

Current Issues in Pension Financial Reporting

30 June 2009

The key financial assumptions used in valuing the 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. The last year or more has been a time 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 the audit of pensions disclosures should be aware of.

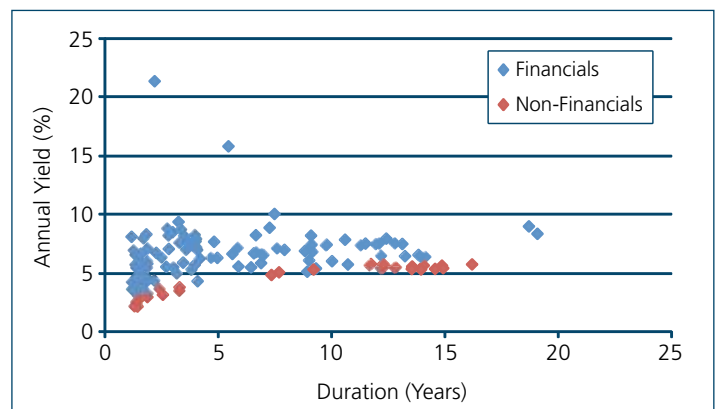
Discount Rate

The table below shows some of the key market indices that could be used to derive the discount rate. The yield on government bonds (gilts) is also shown for comparison:

Index	30/06/2009	31/03/2009	30/06/2008
Barclays Capital Sterling Non Gilts AA Over 15 years	6.36%	6.74%	6.51%
ML Sterling Non Gilts AA Over 15 years	6.38%	6.92%	6.64%
ML Sterling Corporates AA Over 15 years	6.44%	6.93%	6.71%
iBoxx Sterling Corporates AA Over 15 years	6.20%	6.69%	6.70%
Over 15 year Gilt Yield	4.12%	3.76%	5.18%

The spread of corporate bond yields above gilt yields has narrowed over the past three months. This is largely as a result of falls in the yields on the individual corporate bonds which make up the index rather than some of the falls we saw earlier in the year as high yielding financial AA rated bonds were downgraded. Falls in the above indices are likely to result in lower discount rates being adopted which in turn result in a higher value being placed on pension scheme liabilities.

The graph opposite shows the individual yields on the bonds that made up the iBoxx AA Sterling Corporate Bond All Stocks Index as at 30 June 2009.



Discount Rate (Continued)

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

- The yield on AA bonds continues to vary with duration 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 although this is probably less of an issue now given that there is less variance than three months ago. It is possible to consider an 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. However the difference at 30 June 2009 on the Merrill Lynch indices was again relatively small.
- Yields on AA bonds issued by financials continue to be higher than those issued by non-financials. This reflects the continued uncertainty in the financial sector. For example, excluding financials would reduce the iBoxx Sterling Corporates AA Over 15 years by about 0.5% pa to 5.7% pa.

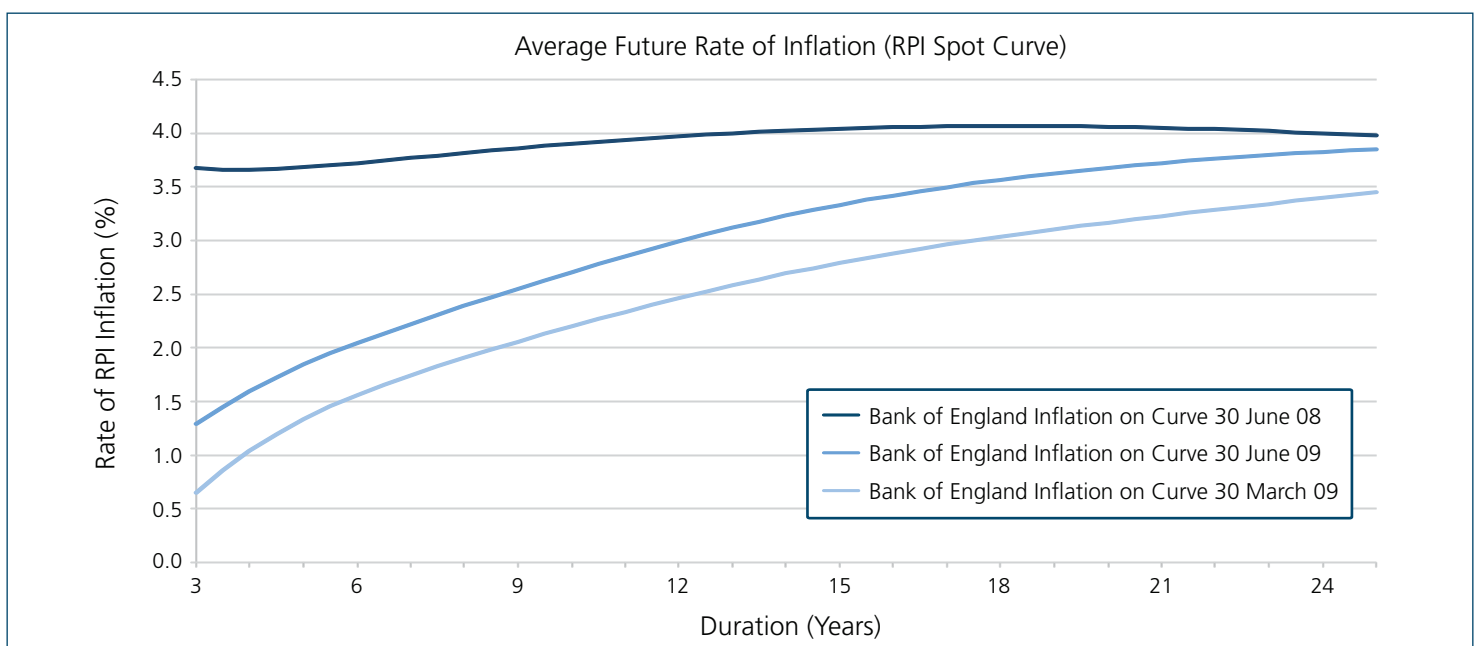
Inflation

The Bank of England's 20 year market implied inflation figure was 3.75% pa as at 30 June 2009. 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.

Increases in the implied inflation figure over the last three months are likely to be reflected in the chosen assumptions

and could result in a greater value being placed on a scheme's liabilities. The inflation curve as at 30 June 2009 is much steeper than it was a year previously. This means that determining the appropriate term to use is more important than a year ago.

However, there has been a significant amount of volatility in the Bank of England long term implied inflation measure over recent months. Companies might wish to consider whether or not there is an argument at looking into more stable approaches when determining a view on long term inflation.



Other Pension Accounting Issues

Buyout exercises – 2008 was 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 an employer to close a 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. The implications may also be different depending on the accounting standard used.

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.

Please contact your Barnett Waddingham consultant if you would like to discuss any of the above topics in more detail. Alternatively, please contact either:

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