REPORTING STATEMENT

REPORTING STATEMENT:

RETIREMENT BENEFITS - DISCLOSURES

ACCOUNTING
STANDARDS
BOARD

This Reporting Statement is designed as a formulation and development of best practice; it is intended to have persuasive rather than mandatory force and is not an accounting or reporting standard.

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REPORTING STATEMENT: RETIREMENT BENEFITS – DISCLOSURES

INTRODUCTION

1. This document sets out a Reporting Statement 'Retirement Benefits – Disclosures'. The Reporting Statement builds on Financial Reporting Standard (FRS) 17 'Retirement Benefits' (as amended in December 2006) and sets out additional disclosures that complement the disclosure requirements of FRS 17. It is a best practice guide and is not mandatory.

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 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. In May 2006 the ASB issued for comment a Financial Reporting Exposure Draft (FRED) of a proposed amendment to FRS 17 and a draft Reporting Statement 'Retirement Benefits – Disclosures'. In finalising this document the ASB has taken into consideration the comments received in respect to the FRED.

4. The ASB considered the amended FRS 17 addressed many, but not all, of the concerns of commentators and so decided to develop the Reporting Statement. As the amendment to FRS 17 replaced the disclosure requirements set out in the previous version of FRS 17

with those of International Accounting Standards (IAS) 19 'Employee Benefits' the ASB noted the Reporting Statement can be applied by entities adopting either UK or International Financial Reporting Standards (IFRS).

5. The ASB was conscious that any additional disclosure requirements, beyond those set out in the amended FRS 17, should address the needs of users whilst not being cumbersome to preparers. 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

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

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

c. The 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 the principal assumptions used to measure the scheme liabilities;

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

   v the future funding obligations in relation to the defined benefit scheme; and

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

d. The principles set out in the Reporting Statement aim to assist the users of financial statements in understanding the risks and rewards, and funding obligations, arising from defined benefit schemes.

REPORTING STATEMENT: 'RETIREMENT BENEFITS – DISCLOSURES'

OBJECTIVE

1. The objective of this Reporting Statement is to recommend 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 a defined benefit scheme are clearly identified.

SCOPE

2. This 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 Reporting Statement:

   Accumulated Benefits Obligation – the liability calculated on the projected unit method as defined in FRS 17 'Retirement Benefits' where no allowance is made for projected earnings.

Cost of buying out scheme benefits – this cost is based on an actual insolvency amount where this is available, or estimated using a suitable method based on the guidance contained in Guidance Note 9 'Funding Defined Benefits – Presentation of Actuarial Advice' adopted by the Board of Actuarial Standards.

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.

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. FRS 17* 'Retirement Benefits', paragraph 76 (IAS 19 'Employee Benefits' paragraph 120), requires an employer to disclose information that enables users of financial statements to evaluate the nature of its 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

* *As amended December 2006.*

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 explain significant and unusual powers that have been granted to the trustees (managers) of the scheme that could have a material financial effect on the reporting entity.

8. **The financial statements should include sufficient information about the principal assumptions the entity has 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 FRS 17 (or IAS 19), mortality rates.**

9. FRS 17 paragraph 77(m) (IAS 19 paragraph 120A(n)) requires the entity to disclose the principal actuarial assumptions used as at the balance sheet date. This Reporting Statement recommends, where otherwise not required, that the assumptions disclosed include mortality rates.

10. Information provided in the financial statements should communicate in a clear and effective manner the number of years post retirement it is anticipated pensions will be paid to members of the defined benefit scheme. Where

the number of years assumed differs depending on geographical, demographical or other significant reasons, the different mortality rates should be separately disclosed.

11. Where it is anticipated a change in mortality rates could have a material effect on the measurement of the scheme liabilities a sensitivity analysis, as recommended by paragraph 12 of this Reporting Statement, should be provided.

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 the balance sheet date.**

    For the purposes of this disclosure, all other assumptions should 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 changes in the assumptions could affect the measurement of scheme liabilities.

14. Where an entity chooses not to provide a sensitivity analysis, it may decide to provide alternative disclosures that provide greater information about the nature of scheme liabilities. Such information may include an analysis of liabilities between pensioners, deferred pensioners and employed members.

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

16. FRS 17 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*.

17. One such alternative approach is the cost of buying out benefits. In certain jurisdictions this amount may be disclosed to trustees (managers) and/or members of defined benefit schemes. Where the cost of buying out benefits is made available to trustees (managers) and/or members of defined benefit schemes it is recommended that the financial statements also disclose the cost of buying out benefits.

18. Another alternative approach for measuring defined benefit scheme liabilities is the accumulated benefits obligation (ABO). The ABO is similar to measuring defined benefit scheme liabilities using the projected unit method but does not take into consideration future salary increases. An entity may consider it useful to disclose the ABO when explaining how scheme liabilities are measured.

19. **The financial statements should disclose information that enables the users of financial statements to understand the funding obligations**

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* *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'.*

(estimated where applicable) that the entity has in relation to defined benefit schemes.

20. FRS 17 paragraph 77(p) (IAS 19 paragraph 120A(q)) 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 accounting 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 accounting 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.

21. The financial statements should disclose rates or amounts 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.

22. The funding requirements for defined benefit schemes are often regulated by legislation. An entity may be required or may choose to agree principles for funding scheme liabilities with the trustees (managers) of the scheme. The financial statements should disclose the funding principles the entity has agreed or operates with regard to defined benefit schemes.

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

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* *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.*

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.

24. 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. A measure of this is the duration of scheme liabilities, which should be disclosed in the financial statements.

25. The duration of the scheme's liabilities may not alone provide users with information as to how the cash flows of defined benefit schemes fall due. In addition to the duration of liabilities, the financial statements should disclose information that allows users to understand the projected cash flows of defined benefit schemes. This information might usefully be presented in graphical form.

26. **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 financial instruments held by defined benefit schemes at the balance sheet date.**

27. For each type of risk arising from financial instruments held by defined benefit schemes, an entity may 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.

28. An entity may disclose a sensitivity analysis, such as value-at-risk, for types of risks to which the defined benefit scheme is 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.

29. FRS 17 paragraph 77(i) (IAS 19 paragraph 120A(j)) 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. It is recommended that this disclosure includes the expected rate of return assumed for each major category of scheme assets for the period presented.

30. 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.

ILLUSTRATIVE EXAMPLES OF 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 Reporting Statement. The disclosures provided should supplement those disclosures provided in accordance with FRS 17 and IAS 19.

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 have been granted the power to 'call' for additional contributions in the event of certain circumstances. The circumstances in which the trustees can exercise this power include a disposal that accounts for more than 15% of the net assets, as reported in the consolidated Balance Sheet or when the funding position of the scheme falls below 65% of the scheme liabilities.

* *This disclosure is also provided in accordance with FRS 12 'Provisions, Contingent Liabilities and Contingent Assets' and IAS 37 'Provisions, Contingent Liabilities and Contingent Assets'.*

Illustration 2 – Disclosure of principal assumptions
(Paragraphs 8 to 11)

Principal actuarial assumptions at the balance sheet date:

	UK		USA	
	2006	*2005*	*2006*	*2005*
Discount rate at 31 December	5%	5.7%	5.25%	6.25%
Expected return on plan assets at 31 December	5.4%	7.0%	6%	7.5%
Future salary increases	5%	4%	4.5%	3.8%
Future pension increases	3%	2%	2.9%	3.0%
Proportion of employees opting for early retirement	30%	30%	25%	25%

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 assumed life expectations on retirement at age 65 are:

	UK		USA	
	2006	*2005*	*2006*	*2005*
Retiring today				
Males	20.1	20.1	19.5	19.5
Females	22.9	22.9	21.8	21.8
Retiring in 20 years				
Males	21.4	21.3	21.1	21.0
Females	24.1	24.0	23.0	23.0

Illustration 3 – Sensitivity analysis of the principal assumptions used to measure scheme liabilities
(Paragraphs 12 to 14)

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%	Increase/decrease by 9.5%
Rate of inflation	Increase/decrease by 0.5%	Increase/decrease by 5.5%
Rate of salary growth	Increase/decrease by 0.5%	Increase/decrease by 3%
Rate of mortality	Increase by 1 year	Increase by 4.5%

Illustration 4 – How the liabilities arising from defined benefit schemes are measured
(Paragraphs 15 to 18)

The Group provides retirement benefits to some of its former and approximately 60% of current employees through defined benefit schemes. 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 in which the scheme liabilities make allowance 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 increases. At the balance sheet date the accumulated benefit obligation was £xm.

An alternative method of valuation to the projected unit method is 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.

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

Illustration 5 – Future funding obligations in relation to defined benefit schemes
(Paragraph 19 to 25)

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 2005. Following the valuation the Group's ordinary contributions rate increased, with effect from 1 January 2006, 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 2008. 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 levels of contributions are based on the current service costs and the expected future cash flows of the defined benefit scheme. 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.

The benefits payable by the defined benefit scheme are expected to be paid as follows:

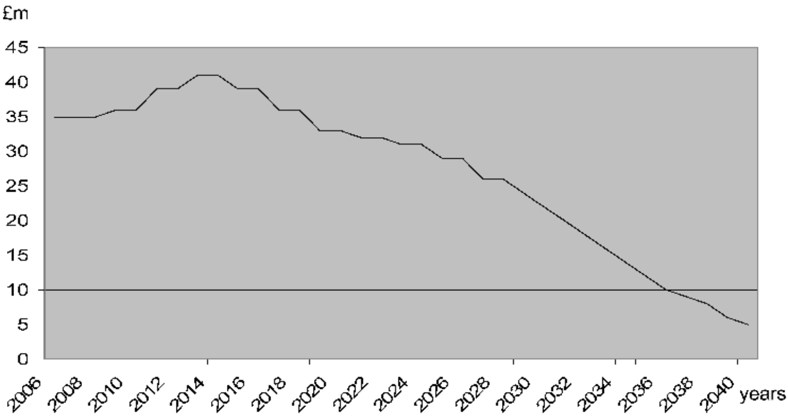

Illustration 6 – Nature and extent of the risks arising from financial instruments held by the defined benefit scheme

(Paragraphs 26 to 30)

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 percentage 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 and Emerging Markets.

APPENDIX A

THE DEVELOPMENT OF THE REPORTING STATEMENT

This development of the Reporting Statement accompanies, but is not part of the Reporting Statement.

Introduction

A1. This development of the Reporting Statement summarises the Accounting Standards Board's (ASB) considerations in reaching its conclusions in the Reporting Statement for 'Retirement Benefits - Disclosures'.

Background

A2. The 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 is 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 retirement benefit schemes has changed significantly since FRS 17 was published, which could not have been anticipated when FRS 17 was developed. 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. In 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 during 2007.

A6. 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.

A7. In view of comments received following the implementation of FRS 17 the ASB decided to undertake a review of disclosures for retirement benefit schemes as set out in FRS 17. The review was distinct from the wider research project and had a narrow focus on how disclosures for defined benefit schemes could be improved in the short-term giving particular consideration to the changes made in the UK regulatory regime.

Approach to the review

A8. To assist in its research project the ASB formed a Pensions Advisory Panel in the UK, with members who could provide a variety of expert perspectives on pensions accounting, including those of actuaries, regulators, auditors, the preparers and users of financial statements. 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 review of disclosures 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 review. The ASB would like to thank the members of the Panel and Working Group for their contribution to the Reporting Statement.

A9. Following research on possible improvements to disclosures for defined benefit schemes a number of recommendations were made to the ASB for consideration. The ASB then considered how these recommendations could be implemented within the context of existing UK Financial Reporting Standards.

A10. In May 2006 the ASB issued a Financial Reporting Exposure Draft (FRED) that proposed to replace the disclosure requirements set out in FRS 17 with those of IAS 19 'Employee Benefits.' In addition the FRED set out a draft Reporting Statement which proposed disclosures that would complement those disclosures required by the amended FRS 17.

A11. Respondents to the FRED were generally in agreement with its proposals to replace the disclosure requirements of FRS 17 with those of IAS 19. In December 2006 the ASB published an amendment to FRS 17. Respondents, however, expressed mixed views in relation to the proposals set out in the draft Reporting Statement. These views have been considered in developing the Reporting Statement.

Objective

A12. The objective of the Reporting Statement is to recommend disclosures that provide the users of financial statements with information, in addition to the disclosure required by the amended FRS 17 (or IAS 19), 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.

Scope of the Reporting Statement

A13. In reaching its decision to issue a Reporting Statement the ASB gave due consideration to the needs of users of financial statements. The ASB was also conscious that any additional disclosure requirements, that went beyond those set out in the amended FRS 17, should not be cumbersome to preparers. Some respondents to the FRED, however, questioned the ASB's decision to propose a Reporting Statement. The ASB decided it should set out clearly its considerations in deciding to propose a Reporting Statement.

A14. When the ASB decided to propose a Reporting Statement it considered that the needs of the users of UK financial statements had been influenced by changes in the UK regulatory environment. However, it noted UK quoted entities generally apply International Financial Reporting Standards (IFRS) and therefore an amendment to the disclosure requirements in FRS 17 alone may not address the needs of users. The ASB sought to find a solution which improved disclosures provided by UK entities whether the entity applied International or UK Financial Reporting Standards.

A15. The ASB noted, in January 2006, it had published a non-mandatory Reporting Statement: 'Operating and Financial Review' which is a formulation of best practice and is intended to have persuasive rather than mandatory force. The ASB considered it could achieve its objective of improving disclosures for defined benefit schemes by publishing a Reporting Statement that addressed the disclosure requirements for defined benefit schemes.

A16. In reaching its decision to publish a Reporting Statement the ASB gave due consideration to its strategy for convergence of UK Financial Reporting Standards with those of International Financial Reporting Standards. Although the ASB is still considering its convergence plan, it had previously stated*:

> *In general there is little case for UK accounting standards being more prescriptive than IFRS. However, the ASB will not, as a matter of policy, preclude the possibility of promulgating standards that go beyond IFRS where, in its judgement, the need for this is demonstrable.*

The ASB gave due consideration to this statement and decided that there was a clear demonstrable need to encourage improvements in the disclosure relating to defined benefit schemes.

A17. During its redeliberation of the proposals in the draft Reporting Statement, the ASB reconsidered its decision to propose a Reporting Statement. The ASB affirmed its decision, noting that the amendment to FRS 17 alone would not address the needs of users and that the Reporting Statement was complementary to the amendment made to FRS 17.

A18. Some respondents to the FRED expressed a concern that the role of the Reporting Statement was not clear. During its redeliberations the ASB noted that it had, in the past, issued not only the Reporting Statement – 'Operating and Financial Review' but it had also issued Statements on 'Interim Reports' and 'Preliminary Announcements'. These statements all specified that they were designed as a formulation and development of best practice and are intended to have persuasive rather than mandatory force.

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* *Draft Policy Statement (2005) – Accounting Standard Setting in a Changing Environment: the Role of the Accounting Standards Board.*

A19. The ASB considers that the role of the Reporting Statement is that of a best practice guide. The ASB also reaffirmed its early 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.

Principles

Relationship between the entity and trustees (managers) of the defined benefit scheme

A20. The draft Reporting Statement proposed that the directors disclose information that enabled 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.

A21. In making this proposal the ASB was conscious of the importance of the independent role of trustees (managers) of 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 consider 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.

A22. A number of respondents were concerned that the proposals as set out in the draft Reporting Statement would lead to cumbersome disclosures that were complex and difficult to understand. These respondents considered that the level of complexity could lead to 'boilerplate' disclosures that provided very little information to the users of financial statements.

A23. Some respondents, however, accepted there was a need for greater disclosures regarding the relationship between the entity and trustees (managers) and considered the disclosures recommended in the draft Reporting Statement should focus on any 'out-of-the ordinary' powers of, or constraints on the trustees, or schemes for which the trustees' position differs significantly from that for other UK schemes.

A24. The ASB considered the alternative views of respondents. The ASB, however, retained its view that there was a need for financial statements to provide information that assisted a user to understand the relationship between the entity and the trustees (managers) of the scheme but agreed that the wording in the Reporting Statement should make clear that disclosure should address powers that were both significant and unusual in relation to the legal and regulatory framework to which the entity operated. It also noted that disclosure was only recommended where these powers could have a material financial affect on the reporting entity.

Principal assumptions used to measure scheme liabilities

A25. A particular concern highlighted by commentators in relation to the previous FRS 17 was the absence of the requirement to disclose mortality rates used to calculate scheme liabilities. In developing the FRED, issued in May 2006, the ASB noted that IAS 19 requires the principal actuarial 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 required only the principal financial assumptions to be disclosed. In the FRED the ASB decided, consistent with its policy of convergence, not to amend the text of IAS 19 (as adopted into FRS 17) to specify the disclosure of mortality rates but to recommend in the draft Reporting Statement that mortality rates be disclosed.

A26. Respondents to the FRED were generally in agreement with the proposal to disclose mortality rates. A number of respondents did, however, question the illustrative example set out in the draft Reporting Statement. Those that questioned the illustrative example noted that the example was not consistent with the recommendation in the draft Reporting Statement. The ASB thereby amended the illustrative example in the Reporting Statement.

A27. The ASB, in amending the illustrative example in the Reporting Statement, also took into consideration the views of some respondents that too much emphasis was placed on the disclosure of mortality rates and that other assumptions may be significant.

A28. In addition, some respondents asked for greater clarification as to how disclosures for mortality rates should be set out in the financial statements. In view of respondents' comments, the ASB considered whether it should provide more prescriptive guidance than that set out in the draft Reporting Statement.

A29. In considering whether to provide more prescriptive guidance for the disclosure of mortality rates the ASB took into consideration the report issued by the Financial Reporting Review Panel which noted the inconsistency in disclosure of mortality rates gave rise to a lack of comparability between reporting entities.

A30. The ASB was also mindful of the ongoing research project into pension accounting and considered it should not provide prescriptive guidance while the research work was ongoing. The ASB did, however, reiterate its earlier view that disclosure of the number of years post retirement (mortality rate) it is anticipated pensions will be paid to members of the scheme would provide more useful information to users of financial statements than details of a mortality standard table used, or details of a cohort factor, which may require a user to undertake further research to determine the actual number of years.

A31. The ASB also noted that the 'Statement of Principles for Financial Reporting' notes that good presentation ensures that the essential messages of the financial statements are communicated clearly and effectively in a simple and straightforward manner as is possible.

A32. The draft Reporting Statement also carried forward as a recommendation a requirement from the previous FRS 17 that 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 costs will increase as the members of the scheme approach retirement. The ASB took into consideration the views from respondents who considered the disclosure was misleading. In view of the comments received the ASB decided to remove the recommendation from the Reporting Statement.

Sensitivity analysis of the principal assumptions used to measure scheme liabilities

A33. In developing the draft Reporting Statement the ASB had taken into consideration that the measurement of scheme liabilities is inherently uncertain and based on assumptions selected by the entity's managers (directors). The ASB also noted that neither the previous FRS 17 nor IAS 19 required a sensitivity analysis that disclosed the effect that changes in assumptions made to the measurement of scheme liabilities. The ASB decided to recommend in the draft Reporting Statement that the financial statements include a sensitivity analysis for the principal assumptions used to measure the scheme liabilities.

A34. In forming this view the ASB gave due consideration to the views of some commentators that greater information should be provided about the defined benefit scheme to allow users to undertake their own sensitivity analysis, whilst others considered that the reporting entity should prepare the sensitivity analysis. 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.

A35. Although respondents to this recommendation noted the benefit of the disclosure, some expressed a concern regarding the additional costs incurred in the preparation of the sensitivity analysis. They noted the additional costs might outweigh the benefits of disclosure.

A36. The ASB considered this concern but noted that the Reporting Statement is a best practice statement and is not mandatory. The ASB considered therefore the reporting entity should decide whether on cost/benefit or other grounds to include such an analysis. The ASB also considered that where an entity decided not to include a sensitivity analysis it could provide alternative disclosures that enable users to understand scheme liabilities.

How the liabilities arising from defined benefit schemes are measured

A37. The draft Reporting Statement recommends that the financial statements should disclose information that enable users to understand the nature of the liabilities arising from defined benefit schemes. In making this recommendation the ASB noted that FRS 17 requires scheme liabilities to be measured using the projected unit method. There are, however, alternative approaches to the measurement of defined benefit scheme liabilities*.

A38. In the draft Reporting Statement it was noted one alternative approach was the cost of buying out benefits with a suitable insurance entity at the balance sheet date.

A39. In setting out its proposals in the draft Reporting Statement the ASB considered a number of points of view on this disclosure. The ASB, noted that with the improved disclosures proposed in the draft Reporting Statement, users of financial statements may be able to estimate the

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* *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'.*

cost of buying out scheme benefits with a suitable insurance entity at the Balance Sheet date. The ASB was 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 cost of buying out scheme liabilities 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.

A40. The majority of respondents to the draft Reporting Statement did not support the recommendation to disclose the cost of buying out scheme liabilities. The principal arguments put forward by these respondents were:

- users would misunderstand the disclosure, particularly regarding future funding requirements;

- this misunderstanding will lead to more scheme closures;

- there is limited actuarial guidance on how to calculate this amount – as a consequence the calculation is subjective;

- The Pension Regulator (TPR) had removed buy-out as a scheme trigger for funding regulations and therefore disclosure is inconsistent; and

- the insurance market is not sufficiently homogenous to assure reliable measurement.

These respondents supported the concerns the ASB had set out in The Development of the Draft Reporting Statement, namely:

- that the disclosure of a buy-out cost is not consistent with the going-concern concept;

- the buy-out cost may not be easily available for non-UK schemes; and

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

A41. During its redeliberation of this proposal the ASB noted that in the UK under the Occupational Pension Schemes (Employer Debt) Regulations 2005 (SI 2005/678), the debt on the employer on the winding up of a pension scheme will be determined on a full buy-out basis. In addition the ASB noted:

(i) S224 of Pensions Act 2004 requires that the trustees or managers obtain valuations:

   a. at intervals of not more than one year or, if they obtain actuarial reports for the intervening years, at intervals of not more than three years, and

   b. in such circumstances and on such other occasions as may be prescribed.

(ii) summary funding statements disclose the buy-out amount.

A42. The ASB considered the comment made by respondents that there was a lack of guidance on how to disclose the cost of buying out scheme liabilities. The ASB, however, noted that Guidance Note 9 'Funding Defined Benefits – Presentation of Actuarial Advice' as adopted by the Board of Actuarial Standards provided some guidance on how to calculate this amount. The Board therefore decided to specifically refer to the Guidance Note in the Reporting Statement.

A43. The ASB took into consideration the views of respondents very carefully but could find no justification that information made available to members of defined benefit schemes and/or trustees (managers of schemes), should not be made available to members (investors) of the entity. However the ASB noted the concern of respondents and decided to amend the recommendation in the draft Reporting Statement to only recommend disclosure where the cost of buying out benefits is made available to trustees (managers) and/or members of defined benefit schemes.

A44. In considering the comments from respondents regarding this disclosure the ASB noted that some commentators had highlighted that the illustrative example discussed the Accumulated Benefits Obligation (ABO) in addition to the amount that would be required to buy out benefits. Respondents had noted that it might be useful for users of financial statements to understand the effect on scheme liabilities arising from future salary growth assumptions but, that the Reporting Statement should define the terms and provide clarification that the term is a suitable alternative. The ASB agreed with respondents and amended the Reporting Statement accordingly.

Future funding obligations in relation to defined benefit schemes

A45. The amended FRS 17 requires an entity to disclose details of any contributions agreed to be paid in the next accounting 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 accounting 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. In developing its proposals in the draft Reporting Statement the ASB, supported by the views of its Advisory Panel, considered that greater information regarding funding would allow users to evaluate how funding obligations affect an entity's economic resources.

A46. In recommending that greater information be provided regarding funding obligations the ASB 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 formed 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.

A47. 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 considered 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.

A48. Respondents to the draft Reporting Statement were generally in agreement with the need for greater information requiring funding obligations but were concerned that funding requirements are reviewed regularly between the entity and the trustees (managers) of retirement benefit schemes. They therefore considered that detailed funding projections may be misleading and would not provide useful information to users of financial statements. The Board took the views of respondents into consideration and decided that details of funding obligations should be of a narrative nature.

A49. In addition to understanding agreed contribution levels for defined benefit schemes, it was noted by some commentators that it is important also to understand how long on average the liabilities of a retirement benefit scheme mature. The Reporting Statement recommends that the financial statements should disclose the duration of the scheme liabilities.

A50. The Reporting Statement also recommends that information should be provided with regard to how the liabilities of the defined benefit scheme fall due. Some respondents questioned this recommendation, arguing that these are the cash flows of the scheme and are separate from those of the reporting entity. Consequentially, they had no direct impact on the cash flows of the entity and should not therefore be disclosed in the reporting entity's financial statements. The ASB, however, considered that the cash flow information provided useful information to users of financial statements as it allowed users to understand the profile of cash flows including peak cash flows. The ASB therefore decided to retain the disclosure but agreed a graphical presentation of the information may be of more use to users of financial statements.

Nature and extent of the risks arising from financial instruments held by the defined benefit scheme

A51. FRS 17 as amended requires scheme assets to be analysed only by class of asset. This classification does not enable users to evaluate the risks arising from financial assets or liabilities that might be held by the scheme. The 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 financial assets or liabilities held by the defined benefits scheme.

A52. In making this recommendation the Board 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.

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