amended. The ASB therefore proposes that the draft Reporting Statement should specifically recommend that mortality rates should be disclosed. As a consequence draft FRS 17 requires disclosure where mortality rates are considered to be a principal assumption and the draft Reporting Statement recommends information about the principal assumptions used to measure scheme liabilities including mortality rates be disclosed.

A25 The ASB also considered how mortality rates should be disclosed. The draft Reporting Statement recommends that the assumption disclosed includes the number of years post retirement (mortality rate) it is anticipated pensions will be paid to members of the scheme. The ASB considers disclosure of the number of years will provide more useful information to users of financial statements than details of a mortality standard table used, which may require a user to undertake further research to determine the actual number of years.

A26 The measurement of scheme liabilities is inherently uncertain and based on assumptions selected by the entity's (managers) directors. At present neither FRS 17 nor IAS 19 require a sensitivity analysis. Some commentators have, however, suggested such an analysis is required to allow users of financial statements to understand how the measurement of scheme liabilities is affected by the assumptions selected. In contrast other commentators propose that greater information should be provided about the defined benefit scheme to allow users to undertake their own sensitivity analysis.

A27 The ASB considered these two views and concluded that a sensitivity analysis prepared by the reporting entity would provide more reliable information than an external user of the financial statements could prepare. The draft Reporting Statement therefore recommends that the financial statements include a sensitivity analysis for the principal assumptions used to measure the scheme liabilities.

A28 The draft Reporting Statement recommends that the financial statements should disclose information that enables users to understand the nature of the liabilities arising from defined benefit schemes. In making this recommendation the ASB notes that FRS 17 requires the scheme liabilities to be measured on an actuarial basis using the projected unit method. There are, however, alternative approaches to the measurement of defined benefit scheme liabilities*.

A29 One alternative approach is the buy-out cost with a suitable insurance entity for the scheme liabilities at the balance sheet date. In the UK the Occupational Pension Schemes (Employer Debt) Regulations 2005 (SI 2005/678) confirm that from 6 April 2005 the debt on the employer on winding-up of a pension scheme will be determined on a full buy-out basis. In view of this fact, and that the actuarial profession requires an actuary to disclose the amount estimated on a buy-out basis in the actuarial report, the ASB gave consideration as to whether disclosure of the buy-out cost should be disclosed in the reporting entity's financial statements.

A30 The ASB considered a number of points of view on this possible disclosure. Those that support the disclosure of the buy-out cost identified the following reasons for disclosure:

- it identifies what the pension obligation would be were the entity to decide to settle its pension obligation, rather than fund the scheme on an ongoing basis; and

- as the information is to be made available in the actuarial report it would be sensible to include the amount calculated on a buy-out basis in the financial statements and avoid estimates being made.

A31 Those that did not support the disclosure noted:

- that the disclosure of a buy-out cost is not consistent with the going-concern concept. These commentators argue that the buy-out cost is a measurement of the amount required to settle the scheme liabilities rather

---

* *The measurement of defined benefit scheme liabilities is discussed in paragraphs 11 to 22 of The Development of the FRS to FRS 17 'Retirement Benefits'.*

than to continue the defined benefit scheme on an ongoing basis;

- the buy-out cost may not be easily available for non-UK schemes. This would result in additional costs being incurred which out-weigh the benefit of disclosure; and

- the amount is merely an estimate and an active market does not exist for these obligations.

A32 The ASB considers that with the improved disclosures proposed in this Exposure Draft a user of financial statements may be able to estimate the buy-out cost. The ASB were concerned that this could give rise to a number of estimates being made that may be inaccurate. The ASB therefore decided to recommend disclosure of the buy-out cost in the draft Reporting Statement but to specifically seek the views of constituents on whether this disclosure should be included in the final Reporting Statement.

A33 Draft FRS 17 requires an entity to disclose details of any contributions agreed to be paid in the next annual period to the defined benefit scheme. Scheme liabilities are, however, often of a long-term nature and contributions expected to be paid in the next annual period may not provide sufficient information to allow the users of the financial statements to understand how the funding requirements for scheme liabilities impact the economic resources available to the entity, including its cash-flow. The ASB, supported by the views of its Advisory Panel, believes that greater information regarding funding would allow users to evaluate how funding obligations impact an entity's economic resources.

A34 In proposing that greater information should be provided regarding funding obligations the ASB has considered the regulations introduced in the UK setting out a new funding regime for defined benefit schemes. The new funding regime proposes a partnership approach between employers and trustees (managers) of defined benefit schemes. The ASB is of the view that users of financial statements would gain from a greater understanding of agreements reached between the trustees (managers) of defined benefit schemes and the reporting entity regarding not only agreed contributions but also funding principles.

A35 The ASB gave consideration to the number of defined benefit schemes that are, at present, in deficit. Some entities have entered into agreements with the trustees (managers) of the defined benefit scheme to make additional ('special') contributions to the scheme in order to reduce the current level of deficit. These 'special' contributions are often separate from 'regular' contributions and are to be made over a specified period of years. The ASB considers that disclosure of both 'regular' and 'special' contributions would provide the users of financial statements with information about how an entity's cash flows are affected by 'regular' and 'special' contributions.

A36 In addition to understanding agreed contribution levels for defined benefit schemes, it has been noted by some commentators that it is important also to understand how long on average the liabilities of retirement benefit scheme mature. The draft Reporting Statement proposes that the financial statements should disclose the duration of the scheme liabilities.

A37 As noted previously, in developing the proposals in the Exposure Draft the ASB has considered new regulations in the UK. The Pensions Act 2004 established the Pension Protection Fund (PPF). The PPF has been formed principally to pay compensation to members of defined benefit schemes, following an insolvency event of the sponsoring employer where there are insufficient assets to pay benefits at the PPF compensation level. The compensation payments are funded partly by the assets transferred to the PPF from the scheme in question and partly from an annual levy on other pension schemes. Although some commentators have suggested that the financial statements should disclose the amount of the PPF levy placed on the defined benefit scheme, the ASB formed the view that the PPF levy was similar to other expenses of a defined benefit scheme, which did not require separate disclosure, and therefore could find no specific reason to require disclosure of this expense.

A38 The ASB has also considered the new statutory regime in the UK for funding defined benefit schemes, including whether the financial statements should disclose certain "triggers" that the Pensions Regulator proposes to introduce for monitoring the funding of defined benefit schemes. One of the factors the Pension Regulator proposes to use to monitor scheme funding is the amount of compensation that the Pension Protection Fund would be required to pay in the event of the sponsoring employer becoming insolvent. The ASB has given due consideration to the benefit of this disclosure but takes the view that the level of compensation payable in the event of insolvency is a matter between the members of the scheme and the scheme itself. The ASB noted that the amount of compensation payable in the event of insolvency does not represent a liability of the reporting entity and therefore the ASB is not proposing disclosure of this amount.

A39 In setting out the recommendations in the draft Reporting Statement the ASB notes that draft FRS 17 requires scheme assets to be analysed only by class of asset. This classification does not enable users to evaluate the risks arising from financial instruments that might be held by the scheme. The draft Reporting Statement therefore recommends that the financial statements disclose information that enables users of financial statements to evaluate the nature and extent of the risks arising from the assets held by the defined benefits scheme. In making this recommendation the ASB took into consideration the growing trend of 'Liability Driven Investment' which aims to reduce the risk by focusing on the significant risks and narrowing the range of possible outcomes, using financial instruments.

ISBN 1-84140-810-7

9 781841 408101

UP/ASBD-BI6291

Further copies. £5.00 post-free, can be obtained from:

FRC Publications

145 London Road

Kingston Upon Thames

Surrey KT2 6SR

Telephone: 020 8247 1264

Fax: 020 8247 1124

OR ORDERED ONLINE AT: www.frcpublications.com