FRAB (79)02
8 MAY 2006

HM TREASURY

Financial Reporting Advisory Board Paper

DISCOUNT RATE FOR PENSION LIABILITIES

Issue:	Considering the appropriate discount rate for pension liabilities for 2007-08
Impact on guidance:	None at present.
UK GAAP adaptation?	No.
IAS/IFRS compliant?	Yes
IPSAS compliant?	N/A
Impact on budgetary regime	Budgets are unaffected (as budgets measure cash flows), but there are implications for Estimates
Recommendation:	The FRAB is invited to consider the proposals listed in paragraph 3.
Timing:	The proposals will affect 2007-08.

DETAIL

Background

1. At its meeting on 8 March 2004 (FRAB(66)10), the FRAB agreed that from 2005-06, pension liabilities should be accounted for as consistently as practicable with FRS17. This included using a discount rate based on the returns from AA corporate bonds. The agreed rate (later determined by GAD to be 2.8 per cent real) was to be reviewed every two years to coincide with Spending Reviews, ie it would apply for 2005-06 and 2006-07.

2. However, the Spending Review planned for 2006 – which would have set the framework for 2007-08 and 2008-09 – has been overtaken by the Comprehensive Spending Review which will apply for 2008-09 and 2009-2010. It is thus a moot point what arrangements should apply to 2007-08. Continuing use of a discount rate of 2.8 per cent for 2007-08 would be consistent with linking the review of the appropriate rate to the Spending Reviews but, against a background of a much lower current rate of returns from corporate bonds, this leaves government and FRAB open to the charge that they have implemented FRS17 in a way which underestimates the pension liabilities. There

have been a number of press articles and Parliamentary questions which have attacked the discount rates currently used on similar grounds.

Proposal

3. The proposals are thus:

- That the current rate of 2.8 per cent real should not be used to discount the pension liabilities at 31 March 2008;
- Rather, a more up-to-date rate based on returns from AA Corporate Bond rates should be established – probably as at the end of November 2007 (see paragraph 4 below) to fit in with the budgeting timetable;
- To consider further whether it would be practical to review the discount rate annually (in line with FRS17) or biennially to coincide with future spending reviews;

Impact on budgets

4. Although budgets are not affected (as budgets reflect the cash flows not the FRS17 entries) there will be an effect on Estimates which seek Parliamentary approval for, inter alia, the interest cost which will be affected by any change in the discount rate. In practice, the latest opportunity to amend the Estimates for 2007-08 will be the Spring Supplementary Estimates which will be finalised in February 2008. This means that the appropriate discount rate will need to be determined as at the end for November 2007 to give time for the appropriate calculations to be made and the Spring Supplementary Estimates prepared.

UK GAAP compliance

5. If the discount rate is reviewed annually, the proposals are GAAP compliant (FRS 17). Continuing with biennial reviews would be an adaptation of FRS 17.

IAS/IFRS compliance

6. The use of high quality corporate bond rates for discounting pension liabilities is compliant with IAS 19.

IPSAS compliance

7. N/A

Proposed amendment to the FreM

8. None at present.

Impact of amendment on Department Yellow

9. None.

Summary and recommendation

10. The FRAB is invited to:

- Note the proposal to review the discount rate for pension liabilities for 2007-08 – while continuing with a AA corporate bond rate;

- Comment on whether the rate should be reviewed annually, or biennially to coincide with Spending Reviews.

HM Treasury

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