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Your ref
Our ref DSW/SLC
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Dear Ms Sansom

The Future of Financial Reporting: FRED 48

Thank you for the opportunity to comment on the revised financial reporting exposure drafts issued in January 2012. We broadly welcome the proposed changes and support the fundamental overhaul of the current FRSSs. There are, however, a number of changes which impact on both the financial statements of pension schemes and their preparation, which do not appear to meet the ASB's stated objectives.

Background

Universities Superannuation Scheme Limited is the corporate trustee of the Universities Superannuation Scheme (USS). USS was established in 1975 and provides pension benefits for academic and senior administrative staff of UK universities and a number of other UK institutions which are engaged in higher education or research.

At 31 March 2011, there were 386 institutions participating in USS, comprising all the pre-1992 UK universities and 245 other institutions. Total membership of the scheme, including pensioners and those entitled to deferred benefits, was 288,000 and the value of the fund was £32.8 billion.

In responding to the consultation, we have grouped our comments according to the ASB's questions.

Question 1

The ASB is setting out the proposals in this revised FRED following a prolonged period of consultation. The ASB considers that the proposals in FREDs 46 to FRED 48 achieve its project objective:

To enable users of accounts to receive high-quality, understandable financial reporting proportionate to the size and complexity of the entity and users' information needs.

The key area where we believe the ASB's objective is not met is the inclusion of defined benefit pension schemes within the scope of the definition of "Financial Institutions".

The consequence of this is a requirement for lengthy disclosures relating to the risks in the portfolio. The information specified will undoubtedly be different to that used by the trustees to manage the fund and schemes will incur additional costs in both preparing the financial statements disclosure and having it audited.

The financial position and health of a defined benefit pension scheme requires an understanding of the strength of the employers' covenant, the investment strategy and the actuarial assumptions used to value and fund the scheme. Much of this detail is in documents specified by the pensions legislation eg the statement of funding principles and the statement of investment principles, which are often presented alongside the financial statements.

The exposure draft confirms that a measure of the scheme's actuarial liabilities will not be required on the statement of net assets. These liabilities carry interest and inflation risks similar to the assets of the scheme, this is recognised by many schemes that now operate a liability-driven investment strategy. The proposed disclosure is potentially misleading if only the risks associated with part of the investment strategy are disclosed.

As currently drafted, FRS102 would require disclosures which are overly long, do not assist the user of the financial statements gain a comprehensive overview and may, in fact, be potentially misleading because they are incomplete.

Our preferred solution would be to exclude all pension schemes from the definition of a financial institution, but as a minimum defined benefit schemes should be excluded. The current SORP should be revised to ensure the financial statements and other documents contain sufficient information to enable the financial position of the scheme to be understood.

Question 4

Do you agree with the definition of a financial institution? If not, please provide your reasons and suggest how the definition might be improved.

Overall we would agree with the definition of a financial institution. However this definition includes all retirement benefit plans. We believe that a defined benefit pension scheme is sufficiently different from other entities and we do not agree that they should be included within the scope of the definition of financial institutions. The reasons for this are as follows:

- Member benefits are not directly linked to the performance of the scheme's assets and defined benefit pension schemes do not meet the ASB's test of "entities seeking to generate wealth from financial instruments". Information about the covenant provided by the employers is arguably far more important than lengthy disclosures relating to investment risk;

- Requiring these disclosures is contrary to the ASB's stated objective in that they are disproportionate to the users' information needs;
- The analysis required for disclosure in the financial statements is different to the risk information presented to our trustee board and the investment committee and consequently would be unduly burdensome to produce; and
- The exposure draft does not require an estimate of the actuarial liabilities to be included in the balance sheet of the scheme. Providing the required information for only those assets and liabilities disclosed on the balance sheet is misleading as there are significant similar financial risks, primarily inflation and interest rate risk, in the determination of actuarial liabilities. This is particularly relevant for schemes where the investment strategy is driven by an asset/liability or liability-driven investment approach.

We believe that disclosure of these risks would be more meaningful for defined contribution schemes where investment risks are shouldered by the individual members of such schemes, even though individual member investment risks are unlikely to be aligned with the scheme's strategic plan. However, as it stands the definition of a financial institution does not recognise this fundamental distinction.

Our preference is for the revised SORP to specify financial risk disclosures that are appropriate for defined benefit schemes and which take into account the other information which trustees are required to disclose.

Question 6

The ASB is requesting comment on the proposals for the financial statements of retirement benefit plans, including:

- (a) Do you consider that the proposals provide sufficient guidance?**
- (b) Do you agree with the proposed disclosures about the liability to pay pension benefits?**

In response to the two specific questions:

- (a) The requirements for retirement benefit plans in FRED 48 are consistent and in strong alignment with IAS 26. The guidance covers both financial and non-financial information requirements. We believe that, in general the guidance for financial information is sufficient, however, the guidance relating to non-financial information seems unnecessary given that the disclosure of this information will already be a mandatory requirement for inclusion within the trustee report. It seems inappropriate to include such requirements again within this exposure draft. We believe that the ASB should remain focused exclusively on the recognition, measurement and presentation of financial information.

- (b) The disclosures relating to the liability to pay pension benefits appears to be a hybrid set of requirements fused from IAS 26 and the existing reporting of actuarial information as prescribed by the PRAG's SORP. A key inconsistency, for example is that IAS 26 requires the disclosure of vested and non-vested benefits, but this is not required for the Summary Funding Statement and whereas this statement includes liabilities on a buy-out, or wind-up, basis, this is not required per IAS 26. We agree that the actuarial information should be a separate report alongside the financial statements or in the notes to the financial statements rather than as per IAS 26 which allows the option to effectively generate a balance sheet consisting of actuarial liabilities within the net asset statement.

There are also a number of proposals in the exposure draft which would have significant impact on the financial statements of pension schemes. We have highlighted below those areas of concern.

Transaction costs

Paragraph 11.13 of FRED 48 states that on initial recognition, a financial asset shall be measured "at the transaction price (including transaction costs except in the initial measurement of financial assets and liabilities that are measured at fair value through profit and loss)..." Paragraph 11.14 states that financial instruments should be measured "without any deduction for transaction costs the entity may incur on sale..."

Currently, the SORP requires pension schemes to add transaction costs to purchase costs and net them off sale proceeds, as appropriate, with the total amount of direct transaction costs on all investment types disclosed in the notes to the accounts.

In practice, pension schemes measure investment performance net of transaction costs. This is consistent with the current treatment under the SORP. The proposed change in treatment will lead to significant work for schemes in re-engineering accounting processes to reflect the transaction costs through profit and loss. This will yield no practical benefit in terms of additional information to users of the accounts, as transaction costs are already separately disclosed.

Furthermore, the limited wording relating to transaction costs within FRED 48 is unclear and does not set out the required treatment explicitly.

Our preference is for pension schemes to be allowed to retain the option of adopting the current treatment of capitalising transaction costs.

In any event, additional narrative should be added to FRED 48 to make explicit the required treatment or choice of treatments for transaction costs.

Consolidation

Paragraph 9.9 (b) states that a subsidiary should be excluded from consolidation where "the interest in the subsidiary is held exclusively with a view to subsequent resale and the subsidiary has not previously been consolidated into the consolidated financial statements".

Paragraph 9.9(a) states that “A subsidiary meeting the requirements of paragraph 9.9(b) and held as part of an investment portfolio shall be measured at fair value with changes in fair value recognised in profit or loss. A subsidiary is held as part of an investment portfolio if its value to the investor is through fair value as part of a directly or indirectly held basket of investments rather than as a media through which the investor carries out its business...”

It is important to note that a pension scheme is not a trading entity and is not a business. Therefore, we consider that it is appropriate for pension schemes to treat all subsidiaries used to hold investment assets as investments held for resale and for such entities to be measured at fair value and excluded from consolidation in scheme accounts. This would allow consistent treatment across investment assets, whether these assets are held directly or through a special purpose subsidiary entity.

We therefore seek clarification that this is the intended application of FRED 48 for pension schemes and suggest that this is made explicit either within FRED 48 or through the SORP.

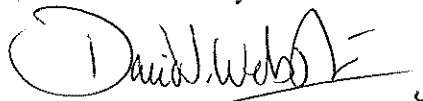
Valuation of non-financial assets eg investment property

Paragraph 34.39 cross refers to paragraphs 11.27-32 in relation to the determination of the fair value of net assets available for benefits. These paragraphs relate only to financial assets. Consideration should be given to providing guidance on the determination of the fair value of other types of asset, for example investment property, perhaps by cross reference to other relevant sections of the standard.

Summary

We are supportive of the ASB's proposals, however, we do not believe that defined benefit pension schemes should be included within the definition of a financial institution. We have also highlighted where we believe further clarification would be beneficial and also matters where the proposals lead to changes from the current SORP without clear benefits for the users of the financial statements.

Yours sincerely



David S Webster
Chief Financial Officer