

# Current Issues in Pensions Financial Reporting

31 DECEMBER 2008

Barnett Waddingham

The key financial assumptions used in valuing liabilities under the Accounting Standards FRS17 (UK non-listed), IAS19 (EU listed) and FAS158 (US listed) are the discount rate and the rate of future inflation. 2008 has been a year of unprecedented movements in financial markets which has meant there are now a number of additional considerations for companies trying to set these assumptions and for auditors in determining whether the assumptions are appropriate. This note sets out some of the technical issues that those involved in the preparation and auditing of pensions disclosures should be aware of.

## Discount Rate

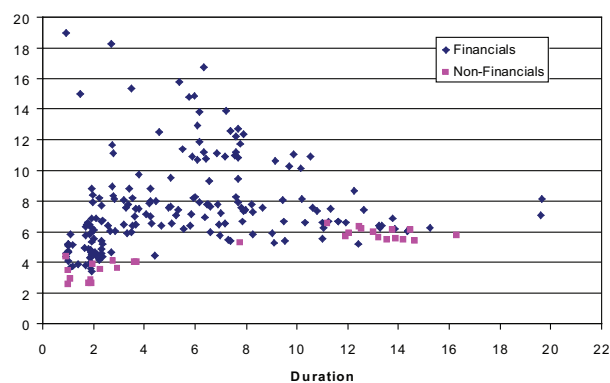
The table below shows some of the key market indices that could be used to derive the discount rate.

	31/12/2008	31/12/2007
Barclays Capital Sterling Non Gilts AA Over 15 years	6.45%	5.65%
ML Sterling Non Gilts AA Over 15 years	6.47%	5.90%
ML Sterling Corporates AA Over 15 years	6.60%	6.00%
iBoxx Sterling Corporates AA Over 15 years	6.71%	5.81%

The iBoxx index yield dropped to 6.43% on 2 January 2009, reflecting a change in the constituents of the index.

One of the features of the "credit crunch" is that the yield on AA bonds, particularly those issued by financial companies, will be much higher than as at 31 December 2007, as can be seen from the above table.

The graph below shows the individual yields on the bonds that made up the iBoxx AA Sterling Corporate Bond All Stocks Index as at 31 December 2008. This graph highlights the huge variation between the yields on individual bonds in general, and between bonds issued by financial and non-financial companies in particular.



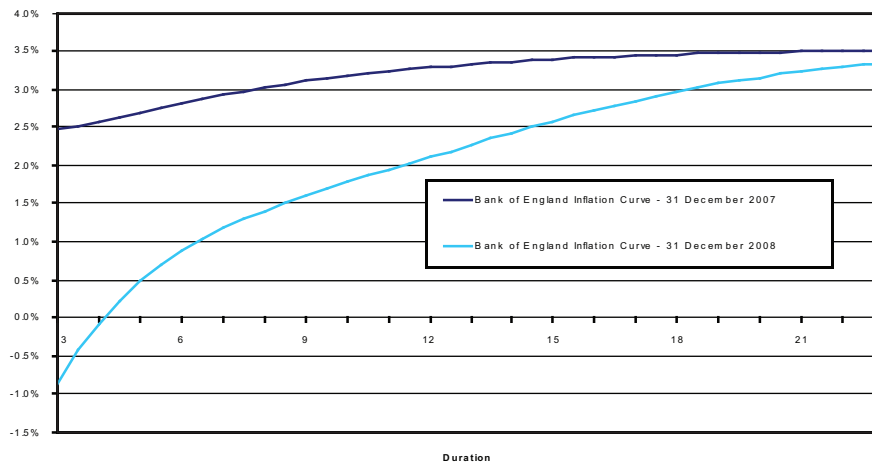
Other issues that should be noted when setting the discount rate include:

- The yield on AA bonds varies with term as can be seen on the graph above. Therefore, the duration of the pension scheme's liabilities should be considered when setting the discount rate. It is possible to consider a AA bond yield curve when setting the discount rate. However, care should be taken as these curves can be derived in a variety of different ways. The methodology chosen can result in big variations in the curve, and therefore also in the assumption adopted.
- AA bond indices can be based on either non-gilts or corporate bonds. The constituents will differ and so will the average yields. The difference was around 0.13% at 31 December 2008 on the Merrill Lynch indices.

## Inflation

The Bank of England's 20 year market implied inflation figure was 3.16% as at 31 December 2008. However, as can be seen from the annualised inflation yield curve below, market implied inflation varies considerably depending on the term being considered. Therefore, different assumptions may be appropriate depending on the term of the liabilities and there are other considerations, such as whether market implied inflation includes an inflation risk premium.

Significantly, the inflation curve as at 31 December 2008 is steeper than it was a year previously which means that determining the appropriate term to use is much more important.



## Other Pension Accounting Issues

Buyout exercises – 2008 has been a busy year in the buyout market, and a number of Schemes have secured some of their pension liabilities with insurance companies. This may have Profit and Loss implications, which are complicated further if the pension scheme is in surplus.

Scheme closures/Redundancy exercises/Business reorganisations – any decision by the Employer to close the Scheme, make employees redundant, or dispose of sections of the business may impact upon the Profit and Loss charge over the year, again this issue could be complicated if the Scheme is in surplus.

IFRIC 14 – From 31 December 2008 IAS 19 accounting figures may be affected by IFRIC 14. IFRIC 14 looks at the implications for recognising surpluses and whether any additional liability should be included on the balance sheet. Please note that IFRIC 14 says that you may have to adopt an additional liability in some circumstances and does not simply limit the amount of surplus you can recognise.

*Barnett Waddingham are running a series of free seminars on pension accounting issues during January. The seminars will be held in or near our offices in Amersham, Bromsgrove, Cheltenham, Glasgow, Leeds, Liverpool and London.*

*Please contact your Barnett Waddingham consultant if you would like to discuss any of the above topics in more detail.*

*Alternatively, please contact either*

*Nick Griggs*

*e-mail: [nick.griggs@barnett-waddingham.co.uk](mailto:nick.griggs@barnett-waddingham.co.uk)*

*or telephone: 01242 538500*

*Paul Hubbard*

*e-mail: [paul.hubbald@barnett-waddingham.co.uk](mailto:paul.hubbald@barnett-waddingham.co.uk)*

*or telephone: 01527 559111*



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