



**DRAFT AMENDMENTS TO FRS 102 – MULTI-EMPLOYER DEFINED
BENEFIT PLANS (FRED 71)**

**RESPONSE FROM ICAS TO
THE FINANCIAL REPORTING COUNCIL**

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Background

ICAS is a professional body for more than 21,000 world class business men and women who work in the UK and in more than 100 countries around the world. Our members have all achieved the internationally recognised and respected CA qualification (Chartered Accountant). We are an educator, examiner, regulator, and thought leader.

Almost two thirds of our working membership work in business and in the not for profit sector; many leading some of the UK's and the world's great organisations. Others work in accountancy practices ranging from the Big Four in the City to the small practitioner in rural areas of the country.

We currently have around 3,000 students striving to become the next generation of CAs under the tutelage of our expert staff and members. We regulate our members and their firms. We represent our members on a wide range of issues in accountancy, finance and business and seek to influence policy in the UK and globally, always acting in the public interest.

ICAS was created by Royal Charter in 1854.

Introduction

ICAS welcomes the opportunity to comment on the Financial Reporting Council's (FRC's) proposed amendments to the Financial Reporting Standard applicable in the UK and Republic of Ireland (FRS 102) set out in Financial Reporting Exposure Draft (FRED) 71 on multi-employer defined benefit plans.

We believe that a change from Defined Contribution (DC) accounting to Defined Benefit (DB) accounting meets the FRS 102 criteria for a change in accounting policy rather than a change in accounting estimate as is proposed in FRED 71.

We view the approach taken in FRED 71 as a pragmatic solution which is intended to address a development in the social housing sector which means that Registered Social Landlords participating in the Social Housing Pension Scheme (SHPS) or the Scottish Housing Associations' Pension Scheme (SHAPS) will shortly have sufficient information for periods ending on 31 March 2018 and on 31 March 2019 to implement DB accounting for these schemes. If the FRC implements the amendments to FRS 102 as proposed in FRED 71, the amendments should be accompanied by a clear statement that the FRC has decided on this occasion to take a pragmatic approach rather than a principles-based approach.

There are other gaps in FRS 102's requirements around accounting by entities participating in multi-employer schemes. Most urgently will be clarification about the treatment of payments made under an agreed deficit recovery plan once the FRED 71 amendments are implemented. Should payments be accounted for through profit and loss or by adjusting the DB accounting liability? We address this point further in our detailed comments on the consultation questions.

Also, there are no requirements which deal with how to account for the following scenarios where:

- A cessation event has occurred and an exit payment agreed and therefore DB accounting is no longer appropriate; and
- A cessation event has occurred, meaning that DB accounting is no longer appropriate, but the scheme and employer are negotiating an exit payment.

We would welcome further consultation by the FRC, or its successor, on these other aspects of accounting.

We set out our comments on the consultation questions below.

Any enquiries should be addressed to Christine Scott, Head of Charities and Pensions, at cscott@icas.com.

Consultation questions

Question 1

Do you agree with the proposed amendments to FRS 102? If not, why not?

Answer

The proposed amendment represents a pragmatic rather than a principles-based approach to changing from DC to DB accounting. If the FRC decides to implement this approach the amendments should be accompanied by a clear statement that the FRC has decided on this occasion to take a pragmatic approach rather than a principles-based approach.

We are aware that it is a development in the social housing sector which has led to these proposed amendments and appreciate that it is important that Registered Social Landlords have a clear and consistent approach made available to them for changing from DC to DB accounting. We also recognise that there is support for this pragmatic approach including from our own members who are social housing sector specialists and acknowledge that the Housing SORP-setting body, consisting of the UK housing regulators, has recently issued guidance in line with the proposed amendments.

Change in accounting policy or change in accounting estimate?

While we support the FRC's responsiveness to the needs of the social housing sector, we are of the view that a change from DC to DB accounting meets FRS 102's criteria for a change in accounting policy. With this in mind, we are reluctant to give our wholehearted support to the proposed amendments which could create a precedent for future departures from FRS 102, Section 10 on accounting policies, estimates and errors.

We set out our reasoning for this in more detail below.

Changes in accounting estimate under FRS 102

The argument for a change in accounting estimate is that pension obligations are already recognised where there is an agreed schedule of contributions to fund a deficit and that the move from DC to DB accounting is merely a change in the way pension obligations are measured. However, not all entities impacted by the proposed amendment necessarily have an agreed deficit recovery plan and therefore may not currently recognise any pension-related obligations.

FRS 102.10.15 states that "When it is difficult to distinguish a change in an accounting policy from a change in an accounting estimate, the change is treated as a change in an accounting estimate".

Treatment as a change of accounting estimate requires the impact to be accounted for prospectively and is the default option, where it is difficult to distinguish between the two possible approaches, and this appears to be the approach which underpins the proposed amendments.

Basis for conclusions: FRED 71 and FRS 102

FRED 71's Basis for conclusions states in paragraph 14 that:

- "Paragraph B28.12 notes that *the measurement of the present value of the obligations under a defined benefit plan for funding purposes differs from the measurement for accounting purposes (i.e. defined benefit accounting), but they are different measurements of the same obligation, not separate obligations*. When a liability has been recognised for the present value of any contributions which arise from an agreement to fund a deficit, the change to defined benefit accounting can be seen as a change to an improved measurement basis, using more complete information, of the same underlying obligations".

[N.B. the words in italics are a direct lift from B28.12 from the Basis for conclusions accompanying FRS 102.]

The above wording from B28.12 is important as it explains why an entity should not recognise both its obligations under an agreed deficit recovery plan plus a DB obligation measured for accounting purposes only. However, what is being measured under each approach is not the same and the approaches are not inter-changeable under FRS 102. Taken with the possibility that where an entity does not have sufficient information to apply DB accounting and does not have an agreed deficit recovery plan, and therefore may not currently record any on balance sheet pension obligations, there is a strong case that a move from DC accounting to DB accounting is in fact a change of accounting policy.

FRED 71 refers to DB accounting as defined in Section 28 of FRS 102 as an improved measurement basis of an entity's DB obligations. However, it is possible for an entity participating in a multi-employer scheme to have pension obligations in a worst case scenario of 'nil' but where DB accounting under FRS 102 requires recognition of a material deficit. An illustrative example of this is set out in the following article on icas.com entitled "[When is a surplus a deficit?](#)". This weakens the claim in the basis for conclusions that DB accounting is an improved measure of the same thing as opposed to being a different thing.

Definition of accounting policies

FRS 102 defines accounting policies as the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements.

This is a shorter definition than the previous UK GAAP definition of FRS 18 on accounting policies:

"Those principles, bases, conventions, rules and practices applied by an entity that specify how the effects of transactions and other events are to be reflected in its financial statements through

- (i) recognising,
- (ii) selecting measurement bases for, and
- (iii) presenting

assets, liabilities, gains, losses and changes to shareholders' funds. Accounting policies do not include estimation techniques".

However, the concepts underpinning accounting policies remain the same.

Changes in accounting policy under FRS 102

When FRS 17 on retirement benefits was implemented, the recognition of net DB pension obligations was treated as a change in accounting policy. Implementation was undertaken over a three year period to enable entities with DB pension schemes to establish their opening position. Under FRS 102, the accounting requirements for net DB pension obligations and the concession for multi-employer schemes are, more or less, the same as under FRS 17.

The main difference is clarification under FRS 102 that, where the multi-employer concession is available, agreed deficit recovery plan liabilities should be recognised instead. Under old UK GAAP, recognition of agreed deficit recovery plan liabilities could have been considered a requirement under FRS 12 on provisions, contingencies and contingent assets but, given that there was a grey area, entities tended not to take this approach.

A change from DC accounting to DB accounting arises when the multi-employer concession is no longer available and given the similarities between FRS 17 and FRS 102 on accounting for net defined benefit liabilities as well as the approach taken by FRS 17 on implementation, we believe that a principles-based approach would be to treat a change from DC to DB accounting as a change in accounting policy.

FRS 102.10.8(a) states that "An entity shall change an accounting policy only if the change is required by an FRS". We believe that the change from DC to DB accounting is a change required by FRS 102.

The FRC's aims for financial reporting standards

With reference to the FRC's aims for providing succinct financial reporting standards, set out in paragraph 2 of FRED 71's basis for conclusions, we believe that treating a move from DC to DB accounting as a change in accounting policy is consistent with the statement that standards should:

- (a) have consistency with global accounting standards through the application of an IFRS-based solution unless an alternative clearly better meets the overriding objective;
- (b) balance improvement, through reflecting up-to-date thinking and developments in the way businesses operate and the transactions they undertake, with stability;
- (c) balance consistent principles for accounting by all UK and Republic of Ireland entities with proportionate and practical solutions, based on size, complexity, public interest and users' information needs;
- (d) promote efficiency within groups; and
- (e) are cost-effective to apply.

Treatment of deficit recovery plan payments when DB accounting is applied

Once an entity with an agreed deficit recovery plan moves from DC to DB accounting, the entity will nevertheless have to account for payments made to the pension scheme under the plan.

We have identified three possible options for this:

1. Scheduled payments are accounted for through profit and loss. Any impact of those payments on the entity's DB accounting obligation will be wrapped up in the accounting information provided by the scheme actuary at the next balance sheet date.
2. On-going employer contributions in relation to members participating in the DB element of the pension scheme are set at a level which is intended to reduce the entity's funding deficit in addition to funding benefits accrued during the accounting period. The element of on-going employer contributions relating to the funding deficit are accounted for through profit and loss. Any impact of those payments on the entity's DB accounting obligation will be wrapped up in the accounting information provided by the scheme actuary at the next balance sheet date.
3. Scheduled payments are deducted from the DB accounting obligation when they are made. Any actual impact of those payments on the entity's DB accounting obligation will be wrapped up in the accounting information provided by the scheme actuary at the next balance sheet date.

Options 1 and 2 impact on an entity's statement of financial performance and recognise the distinction between payments made to reduce an entity's funding deficit and the DB accounting obligation. With option 3 there is no impact on the entity's statement of financial performance and payments made to reduce a funding deficit are less transparent. Option 3 also gives the impression that the entity's funding deficit is the same as its DB accounting obligation. We contend that this is not the case, and it's clear from Section 28 of FRS 102 on employee benefits that these are not inter-changeable.

We believe this is an area of accounting which would benefit from clarification within FRS 102 at the same time as any amendments on how to account for a change from DC to DB accounting.

Timetable for implementing FRED 71 amendments to FRS 102

The proposed effective date for FRED 71 amendments is periods beginning on or after 1 January 2020. This means that entities likely to be impacted will likely have accounting period end dates of 31 December 2020 or 31 March 2021, if the amendments are not adopted early.

We understand that the social housing sector will have sufficient information about net defined benefit pension obligations for periods ending on 31 March 2018 and on 31 March 2019 which means that three years' worth of information will be available for periods ending on 31 March 2020. This would enable entities within this sector to adopt an approach which required a change from DC to DB accounting to be treated as a change in accounting policy within the proposed timescale. This approach would also meet the FRC's test that all entities within the same multi-employer scheme should take the same approach in their accounts.

Question 2

In relation to the Consultation stage impact assessment, do you have any comments on the costs and benefits identified? Please provide evidence in support of your views.

Answer

We agree with the consultation impact assessment to the extent that employers will now have clarity on how to move from DC accounting to DB accounting, when sufficient information becomes available to do so.

However, we do not understand the following comment:

“...the entity...will needto update its measurement of any schedule of contributions to fund a deficit to the date sufficient information became available”.

The change in accounting treatment will not impact on the amount due from an employer to the scheme under any schedule of contributions to fund a deficit. The change will merely change how the employer accounts for its pension-related obligations.

It may be that the impact assessment wording is ambiguous and, therefore, we would recommend revising the wording in the final impact assessment. Ultimately, the proposals will mean that obligations arising from any schedule of contributions to fund a deficit are eliminated from the employer's accounts when sufficient information on their net defined benefit obligations becomes available.