Quattro Pensions
CONSULTING ACTUARIES

news bulletin

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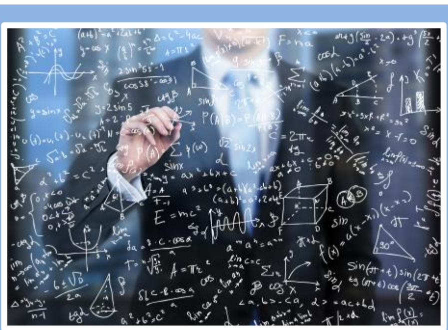

It's beginning to look a lot like… year end

As Christmas and the New Year approaches many companies will have an eye to their financial statements. We highlight some of this year's key issues for accounting for pension schemes.

Getting maximum mileage out of the discount rate

FRS102 and IAS19 require that the rate used to discount future payments should reflect market yields on high quality corporate bonds.

What constitutes a high quality corporate bond is subjective. FRS17 had specified that the discount rate should be set with reference to AA-rated corporate bond yields. Actuaries have typically continued this approach for consistency with prior years.

Now that the accounting standard gives more room for interpretation, there is a wider range of discount rates that may be appropriate.

As an example, it could be argued that A-rated or even BBB-rated corporate bonds are also high quality, given they are all considered "investment-grade" bonds. Referencing bonds with a lower credit rating, albeit still high quality, might allow for a higher discount rate assumption and a lower defined benefit obligation.

Review best estimate assumptions

Companies should check whether other assumptions continue to reflect a "best estimate" of cashflows. In particular, commutation and mortality assumptions may differ from those used in a funding valuation. Less important, and less often reviewed, assumptions such as proportion married may also help to shave the edges off the liabilities.

The impact of GMP equalisation

Trustees of contracted-out schemes are required to equalise benefits for the impact of unequal Guaranteed Minimum Pensions (GMPs) – see our November bulletin for more.

Some auditors are asking for company financial disclosures to include a reserve for GMP equalisation immediately. This could be treated in two ways:

- as a past service cost in the profit and loss account (P&L)
- as an actuarial loss in other comprehensive income (OCI)

In our opinion this is not a change in benefits – since GMP equalisation has been required in law since 1990 – and so we are not drawn to the past service cost approach. Companies should discuss the options with their auditors.

The amount of the reserve could lie anywhere between 0%-4% of liabilities, depending on scheme structure and profile. There are still uncertainties and it is likely to take some time for a method to be agreed.

Future changes to IAS19

The IASB has delayed plans to force sponsoring employers to account for liabilities on a full settlement basis under IAS19 if trustees have a right to wind up the scheme. It will carry out further work on the possible impact of this change before proposing amendments.

Plan amendments under IAS19

Company financial statements could become more volatile under IAS 19. Amendments are effective for annual periods **beginning on or after 1 January 2019.** Early adoption is permitted.

Past service costs relating to plan amendments, curtailments and settlements will be measured using updated assumptions at the date of the change. Previously, the assumptions could be fixed at the start of the financial period.

The current service cost and interest on the net liability must also be measured on the updated assumptions from the date of the change to the end of the period.

Using assumptions at the start of the year, a P&L charge might be:

Current service cost	(£100k)
Interest on net liability	(£400k)
Past service cost	(£200k)
Total P&L charge	**(£700k)**

If the discount rate had fallen by 0.5% and the plan amendment took place half way through the year, the P&L could change to:

Current service cost	(£105k)
Interest on net liability	(£401k)
Past service cost	(£220k)
Total P&L charge	**(£726k)**

The change in the effect of the asset ceiling that may result is recognised in OCI as before.

Companies wishing to minimise the impact on their P&L could include an estimate of the change expected in the defined benefit obligation at the prior year end. The amendment then passes through the OCI in that year, rather than the P&L in the year the change is made.

Please speak to your usual Quattro contact to find out more about the issues and how they may affect you.