

Lane
Clark &
Peacock

Actuaries & Consultants

Accounting For Pensions

Annual Survey 2003



© Lane Clark & Peacock LLP August 2003

For further help, please contact Chris Tavener or Bob Scott in our London office or the partner who normally advises you. For further copies of the report, please contact Charlotte Brown on 0207 432 6603 or download a pdf version from our website www.lcp.uk.com.

This Report may be reproduced in whole or in part, without permission, provided acknowledgement of the source is given. The report is not intended to be an exhaustive analysis of SSAP24, FRS17 or IAS19. Although every effort is made to ensure that the information in this report is accurate, Lane Clark & Peacock LLP accepts no responsibility whatsoever for any errors, or the actions of third parties. Information and conclusions are based on what an informed reader may draw from each company's annual report and accounts. None of the companies were contacted to provide additional information or further details.

Accounting for Pensions

1. Main findings	Page 1
2. Introduction and summary	Page 3
2.1 Introduction	
2.2 Summary	
3. The fate of the defined benefit scheme	Page 8
4. Accounting standards for pension schemes	Page 10
5. LCP's analysis of FRS17 disclosures	Page 12
5.1 Analysis of results	
5.2 FRS17 key assumptions	
5.3 FRS17 and balance sheet risk	
5.4 FRS17 and reward for risk	
6. LCP's analysis of SSAP24 disclosures	Page 24
Appendix 1 – Detailed FRS17 disclosure listing	Page 27
Appendix 2 – FRS17 risk measures	Page 29
Appendix 3 – SSAP24 disclosure scores	Page 31
Appendix 4 – Detailed SSAP24 disclosure listing	Page 33

Lane Clark & Peacock's 2003 publication of "Accounting for Pensions" is the tenth edition of the authoritative survey of practice under SSAP24, the standard that currently regulates accounting and disclosure of pensions information in UK company accounts, and also provides insight into its potential replacement, FRS17.

Lane
Clark &
Peacock

Actuaries & Consultants

1. Main findings

- Under the new accounting standard for pension schemes effective from 2005 (FRS17), a deficit appears on a company's balance sheet if there is a shortfall in the assets of a pension scheme compared to the value placed on its liability to pay benefits, and excess assets appear as a surplus.

For FTSE 100 companies with UK defined benefit pension schemes, Lane Clark & Peacock ("LCP") estimate that the total deficit (or shortfall in assets) under FRS17 has soared in the past year to over £55 billion by the middle of July 2003. One year ago the estimated deficit was £25 billion.

- As of mid July 2003, for every £100 of FRS17 liability, LCP estimates that the pension schemes of the FTSE 100 companies held only £80 of assets.
- Of the 90 FTSE 100 companies with UK defined benefit pension schemes, only 13 disclosed an FRS17 surplus at their respective 2002 accounting year-ends while 77 disclosed a deficit. Of the 13 companies, 10 have already reported deficits in their 2003 accounts as a result of the fall in the equity markets in the Summer of 2002.
- Without higher contributions to their pension schemes, a substantial recovery in equity markets is needed for assets to meet liabilities in the near future.

LCP estimate that the FTSE 100 would need to climb to over 6,000 by this time next year from its current level of around 4,000 to eliminate the estimated aggregate FRS17 pension scheme deficit. This is a rise of over 50%.

- Contributions paid by FTSE 100 companies have not kept pace with the FRS17 value of retirement benefits earned by their employees in the accounting years ending in 2002. For the companies we have been able to analyse, employees earned retirement benefits worth £4.2 billion under FRS17 over the year while employers' contributions totalled only £3.6 billion. An FRS17 contributions gap of £600 million.
- Once FRS17 is adopted, companies' balance sheets are exposed to the volatile movement of the equity markets. This survey highlights those FTSE 100 companies most exposed.

- There is wide variation in the assumptions made by directors for the expected long-term rate of return on equities held by pension schemes. The potential impact on reported profits is material.
- The potential cost to the FTSE 100 companies of the Government's proposals to protect pension benefits could currently be over £110 billion.
- Although attention is naturally focused on FRS17 disclosures, most companies still use SSAP24 to book pension costs in their accounts. Our analysis has revealed that, disappointingly, the quality of companies' disclosures under SSAP24 has deteriorated since last year.

2. Introduction and summary

2.1 Introduction

The survey aims to provide an insight into the disclosure of pension scheme costs in companies' accounts, comparing the different practices that the largest UK quoted companies have adopted.

The number of pages in companies' accounts dedicated to pensions has increased dramatically over the last year – perhaps appropriately given the significant impact pensions are starting to have on companies' finances.

In this survey we analyse these pension cost disclosures for the companies comprising the FTSE 100 as at 1st January 2003, looking at accounting periods ending in 2002. The companies making up the FTSE 100 change over time. Twelve companies were new this year. Comparisons must be handled with care, but general trends are still evident.

Information and conclusions are based on what an informed reader may draw from each company's annual report and accounts. We do not approach companies or advisers for additional information or explanation.

The existing accounting rules, set out in SSAP24, continue to form the basis of the pension costs included in the primary financial statements of the vast majority of FTSE 100 companies. Its replacement, FRS17, remains in its transitional phase and merely requires additional items of information to be disclosed in the notes to the accounts. More details on the accounting rules are provided in Section 4.

FRS17

Of the companies reporting in 2002, 90 offer UK defined benefit pension schemes and have either adopted FRS17 for their primary statements or disclosed FRS17 information under the transitional requirements. Our detailed analysis of this information is given in Section 5, and our summary on page 4.

SSAP24

Our annual analysis of the quality of companies' disclosures under SSAP24 is given in Section 6. Disappointingly, the quality has deteriorated since last year.

2.2 Summary

FRS17 deficits

Under FRS17, a measure of the surplus or deficit in the pension scheme appears directly on the company's balance sheet.

In the middle of July 2003, we estimate the aggregate deficit under FRS17 of the pension schemes sponsored by companies in the FTSE 100 is over £55 billion. This is on an estimated pension scheme asset base of just under £200 billion.

The deficit has more than doubled since this time last year, primarily due to the exposure of pension scheme assets to the fall in equity markets.

This deficit has been calculated as the sum of the companies' FRS17 liabilities less the sum of the assets of the pension schemes they sponsor, and like all deficits or surpluses quoted in this report, is prior to any adjustment for tax.

The experience of two particular companies is given below.

In last year's survey *Friends Provident* had the highest ratio of pension scheme assets to FRS17 liabilities of 135%. Over the year the ratio has tumbled by 40%, to 95%. The combined schemes of *Friends Provident* are now in deficit. The fall is primarily due to the schemes having more than 80% of their assets invested in equities.

The largest fall in an FRS17 position was just under £5 billion. Over the accounting year, the pension schemes of *BP* moved from a surplus of £1.5 billion to a deficit of £3.4 billion. This represents a fall of 32% in the ratio of assets to FRS17 liabilities. *BP* recently announced its intention to make payments of up to \$2 billion to its pension funds in the second half of 2003, to help clear the deficits.

Company contributions

Overall the combined FRS17 deficit for the companies we were able to analyse was not being reduced by the payment of cash to their retirement benefit schemes. Quite the opposite in fact.

Our analysis reveals that the employees of many companies have earned benefits over the accounting periods ending in 2002 that are worth more (as measured under FRS17) than the contributions paid by their employers.

Some companies in our survey paid no contributions to their final salary schemes during their accounting periods ending in 2002. These include *Rentokil Initial* and *Friends Provident*, both of whom disclosed FRS17 deficits at their year-ends. More details are provided in Section 5.4.

Friends Provident

BP

Rentokil Initial

Friends Provident

Lane
Clark &
Peacock

Actuaries & Consultants

Without significant additional contributions towards eliminating their FRS17 deficits, many companies will need their pension schemes to continue to invest in risky investment classes, such as equities, in the hope of achieving investment returns in excess of the interest costs that are accruing on their FRS17 liabilities.

Under FRS17, company directors disclose the rates of return they expect to earn on their pension schemes' assets. The 2002 disclosures show expected excess investment returns equivalent to over £2.5 billion pa. These would need to be achieved for over 20 years to fund the aggregate FRS17 deficit of £55 billion as at mid July 2003.

Companies' balance sheets at risk

Investment in equities can lead to a volatile FRS17 position, which can severely impact on balance sheets. This is particularly the case where the pension scheme is large in relation to the size of the sponsoring company's balance sheet.

Our analysis highlights 7 companies whose balance sheets were highly exposed to volatile equity movements. These companies are *BT Group*, *BAE Systems*, *British Airways*, *ICI*, *Invensys*, *Rolls-Royce* and *Royal & SunAlliance*.

We discuss these risks in more detail in Section 5.3.

Subjective profits

Investing in equities also impacts on the profits recorded by companies in their accounts.

Under FRS17 the expected long-term investment return on the assets held by the company's pension schemes is credited to its profit and loss account. Directors taking a more optimistic view of future investment returns can increase the reported profits – quite dramatically in some cases.

Unsurprisingly, there is a wide variation between companies in the assumed long-term rates of return from equities, from 5.1% pa used by *P&O Princess Cruises* to 9% pa used by *Reed Elsevier* and *Cadbury Schweppes*. The most common assumption used was 8% pa.

We estimate that pre-tax profits calculated under FRS17 could potentially increase by over £1 billion if every FTSE 100 company increased their expected rate of return on equities for their UK schemes by 1% pa. To put this in context, in 2002 the aggregate pre-tax profits reported for these companies was £42 billion.

BT Group

BAE Systems

British Airways

ICI

Invensys

Rolls-Royce

Royal and SunAlliance

P&O Princess Cruises

Reed Elsevier

Cadbury Schweppes

The future's bright?

In light of the fall in equity markets over the year, we have examined how companies have reviewed their assumptions for the expected rate of return on equities in 2002 compared to the previous year.

It appears companies have reacted differently. Of the companies for whom information is available, 32 have increased the expected long-term rate of return on equities and 21 have reduced it.

The more optimistic companies who have increased their rate of return by 1% pa or more over their accounting year include *Abbey National*, *BAE Systems*, *HSBC Bank* and *Reed Elsevier*.

We can only speculate at the reasons for more increases than decreases. Are directors truly more optimistic for the rate of return on equities than a year ago? We discuss this in more detail in Section 5.2.

Expected returns under scrutiny

The credit taken for expected equity returns, and expected asset returns more generally, are under scrutiny by the International Accounting rule makers ("the IASB"). We consider the significant developments in international accounting in Section 4.

Double whammy

Although it is easy to focus on the performance and risks of the assets, there is another side to the coin. Deficits measured in accordance with FRS17 have not only increased due to decreasing asset values, but also due to the rise in the measured value of the liabilities.

Under FRS17, the value of a pension scheme's benefit payments is measured relative to the price of AA-rated corporate bonds. The value of corporate bonds has increased over 2002, increasing the value placed on FRS17 liabilities. This effect is often overlooked, but can be very significant, and is examined in more detail in Section 5.2.

Exit costs

On 11th June 2003 the Government published new provisions for improving member protection.

Under these provisions, companies wishing to cease future support for their UK pension schemes will now be required to meet the full cost of securing the benefits with an insurance company. This cost will generally exceed the FRS17 value placed on their liabilities. Companies' credit ratings may potentially be affected. This is discussed in Section 3.

Abbey National

BAE Systems

HSBC Bank

Reed Elsevier

Lane
Clark &
Peacock

Actuaries & Consultants

Some poor SSAP24 disclosures

The quality of pension disclosures under SSAP24 had been improving steadily until recently. However, for the second year in a row, the average standard of disclosure under SSAP24 has slipped, albeit only slightly. Could this be because companies have devoted more time to the new, higher profile, FRS17 figures, rather than concentrating on providing fuller information on the pension costs that they are currently charging against their profits?

The lowest SSAP24 disclosure scores were obtained by *Bunzl* and *Tomkins*, both new entrants to the FTSE 100 this year. The additional information required to be disclosed by FRS17 does mean that the SSAP24 disclosure is less critical than it used to be.

A detailed explanation of the analysis of the FTSE 100 companies' SSAP24 disclosures is provided in Section 6.

Bunzl

Tomkins

3. The fate of the defined benefit scheme

More risk, more expense

Defined benefit schemes have become intrinsically more risky for companies and certainly more expensive than they used to be.

Many companies have taken the step of closing their defined benefit (or “final salary”) schemes to new entrants. Reducing the size and variability of pension costs has been a key driver.

But closure does not solve things overnight. Without careful planning, things can get worse rather than better.

An inevitable consequence of closing a scheme to new entrants is that the clock starts to tick down to wind-up, the scheme’s ultimate “end game”. The time frame for planning ahead can be shortened considerably.

Careful management of a closed scheme is critical in order to control the risks falling on the sponsoring company.

Improving member protection

The stakes were raised on 11th June 2003 following the publication by the Government of steps that it will take to reform occupational pensions.

The changes include improving member protection. In particular, employers, who choose to cease financial support to their UK schemes, may now be required by the trustees to meet the full cost of securing the benefits with an insurance company (although trustees can accept a lower amount if circumstances warrant).

Overnight, the option for employers to walk away from their defined benefit schemes has become very unattractive. The “exit cost” for employers has been raised, perhaps to a level that traps employers into supporting the benefits already accrued in schemes for the foreseeable future (unless the equity markets rally to save the day!)

The cost of purchasing the benefits in full with an insurance company is, in most cases, significantly higher than the value of the liabilities measured and disclosed under FRS17.

We estimate that, as at mid July 2003, trustees of UK schemes sponsored by FTSE 100 companies could claim in aggregate over £110 billion if the companies want to cease financial support. This is approximately 12% of the market capitalisation of these companies (of just over £900 billion).

Credit ratings

As termination liabilities to companies have become more onerous, credit ratings for many companies with large defined benefit schemes are likely to be under review.

It is reported that credit rating agencies take into account the management and financial health of a company's pension scheme when reviewing a company's own credit rating. For example, credit rating agency Standard & Poor's lowered its long-term corporate credit rating of *Rolls-Royce* in May, citing as a reason its unfunded pension liabilities.

It remains to be seen to what extent the credit rating agencies will reassess a company's rating allowing for the new obligation to top up a pension scheme's assets to meet the cost of securing the benefits with an insurance company. If they do, the credit ratings of companies with poorly funded pension schemes that are relatively large compared to the company could be at risk.

Rolls-Royce

4. Accounting standards for pension schemes

There are two main UK standards for reporting pension costs in companies' accounts, known as SSAP24 and FRS17.

The current standard that is in force is SSAP24, which the majority of companies use to book pension costs in their accounts. FRS17 is the new standard due to be fully effective from 2005, although we discuss potential changes below that may impact on this.

Accounting aims

SSAP24 has been in existence for fifteen years. It is supposed to ensure accounting for pension costs on a systematic and rational basis over the employees' careers with sufficient disclosure of the assumptions used to allow informed readers of the accounts to understand the accounting treatment. In practice, insufficient disclosure in the past has left UK pension accounting shrouded in a veil of mystery.

For those who understand the new FRS17 disclosures, this veil is now being lifted. FRS17 aims to give "adequate" disclosure. It is certainly adequate by volume, but concerns remain that undue credence will be given to the effect of incorporating FRS17 figures into the financial statements.

New proposals

There are proposals for additional items to be disclosed under both US and International Accounting Standards including, for example, an indication of the sensitivity of the results to a change in the assumptions. Whilst a full table of all sensitivities would be onerous, we suggest that simply disclosing a figure for the average term of the future cashflows would enable analysts to estimate the movement in the FRS17 liability for a given change in market yields. This figure is readily available and would provide valuable insight into the figures already disclosed.

Importance of assumptions

Under SSAP24, the assumptions adopted merely dictate the pace at which cost is recognised in the company's profit and loss account. Any variation between experience and the assumptions is charged against (or credited to) profit in subsequent years.

This contrasts sharply with FRS17, under which the cost to be charged to the profit and loss account is directly determined by the assumptions directors make. If experience turns out to be more favourable than assumed (for example through high investment returns) this creates a gain. Conversely, poor experience creates a loss. Under FRS17, gains and losses feed into the Statement of Total Recognised Gains and Losses ("STRGL"), rather than impacting on the profit and loss account.

Variations in assumptions

The assumptions used for SSAP24 should, overall, represent a “best estimate”. However, a number of scenarios may be considered reasonable, and in practice companies use a wide range of assumptions to determine cost.

FRS17 goes further than SSAP24 in requiring that each individual assumption for projecting the benefits should be a best estimate. As for last year, we have found that best estimates still vary from company to company.

Further, the assumptions an individual company has adopted can vary year on year, particularly for what is arguably the most subjective assumption – the estimate of the future return from equities. This is discussed in Section 5.2.

Accounting uncertainty

The European Union has passed legislation that requires all listed companies to prepare accounts in accordance with International Accounting Standards for accounting periods starting on or after 1st January 2005.

For pensions, the rules are set out in International Accounting Standard 19 (“IAS19”) which will effectively replace both of the existing UK standards SSAP24 and FRS17. As currently published, IAS19 is significantly different to both sets of UK rules, but the International Accounting rule maker (“the IASB”) is in the process of reviewing IAS19.

The new international rules are expected to be similar to FRS17 in principle, albeit based on the existing international structure and with some significant differences in the presentation. For example, it is likely that different components of the pension cost will be recognised in different sections of the performance statement and certain elements (such as the expected return on assets) are expected to be eliminated altogether.

It is hoped that these revisions will be completed late in 2004, in time for the new rules to apply for accounting years starting on or after 1st January 2005; a draft set of rules is due to be published later this year for industry comment. We welcome a harmonised set of accounting rules governing Europe and much of the rest of the world. However, in this complex area we believe it is critical to have adequate review of the draft rules before final revisions to IAS19 are put through.

In these uncertain times, companies will need to keep a constant eye on how their pension schemes are impacting on their accounts.

5. LCP's Analysis of FRS17 disclosures

90 FTSE 100 companies reporting in 2002 offer UK defined benefit pension plans and have either fully adopted FRS17 or disclosed FRS17 information under the transitional requirements.

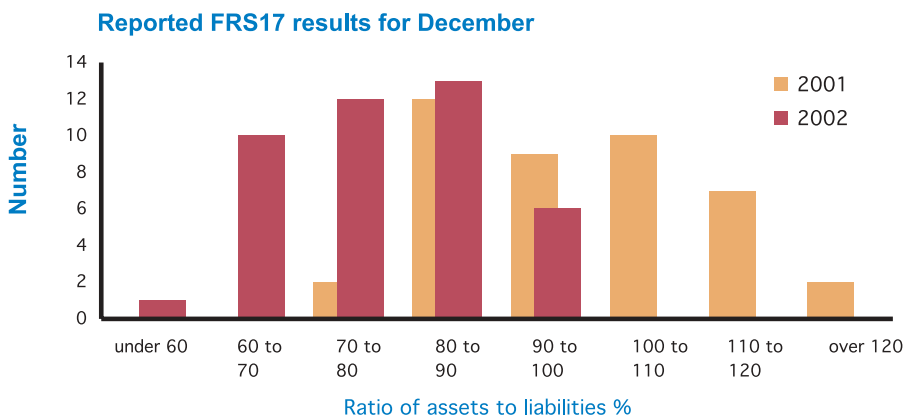
For 66 of these companies, 2002 was their second year of reporting under FRS17. For these companies we can examine not only their balance sheet position, but also consider the information provided under FRS17 for their profit and loss accounts.

Many companies offer post-retirement healthcare provision, which we have excluded from our analysis where possible. Overseas pension arrangements have been included.

5.1 Analysis of results

FRS17 takes a snapshot of the surplus or deficit at the company's year-end and, if adopted, appears directly on the balance sheet.

A full list of the disclosed FRS17 surpluses and deficits at companies' year-ends is set out in Appendix 1. The chart below shows the range of results, expressed as a ratio of assets to FRS17 liabilities, for FTSE 100 companies with year-ends in December 2001 and 2002. The chart shows the dramatic reduction in funding ratios.



Of all FTSE 100 companies, levels in excess of 100% were very much the exception rather than the norm. 13 companies showed a surplus at their respective 2002 year-ends and 77 showed a deficit.

However, 11 of the 13 companies showing a surplus reported results before the fall in the equity markets in the Summer of 2002. The results reported for these 11 companies in 2003 indicate that 10 have moved into deficit.

Northern Rock

After a year of falling equity markets *Northern Rock* stands out as the only company analysed whose pension scheme deficit has reduced, albeit marginally. This is primarily due to the significant cash that the company has paid into its pension scheme outweighing the effect of poor investment returns.

Increased disclosures

The volume of disclosure on pension schemes in the notes to companies' accounts has dramatically increased. For example, *Rexam* dedicated over six pages of its accounts to pensions. This is in addition to the disclosures required to cover directors' remuneration.

The disclosures under FRS17 have, in our opinion, been of a generally high standard. Let us not forget, though, that increased disclosure almost certainly means increased cost of disclosure.

We note with interest that some companies have chosen to add to the FRS17 standard disclosures with additional commentary. Some companies, such as *GKN*, *Hays* and *Pearson* have highlighted the effect of falling yields on corporate bonds. *Reckitt Benckiser* has illustrated how sensitive the results are to the subjective, but often important, assumption for the expected rate of return on assets. The effects of some of these assumptions are discussed in the following section.

Early adoption of FRS17

The requirement to adopt fully the provisions of FRS17 has been delayed until 2005. Companies have been able to adopt, if they wish, the provisions of FRS17 in full before 2005. However, only 7 companies in the survey have chosen to do so.

BAA, *BOC Group*, *Friends Provident*, *Gallaher Group*, *Lloyds TSB Group*, *Scottish and Southern Energy* and *WPP Group* have all adopted FRS17 for their 2002 annual reports.

To an extent, the slow take-up may be due to recent European Union legislation that requires all listed companies in the EU to prepare accounts in accordance with International Accounting Standards from 2005. As discussed in Section 4, it is currently not clear what the International Accounting rules will be following the current review. As such, companies that have adopted FRS17 early may see yet further significant changes to the pension accounting treatment from the end of next year.

Northern Rock

GKN

Hays

Pearson

Reckitt Benckiser

Rexam

BAA

BOC Group

Friends Provident

Gallaher Group

Lloyds TSB Group

Scottish and Southern Energy

WPP Group

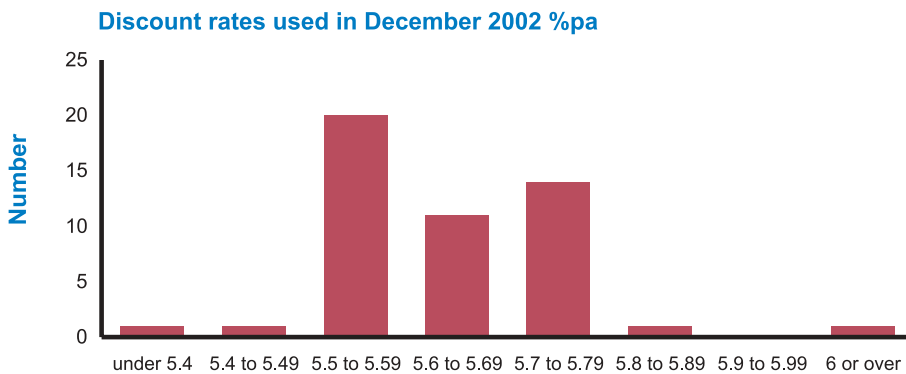
5.2 FRS17 key assumptions

We consider below the various assumptions used to put an accounting cost on retirement benefits. Where a company operates pension schemes in more than one country, we have considered the assumptions used for the UK. Where a company has disclosed a range of assumptions, we have taken the mid-point. Our analysis is of the assumptions disclosed for use as at the accounting year-end.

Discount rate

The discount rate under FRS17 is the annual rate at which the projected future benefit payments are discounted back to the balance sheet date. If available, FRS17 requires the use of a discount rate equal to the yield on a AA-rated bond of equivalent term and currency to the liabilities. However, due to the very long-term nature of pension liabilities, it is frequently the case that a suitable yield cannot be derived directly from the market. This means that an appropriate “proxy” for the AA-rated bond yield must be derived.

The yields on AA-rated corporate bonds, and hence the discount rates, will fluctuate from month to month with market conditions. It is therefore only sensible to compare the discount rates used by companies with the same year-ends. The chart below shows the discount rates used by companies with accounting years ending in December 2002.



Whilst there is a consensus around 5.6% pa, we have found considerable variation in the discount rates adopted, some of which could perhaps be explained due to the different maturities of schemes (if this was disclosed).

For those companies with years ending in December, the highest UK discount rate used was 5.8% pa by *HBOS*. *Old Mutual* quoted a range of 5.5% pa to 6.5% pa, and is shown on the chart above at 6% pa.

HBOS

Old Mutual

Lane
Clark &
Peacock

Actuaries & Consultants

Double whammy

FRS17 deficits have not only increased due to deteriorating asset values, but also due to the rise in the value placed on the liabilities.

The significance of the discount rate is frequently not appreciated. A fall in the discount rates represents a rise in the value of AA-rated corporate bonds, and hence a rise in the measured value of the liabilities of pension schemes under FRS17.

The average discount rate in December 2002 was 5.6% pa. This is 0.3% pa lower than at the same time last year. The fall of as little as 0.3% pa over 2002 in the discount rate could easily have increased the value placed on the liabilities under FRS17 by as much as 6%, equivalent to increasing deficits by approximately £15 billion for the FTSE 100 companies. This is broadly the same impact on FRS17 deficits as a 12% fall in equity markets.

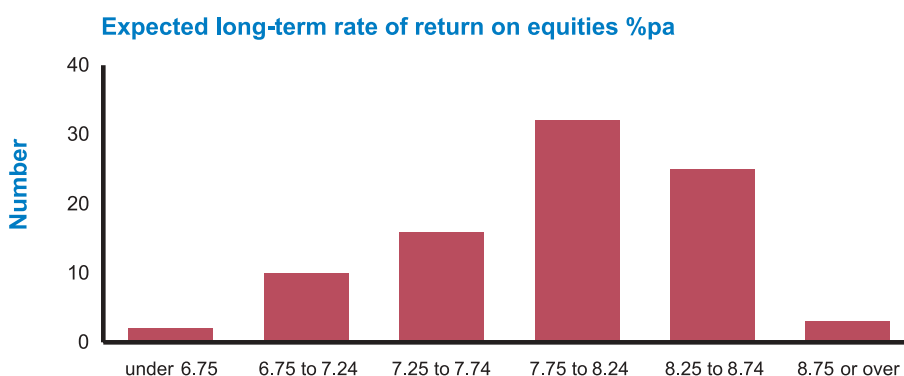
Details of the discount rates used by each company are set out in Appendix 1.

Expected return on equities

Under FRS17, the expected long-term investment return on the pension scheme assets is an entry in the financing line of the profit and loss account. A company's profits are higher under FRS17 if its directors are more optimistic and assume a higher return.

The accounts are required to show the directors' best estimate of the long-term return on each main asset class held, arguably the most subjective of which is the expected return on equities. These expected returns will impact on the reported profits over the following year.

Directors have made a wide range of assumptions, although the general consensus seems to be between 7% pa and 8.5% pa. The most common assumption was 8% pa.

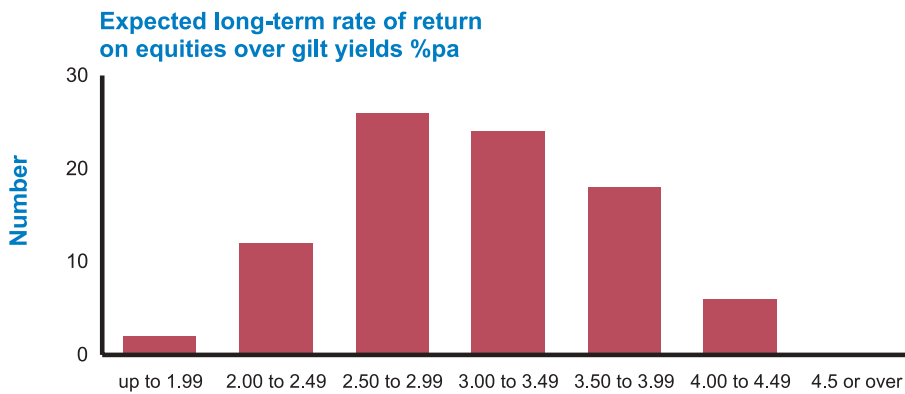


Unusually, *P&O Princess Cruises* have disclosed the same rate of 5.1% pa for the expected return from equities as from bonds. We cannot be sure whether this means the directors hold the view that equities will not

P&O Princess Cruises

outperform bonds in the long-term or if it is simply a matter of choosing not to differentiate between the two asset classes (although this is required by FRS17).

The average long-term expected rate of return on equities for the companies in our survey is some 3.1% pa higher than the long-term yields available on gilts as at the balance sheet dates. This difference represents views of the so called “equity premium”.



Alternatively, the expected long-term out-performance on equities could be viewed relative to the yields on AA-rated corporate bonds. This assumed out-performance is equivalent to a credit to companies’ profits of over £2.5 billion pa under FRS17.

However, this expected return on equities is not guaranteed. The credit for the expected return relies on the risks of the scheme investing in equities. Such risks are not trivial to the company, as investors have experienced over the last three years. These risks are highlighted in Section 5.3.

Subjective profits

The choice of the expected return on equities is subjective. There is no “correct” answer; assumptions within a wide range can be justified. The wide choice of expected returns made by companies is evidence of this.

Reported profits can be very sensitive to this assumption. For example, *Friends Provident* has adopted FRS17 early. In 2002 it booked a pre-tax loss of £37m. The charge for retirement benefits in its profit and loss account was calculated using an expected rate of return on equities of 8.5% pa. Using a rate, closer to the average, of 8% pa would have increased the pre-tax loss by, broadly, £3m to a loss of £40m.

New views

FRS17 states that the rate of assumed long-term future investment return will vary according to market conditions, but it is expected that the amount of return will be reasonably stable.

Friends Provident

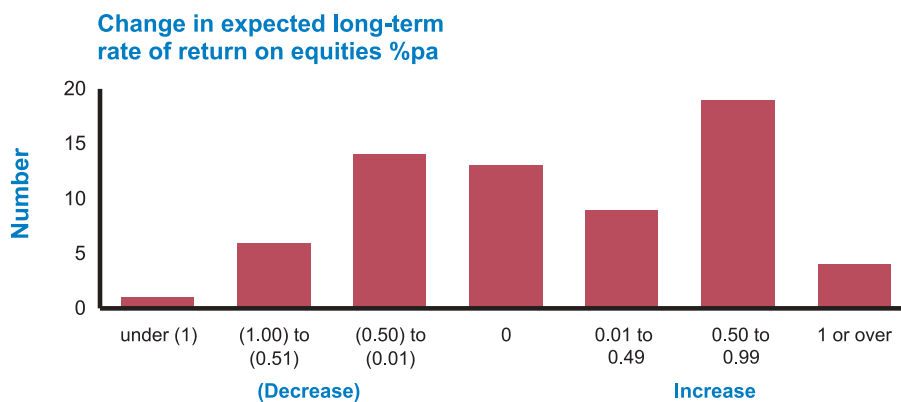
Lane
Clark &
Peacock

Actuaries & Consultants

We have examined how companies have changed their assumptions for the expected rate of return on equities (the UK assumption where the company operates pension schemes in more than one country) over 2002.

Where disclosed, 32 companies have increased their expected rate return on equities and 21 have reduced their expectation. The range is given in the chart below.

We can only speculate at the reasons for more increases than decreases. Are directors truly more optimistic for the rate of return on equities than a year ago? Have they increased the rate of returns to maintain a stable return from equities in light of the fall in the markets over the year? Whatever the reason, there is little doubt that directors are becoming more aware of the influence of FRS17 on their companies' profits and balance sheets.



In 2001 *Unilever Group* disclosed one of the highest expected returns on equities of 9% pa. For 2002 this assumption has been reduced to 8.2% pa. If FRS17 were fully adopted in its current form, we estimate such a simple change would reduce *Unilever Group's* pre-tax profits measured under FRS17 for the following year by over £35m.

Unilever Group

Changes vary within sectors. Below is a comparison of how different companies in the aerospace and defence sector have altered their long-term expected rates of return on equities over the year. We have also provided an estimate of how the change may alter pre-tax profits measured under FRS17 for the following year.

Company	Expected rate of return on equities		Change %pa	Effect on 2003 profits under FRS17 £m
	2001 %pa	2002 %pa		
BAE Systems	7.5	8.5	+1.00	+50
Rolls-Royce	8.4	8.0	-0.40	-10
Smiths Group	8.0	8.25	+0.25	+2

Lower salary growth assumptions

The rate of long-term salary growth assumed can have a significant effect on the eventual pension cost. A lower assumption for salary growth produces a lower projected pension and hence a lower FRS17 liability. We have examined the year-on-year movement for each company in the assumption for salary growth for the UK schemes.

Of the companies where data is available, most companies have not altered their disclosed assumption for future salary growth in excess of inflation for calculating their FRS17 liabilities. However, 15 have reduced their expectation of long-term salary growth, outweighing the 11 companies that have increased their expectation.

Gallagher Group, Old Mutual, HSBC Bank, BOC Group and Anglo American reduced their assumption for salary growth in excess of inflation by more than 0.5% pa.

Hays increased its headline assumption the most, to inflation plus 2.52% pa, an increase of 0.77% pa.

5.3 FRS17 and balance sheet risk

What is risk?

In our 2002 survey we highlighted that some companies' balance sheets are more exposed than others to the volatility resulting from FRS17.

Currently, there are two main ways of reducing the volatility effect of FRS17 on the balance sheet:

- by investing a significant proportion of the pension scheme assets in high grade corporate debt, which would “match” the FRS17 liability so that the assets and FRS17 liabilities would move broadly in line with each other; or
- by reducing the company's exposure to defined benefit pension provision.

The chart overleaf compares the proportion of UK pension schemes' assets (or worldwide if the UK is not separately given) invested in equities for those companies in our survey who have reported balance sheet figures under FRS17 in 2001 and 2002.

Anglo American

BOC Group

Gallagher Group

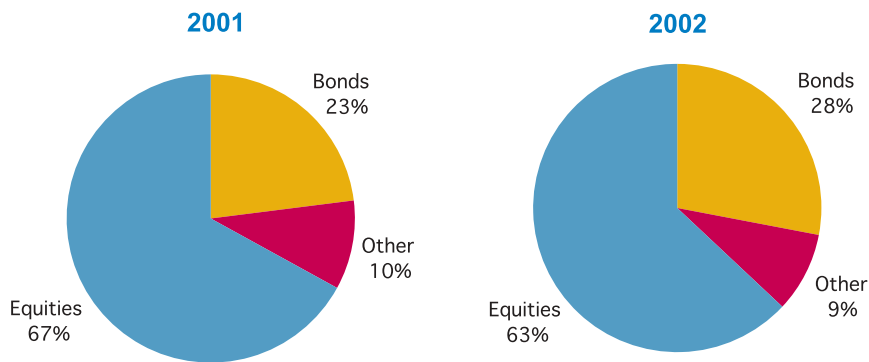
Old Mutual

HSBC Bank

Hays

Lane
Clark &
Peacock

Actuaries & Consultants



The proportion of assets invested in equities has reduced slightly. It is not possible to know from reading companies' accounts whether this is due to the fall in the equity markets, a general shift in investment strategy, or some other reason. It is evident though that companies' exposure to equities remains significant.

The exposure to equities disclosed in the accounts for some companies has changed dramatically. *Barclays* has provided by far the most detailed split of the assets its pension schemes are invested in, dividing the investments between no less than 11 different asset classes. It appears from this detailed disclosure that the percentage of assets invested in equities has fallen markedly from 70% to 51%, reducing the company's balance sheet exposure under FRS17 to the volatility of the equity markets.

Barclays

Measuring the risk

Significant balance sheet risks from equity volatility occur where:

- the pension scheme is large relative to the size of the business (or in particular, the reported balance sheet); and
- the pension scheme is heavily invested in equities.

In Appendix 2 we list the size of each company's pension schemes relative to the company's net asset value. The higher this ratio, the greater the effect of a volatile FRS17 position on the company's balance sheet.

There are alternative ways of measuring the size of a company. As a guide we have also shown the size of the pension schemes relative to the company's market capitalisation.

Below we comment on the impact of equity investment on a few individual companies' balance sheets.

Rentokil Initial

Rentokil Initial was highlighted in last year's survey as a company with negative group shareholders' funds and a very large pension scheme with a fragile FRS17 surplus.

The scheme's large exposure to equities during falling markets has meant the FRS17 ratio has fallen from 103% to 76%, wiping out the surplus disclosed last year, and creating a deficit of £156m. The scheme continues to be heavily invested in equities.

ICI

As highlighted last year, the relatively small exposure to equities for the pension schemes of *ICI* has helped limit the fall in the FRS17 ratio to only 4% over the year. However, the scheme remains very large compared to the company and an equity risk remains.

Rolls-Royce

The deficit of *Rolls-Royce* has increased to £1,839m, representing over 90% of the net assets of the company. In last year's survey, this was 25%. Furthermore, the pension scheme remains two-thirds invested in equities.

Imperial Tobacco Group

Imperial Tobacco Group has a very large pension scheme and disclosed a negative net asset value. Its pension scheme is in deficit. However, the scheme retains a significant proportion of assets invested in equities, exposing the FRS17 position to the possibility of deterioration.

Vodafone Group

In comparison, *Vodafone Group* has a seemingly worryingly low ratio of pension scheme assets to value of liabilities of 43%. However, its pension scheme is, relative to reported net asset value, extremely small.

Rentokil Initial

ICI

Rolls-Royce

Imperial Tobacco Group

Vodafone Group

Lane
Clark &
Peacock

Actuaries & Consultants

Exposed balance sheets

We have identified 7 companies in Appendix 2 that have balance sheets that under FRS17 are notably exposed to volatile movements in the equity markets. As at their 2002 accounting year-end, each has pension schemes:

- with investments in equities of more than 50% of the company's market capitalisation; and
- which are large relative to the size of the company (ie the scheme is greater in size than both the company's market capitalisation and its net asset value).

These companies are *BT Group*, *BAE Systems*, *British Airways*, *ICI*, *Invensys*, *Rolls-Royce* and *Royal & SunAlliance*.

5.4 FRS17 and reward for risk

The reward to a company of having a pension scheme with a high equity exposure and thus the risk of a volatile balance sheet is higher reported profits. For two companies with identical pension schemes, the one with the higher exposure to equities (in favour of, say, bonds) will benefit from a lower pension expense under FRS17, and hence higher profits.

This is because companies generally expect long-term returns on equities to exceed bonds, and, under FRS17, a company books a credit in its profit and loss account for this expected return on its pension schemes' assets.

BAA

For example, *BAA* adopted FRS17 fully in 2002.

During the 2002 accounting year, the UK employees of *BAA* earned final salary benefits with an FRS17 value of £44m. However, the company booked a credit (rather than a cost) of £5m in its profit and loss account.

This is because the company, as permitted under FRS17, took credit in its profit and loss account for an expected return on assets of £116m, based on rates assessed at the beginning of the year.

This expected return is £49m in excess of the interest charge on the FRS17 liabilities of £67m and this excess outweighs the value of the new benefits earned, generating a contribution to profit before tax of £5m. Yet during this "profitable" year, the FRS17 surplus fell from £548m to £427m due to the actual investment performance being worse than expected. No wonder many readers are confused by accounts!

BT Group

BAE Systems

British Airways

ICI

Invensys

Rolls-Royce

Royal & SunAlliance

BAA

Profits vs cash

It should always be borne in mind that the underlying cash cost of a pension scheme is not determined by the particular accounting standard used, nor the assumptions set by the directors on the advice of the actuary. The cash cost to the company is equal to the contributions it pays to meet the benefits for members (and the expenses of administration) over the lifetime of the scheme.

Company pension contribution levels

Each company will have its own objectives and views as to whether it is worthwhile, necessary, or even affordable, to put additional cash into the pension scheme now; rather than keeping hold of it for use by the company.

Our analysis reveals that the employees of many companies have earned benefits over the year that are worth more (as measured under FRS17) than the contributions paid by their employers to their retirement schemes. These companies are thus either deferring the cash cost, or relying on future equity returns to supplement the cost.

Contributions of an amount less than the FRS17 value of the benefits earned over the year will, all other things being equal, increase an FRS17 deficit or erode a surplus.

Our analysis is based on the examination of the companies that are now in their second year of reporting under the transitional arrangements of FRS17 and have disclosed the pension costs that would, on adoption of the standard, appear in their profit and loss accounts.

The table below shows four companies in our survey which have paid no contributions towards the final salary benefits that have been earned by their employees (the FRS17 service cost) during the accounting year.

Company	FRS17 service cost (£m)	FRS17 surplus (deficit) £m
Rentokil Initial	13	(156)
Friends Provident	19	(28)
Scottish and Southern Energy	19	92
BAA	44	427

Rentokil Initial paid no contributions to its schemes during 2002, contributing to the increase in its FRS17 deficit (although the major cause of the increase was the poor investment performance). Its report refers to a financial review of the scheme that may mean they commence paying contributions in the future.

Rentokil Initial

Lane
Clark &
Peacock

Actuaries & Consultants

Friends Provident states in its report that it anticipates that the nil contribution policy will continue during 2003 on the grounds that the deficit is relatively small for its principal scheme which has over £500m of assets. Although small, the financial strength of the scheme has weakened due to the fall in the assets from over £700m at the start of the accounting year.

BAA has ceased its contribution holiday, which it commenced on 1st April 1997, and has started paying contributions with effect from 1st April 2003.

The table below shows the companies that have paid contributions of over twice the FRS17 value of the benefits that have been earned by their employees during the year. All have FRS17 deficits. Most of these companies have stated in their accounts that they are making additional contributions due to the poor financial health of their pension schemes.

Company	FRS17 service cost (£m)	Contributions paid (£m)	FRS17 surplus (deficit) £m
GlaxoSmithKline	224	464	(1,861)
ICI	60	161	(639)
Bunzl	10	32	(64)
AstraZeneca	114	467	(766)
Bradford & Bingley	12	59	(40)
Northern Rock	7	40	(28)

Friends Provident

BAA

6. LCP's analysis of SSAP24 disclosures

Although much attention is inevitably focused on FRS17, it is the SSAP24 numbers that are generally still being booked in company accounts. Adequate disclosure therefore remains essential.

LCP analysed and scored the disclosures of the 81 companies reporting pension costs under SSAP24, as listed in Appendix 4.

BAA, BOC Group, Gallaher Group, Friends Provident, Lloyds TSB Group, Scottish and Southern Energy and WPP Group have not been scored as they have fully adopted the requirements of FRS17 in their 2002 annual report.

All companies have earned a starting score of 10 for the basic items of disclosure. We believe that there are four key additional items that have to be disclosed for a full understanding of the cost. These additional items are listed below with their attaching "score":

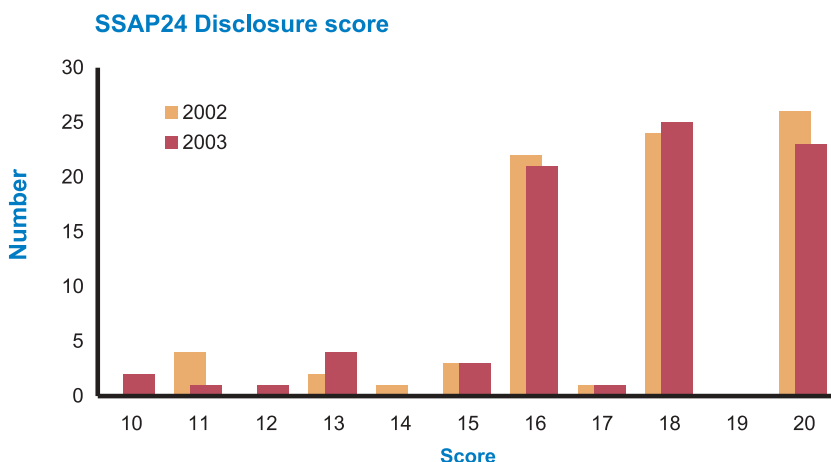
Disclosure required	Score
Asset valuation method	3 or 5
Pension increases	1
Split of regular cost & variation	2
Method of spreading	2

This gives an aggregate score from 10 to 20. An explanation of how a company is awarded a score for each item is provided in Appendix 3.

A full list of each company's score is set out in Appendix 4. The spread of scores is set out below.

Scores

The top score of 20 was achieved by 23 companies this year, down from 26 last year; their details are listed in Appendix 4.



Standards continue to slip under SSAP24

For the second year in a row the average score has fallen year-on-year. The fall is mainly attributable to the new entrants to the FTSE 100 providing, on average, less full disclosure than the “old hands”. The average score for the new entrants is over two points below that for the survivors.

New entrants

Two companies achieved a score of only 10 this year. These are *Tomkins* and *Bunzl*. Both are new constituents of the FTSE 100 this year. In contrast, *Exel*, which is also a new entrant, scored an impressive 20. All three have produced clear and informative FRS17 disclosures.

Of the companies included in last year’s survey, 13 improved their score this year whilst 7 achieved a lower score. While SSAP24 continues to form the basis of the primary statements we would expect to see at least the same level of attention paid to the SSAP24 disclosures as in previous years. Overall, for this group of surviving companies the average score changed little, but there were some marked differences.

“Actuarial value of assets”

The scores for *National Grid* and *Safeway* have fallen by 5 points. This is because they both refer to using an “actuarial value of assets” but, unlike last year, they have not provided sufficient information as to what this asset value was or the assumptions used to derive it.

Impact on profits

Pension cost as a proportion of pre-tax profit can be very high for those companies declaring a low level of profit; relatively small changes in terms of the pension scheme can then severely impact on profitability. In some cases pension costs can be very low, or even an addition to profits. For example, *Exel* showed a pension credit (addition to profit) under SSAP24 of over 9% of total pre-tax profits.

This is because *Exel* has a large pension scheme surplus under SSAP24. The run-off (or amortisation) of this amount provided a credit in its profit and loss account in 2002 of £63m, which more than offset the cost of the retirement benefits its employees earned during the year of £46m.

Behind the times

In contrast to FRS17, SSAP24 does not require the financial position of the pension scheme to be updated annually for current conditions. This means that some companies are booking pension costs in their accounts using asset and liability figures that have not been reviewed for a few years.

Bunzl

Exel

Tomkins

National Grid

Safeway

Exel

Although triennial measurement is permitted (and is often standard practice) under SSAP24, we believe it is good practice (as per paragraph 49 of SSAP24) for companies to highlight the implications of the significant falls in equity markets. This is so that the results of the last formal review disclosed in the company's accounts can be seen in their proper context.

This best practice is not always followed. For example, *Tesco* and *Whitbread* disclosed in their 2002 accounts the financial position of their schemes as at 1999. Despite being heavily invested in equities, they did not highlight any implications of the fall in equity markets.

In contrast, some companies disclosing results of a similar vintage have highlighted in the notes to their accounts the impact of the significant fall in equity markets, including *HSBC Bank*, *Rentokil Initial* and *Six Continents*.

Tesco

Whitbread

HSBC Bank

Rentokil Initial

Six Continents

Appendix 1 – Detailed FRS17 disclosure listing

Company (listed by year-end)	Year- end 2002	Market value of assets £m	FRS17 surplus/ (deficit) £m	Discount rate % pa	Expected return on equities % pa
Next	January	196	(19)	5.50	7.00
Kingfisher	February	1,068	(160)	5.70	8.00
Tesco	February	1,574	(184)	5.80	7.70
Wm Morrison Supermarkets	February	135	7	5.75	7.00
3i Group	March	251	(14)	6.10	8.50
BAA	March	1,654	427	6.20	7.50
Boots Group	March	2,392	166	6.10	N/D
British Airways	March	9,953	(488)	6.00	N/D
British Land Company	March	29	1	6.00	7.00
BT Group	March	27,100	(1,830)	6.00	8.00
Emap	March	77	(13)	6.00	8.30
GUS	March	667	(93)	6.00	8.00
Invensys	March	4,784	25	6.00	8.00
Johnson Matthey	March	650	107	5.80	8.00
Land Securities	March	78	(10)	6.00	7.50
Man Group	March	116	(5)	6.00	7.80
Marks & Spencer Group	March	3,228	(394)	5.90	8.10
National Grid	March	2,698	(237)	6.00	7.80
Safeway	March	895	54	5.90	8.70
J Sainsbury	March	2,814	(368)	6.00	8.25
Scottish & Southern Energy	March	1,683	92	5.90	8.20
Scottish Power	March	3,205	8	6.00	8.00
Severn Trent	March	935	18	6.00	7.75
United Utilities	March	1,775	22	6.00	8.25
Vodafone Group	March	238	(318)	6.00	8.00
Whitbread	March	1,043	(84)	5.90	7.50
Dixons Group	April	393	(76)	6.00	8.00
Scottish & Newcastle	April	1,506	(269)	6.00	8.00
Diageo	June	3,829	(382)	5.90	8.00
Hays	June	217	(96)	5.80	8.00
Smiths Group	July	2,345	(109)	6.00	8.25
Wolseley	July	315	(132)	6.00	7.00
Allied Domecq	August	1,878	(480)	6.00	8.50
Associated British Foods	September	1,716	144	5.50	6.75
BOC Group	September	1,473	(363)	5.50	8.50
Compass	September	658	(288)	5.90	6.50
Daily Mail & General Trust	September	985	(216)	5.50	8.00
Granada	September	927	(381)	6.00	7.40
Imperial Tobacco Group	September	2,121	(296)	5.15	7.55
Six Continents	September	996	(315)	5.50	8.00
Abbey National	December	1,880	(842)	5.75	8.00
Alliance & Leicester	December	628	(297)	5.50	7.00
Alliance UniChem	December	80	(35)	5.40	7.50
Amersham	December	254	(208)	5.50	8.50
Anglo American	December	1,310	(237)	5.60	7.80
AstraZeneca	December	2,877	(766)	5.60	8.30
Aviva	December	4,858	(654)	5.75	8.25

This table shows the key disclosures made by the companies which reported FRS17 figures in their 2002 accounts. The source of the data is each company's annual report and accounts for the accounting period ending in 2002.

The market value of assets and surplus/(deficit) figures (before tax and excluding irrecoverable surpluses) relate to the worldwide position of each company, not just the UK disclosure. The discount rate and expected return on equities refer to the assumptions for the companies' main UK schemes at their accounting year-ends. "N/D" means figures were not disclosed.

Company (listed by year-end)	Year- end 2002	Market value of assets £m	FRS17 surplus/ (deficit) £m	Discount rate % pa	Expected return on equities % pa
BAE Systems	December	8,127	(3,125)	5.75	8.50
Barclays	December	10,703	(1,528)	5.70	8.42
BG Group	December	194	(104)	5.60	8.40
BP	December	12,090	(3,396)	5.75	7.50
Bradford & Bingley	December	328	(40)	5.50	7.00
British American Tobacco	December	3,701	(1107)	5.50	7.50
Bunzl	December	193	(64)	5.50	7.00
Capita Group	December	126	(55)	5.50	7.23
Cadbury Schweppes	December	1,462	(375)	6.00	9.00
Centrica	December	1,882	(831)	5.75	8.40
Exel	December	1,617	59	5.60	8.25
Friends Provident	December	552	(28)	5.50	7.50
Gallaher Group	December	741	(96)	5.50	8.00
GKN	December	1,447	(886)	5.50	7.50
GlaxoSmithKline	December	4,652	(1,861)	5.75	8.25
Hanson	December	1,505	(179)	5.50	7.50
HBOS	December	3,161	(1,136)	5.80	8.50
Hilton Group	December	224	(111)	5.60	8.00
HSBC Bank	December	5,610	(1,874)	5.60	8.50
ICI	December	7,052	(639)	5.70	8.60
Legal & General Group	December	762	(104)	5.50	8.00
Liberty International	December	27	0	5.50	8.00
Lloyds TSB Group	December	9,083	(2,931)	5.60	8.40
Northern Rock	December	154	(28)	5.60	8.60
Old Mutual	December	296	(3)	6.00	7.50
P&O Princess Cruises	December	85	(26)	5.20	5.10
Pearson	December	1,033	(252)	5.70	8.00
Prudential	December	3,570	(547)	5.50	8.00
Reckitt Benckiser	December	600	(47)	5.60	8.00
Reed Elsevier	December	1,791	(137)	5.70	9.00
Rentokil Initial	December	483	(156)	5.75	8.00
Reuters Group	December	130	(65)	5.50	8.25
Rexam	December	2,093	(237)	5.50	7.50
Rio Tinto	December	2,004	(155)	5.60	7.30
Rolls-Royce	December	3,921	(1,839)	5.50	8.00
Royal & SunAlliance	December	3,635	(724)	5.50	7.00
Royal Bank of Scotland Gr'p	December	11,692	(1,856)	5.75	8.40
Schroders	December	302	(16)	5.50	8.00
Smith & Nephew	December	215	(111)	5.60	7.80
Standard Chartered	December	817	(119)	5.70	8.30
Tomkins	December	426	(195)	5.75	8.75
Unilever Group	December	8,289	(2,828)	5.50	8.00
WPP Group	December	295	(185)	5.50	7.30

We have excluded from our survey 10 companies which had no evidence of significant UK defined benefit provision or which did not report pension costs under UK generally accepted accounting principles.

It should be remembered that many companies have for many years recognised unfunded liabilities for their retirement benefit schemes on their balance sheets, often choosing to hold a provision on their balance sheet rather than setting aside monies in a separate arrangement.

Lane
Clark &
Peacock

Actuaries & Consultants

Appendix 2 – FRS17 risk measures

Company	Size of scheme relative to size of balance sheet ¹	Size of scheme relative to market capitalisation ¹	FRS17 ratio ² %	Percentage of assets in equities %
Small % implies:	Low risk	Low risk	Less well funded	Low equity exposure
3i Group	7%	6%	95%	84%
Abbey National	39%	36%	69%	79%
Alliance & Leicester	54%	26%	68%	59%
Alliance UniChem	13%	10%	70%	55%
Allied Domecq	300%	52%	80%	59%
Amersham	39%	12%	55%	65%
Anglo American	13%	11%	85%	65%
Associated British Foods	56%	76%	109%	32%
AstraZeneca	52%	9%	79%	41%
Aviva	53%	55%	88%	63%
BAA	34%	24%	135%	80%
BAE Systems	198%	299%	72%	69%
Barclays	80%	48%	88%	51%
BG Group	9%	3%	65%	79%
BOC Group	101%	42%	81% ⁴	76%
Boots Group	119%	40%	107%	0%
BP	35%	16%	78%	73%
Bradford & Bingley	26%	19%	89%	58%
British Airways	451%	377%	108%⁴	52%
British American Tobacco	87%	47%	78% ⁴	45%
British Land Company	1%	1%	105%	80%
BT Group	10,115%⁵	119%	94%	71%
Bunzl	47%	15%	75%	67%
Cadbury Schweppes	56%	23%	80%	66%
Capita Group	57%	11%	70%	73%
Centrica	113%	38%	69%	80%
Compass	33%	16%	70%	60%
Daily Mail and General Trust	432%	89%	82%	69%
Diageo	64%	15%	91% ⁴	81%
Dixons Group	29%	11%	84%	88%
Emap	45%	4%	86%	51%
Exel	177%	79%	104%	72%
Friends Provident	30%	28%	95%	80%
Gallaher Group	248% ⁵	21%	89%	60%
GKN	243%	159%	62%	60%
GlaxoSmithKline	88%	9%	71%	75%
Granada	80%	70%	71%	82%
GUS	31%	11%	88%	69%
Hanson	63%	83%	89%	45%
Hays	67%	12%	69%	77%
HBOS	27%	17%	74%	78%
Hilton Group	14%	13%	67%	70%
HSBC Bank	41%	12%	75%	61%
ICI	1,354%	281%	92%	24%
Imperial Tobacco Group	3,187% ⁵	33%	89% ⁴	57%

This table shows the companies that disclosed FRS17 results in 2002.

A relatively large pension scheme coupled with a low ratio of assets to value of liabilities represents a significant issue for the company concerned.

However, these figures should not be viewed in isolation. The final column shows the percentage of the assets of the pension scheme that are invested in equities. A high percentage in this column coupled with a large pension scheme means that the company is particularly exposed to a movement in the equity market. For such companies, FRS17 represents a significant risk even if the pension scheme is currently in surplus.

Company	Size of scheme relative to size of balance sheet ¹	Size of scheme relative to market capitalisation ¹	FRS17 ratio ² %	Percentage of assets in equities %
Small % implies:	Low risk	Low risk	Less well funded	Low equity exposure
Invensys	1,227%	110%	101%	50%
J Sainsbury	65%	55%	88%	76%
Johnson Matthey	80%	28%	120%	69%
Kingfisher	39%	25%	87%	66%
Land Securities	1%	2%	89%	60%
Legal & General Group	27%	14%	88%	49%
Liberty International	1%	2%	100%	35%
Lloyds TSB Group	138%	48%	76%	79%
Man Group	23%	4%	96%	47%
Marks & Spencer Group	118%	41%	89%	67%
National Grid	89%	36%	92%	65%
Next	39%	7%	91%	81%
Northern Rock	15%	7%	85%	52%
Old Mutual	8%	9%	99%	35%
P&O Princess Cruises	6%	4%	77%	31%
Pearson	36%	28%	80%	49%
Prudential	109%	47%	87%	70%
Reckitt Benckiser	54%	8%	93%	61%
Reed Elsevier	72%	29%	93%	60%
Rentokil Initial	91% ⁵	15%	76%	80%
Reuters Group	27%	8%	67%	53%
Rexam	238%	126%	90%	41%
Rio Tinto	46%	16%	93%	59%
Rolls-Royce	283%	333%	68%	66%
Royal & SunAlliance	126%	252%	83%	47%
Royal Bank of Scotland Group	47%	32%	86%	66%
Safeway	42%	29%	106%	80%
Schroders	30%	37%	95%	75%
Scottish & Newcastle	84%	44%	85%	80%
Scottish and Southern Energy	99%	29%	106%	74%
ScottishPower	67%	48%	103%	70%
Severn Trent	41%	37%	103% ⁴	75%
Six Continents	24%	25%	76%	51%
Smith & Nephew	63%	9%	66%	69%
Smiths Group	243%	57%	96%	42%
Standard Chartered	20%	11%	87%	25%
Tesco	32%	10%	90%	64%
Tomkins	58%	42%	69%	67%
Unilever Group	261%	64%	75% ⁴	57%
United Utilities	70%	52%	101%	64%
Vodafone Group	0%	1%	43%	87%
Whitbread	60%	59%	93%	80%
Wm Morrison Supermarkets	12%	4%	105%	89%
Wolseley	28%	14%	70%	41%
WPP Group	13%	9%	61%	39%

Companies in red have balance sheets that under FRS17 are notably exposed to volatile movements in the equity markets.

¹ Size of scheme is taken as the greater of the assets and the liabilities. Size of balance sheet is taken to be net asset value (shareholders' funds including minority interests).

² The ratio of the schemes' market value of assets to the liabilities disclosed under FRS17.

³ The percentage is for the company's schemes worldwide.

⁴ Surplus assets that are not recoverable by the company have been included.

⁵ Group net assets disclosed as negative at the year-end.

Lane
Clark &
Peacock

Actuaries & Consultants

Appendix 3 – SSAP24 disclosure scores

How the scoring process works

We analysed and scored the disclosures of 81 companies, as listed in Appendix 4 in a similar way to previous years.

All companies have earned a starting score of 10 for the basic items of disclosure. We believe that there are four key additional items that have to be disclosed for a full understanding. We set these out below, with an explanation of the attaching “score”.

Disclosure required

Asset valuation method

Assets may be taken into account in two ways.

The traditional method in the UK has been to discount future income. We refer to this as the “discounted income” method.

The alternative is to take the assets at market value, or sometimes at a smoothed market value. We refer to such methods as “market value” methods.

For companies using a discounted income method, we were looking for disclosure of the dividend growth assumption, as this has a very important impact on the results. Better still is disclosure of the actual value placed on the assets.

For companies using a market value method, we were looking for a statement that the assets were indeed taken at market value, or if not, what market-related value of assets was used.

A market value method looks quite different to a discounted income method. Where it appeared that a market value method was used, but we were unable to draw a firm conclusion, we awarded 3 rather than a full score of 5. This reflects a failure to comply with the SSAP24 requirement (in paragraph 88h) to state the actuarial method used.

Score: 3 or 5

Disclosure required

Pension increases

The assumed rate of pension increases is necessary for a full understanding, but there is less variability of cost from this assumption.

94% of companies disclosed this item, which is comparable to last year's survey (93%).

Split of regular cost and variation

The regular cost is the ongoing cost to the company of providing the benefits of the pension scheme ignoring surplus or deficit. Disclosure of this item separately from the variation cost (due to any surpluses or deficits) is, therefore, very helpful.

52% of companies disclosed the regular and variation costs separately compared with 54% which did so last year. This is a slight decrease on last year, and remains disappointingly low.

Method of spreading

The actual pension cost will be lower or higher than the regular cost, on account of spreading the surplus or deficit. There are a number of ways this can be done, and each spreading method gives a different pattern for future pension costs.

57% of companies disclosed the spreading method compared to 45% last year, which is a pleasing increase back to the level of the number of companies disclosing the spreading method in 2001.

Score: 1

Score: 2

Score: 2

This gives an aggregate score from 10 to 20. A full list of each company's score is set out in Appendix 4.

Appendix 4 – Detailed SSAP24 disclosure listing

Company	Asset valuation	Pension Incs	Spread method	Split of cost	Total
3i Group	✓*	✓	✓	✓	18
Abbey National	✓*	✓	✓	✓	18
Alliance & Leicester	✓	✓	✓	✓	20
Alliance UniChem	✓	✓	✗	✗	16
Allied Domecq	✓	✓	✗	✗	16
Amersham	✓	✓	✓	✓	20
Anglo American	✓*	✓	✓	✓	18
Associated British Foods	✓	✓	✗	✗	16
AstraZeneca	✓	✓	✓	✗	18
Aviva	✓	✓	✗	✗	16
BAE Systems	✓	✓	✓	✗	18
Barclays	✓	✓	✓	✓	20
BG Group	✓	✓	✓	✓	20
Boots Group	✓	✓	✗	✗	16
BP	✓	✓	✓	✓	20
Bradford & Bingley	✗	✓	✓	✗	13
British Airways	✓	✓	✗	✗	16
British American Tobacco	✓	✓	✓	✓	20
British Land Company	✗	✓	✗	✗	11
BT Group	✓	✓	✓	✗	18
Bunzl	✗	✗	✗	✗	10
Cadbury Schweppes	✓*	✓	✓	✗	16
Capita Group	✓*	✓	✓	✗	16
Centrica	✓	✓	✓	✓	20
Compass	✓	✓	✗	✗	16
Daily Mail and General Trust	✓	✓	✓	✗	18
Diageo	✓	✓	✓	✗	18
Dixons Group	✓	✓	✓	✓	20
Emap	✓	✓	✗	✗	16
Exel	✓	✓	✓	✓	20
GKN	✓	✓	✗	✓	18
GlaxoSmithKline	✓	✓	✓	✓	20
Granada	✗	✓	✗	✓	13
GUS	✓	✓	✗	✗	16
Hanson	✓	✓	✓	✗	18
Hays	✓	✓	✓	✓	20
HBOS	✓	✓	✓	✓	20
Hilton Group	✓	✓	✓	✓	20
HSBC Bank	✓	✓	✗	✗	16
ICI	✓*	✗	✓	✓	17
Imperial Tobacco Group	✓	✓	✗	✗	16
Invensys	✓	✓	✓	✓	20
Johnson Matthey	✓	✓	✗	✓	18
Kingfisher	✓	✓	✓	✗	18
Land Securities	✓	✓	✗	✓	18
Legal & General Group	✓	✓	✓	✓	20
Liberty International	✓	✓	✗	✗	16
Man Group	✗	✗	✓	✗	12

This table shows the disclosures made by the 81 companies surveyed and the corresponding score as explained in Appendix 3.

Where sufficient information was given to show the actuarial value used for assets (for example, if an unsmoothed market value is used) this is counted as being the same as disclosing the dividend growth rate on the traditional discounted income model.

Where the assumptions appear to represent a market value method but have not been stated as such the company has been awarded 3 out of 5 points for the asset valuation, shown as ✓* in the Asset valuation column below.

Company	Asset valuation	Pension Incs	Spread Method	Split of cost	Total
Marks & Spencer Group	✓	✓	X	✓	18
Wm Morrison Supermarkets	✓	✓	X	X	16
National Grid	X	✓	X	✓	13
Next	✓	✓	✓	✓	20
Northern Rock	✓	✓	X	✓	18
P&O Princess Cruises	✓	✓	X	X	16
Pearson	✓	✓	X	✓	18
Prudential	✓	✓	✓	✓	20
Reckitt Benckiser	✓	✓	✓	✓	20
Reed Elsevier	✓*	✓	✓	✓	18
Rentokil Initial	✓	✓	X	X	16
Rexam	X	✓	X	✓	13
Rio Tinto	✓	✓	✓	X	18
Rolls-Royce	✓	✓	✓	X	18
Royal & SunAlliance	✓*	✓	✓	✓	18
Royal Bank of Scotland Group	✓	✓	X	✓	18
Safeway	X	✓	✓	✓	15
J Sainsbury	✓	✓	X	✓	18
Schroders	✓	✓	✓	✓	20
Scottish & Newcastle	✓	X	X	X	15
ScottishPower	✓	✓	✓	✓	20
Severn Trent	✓	✓	X	✓	18
Six Continents	✓*	✓	✓	✓	18
Smith & Nephew	✓*	✓	✓	X	16
Smiths Group	✓	✓	X	X	16
Standard Chartered	✓	✓	✓	✓	20
Tesco	✓	✓	X	X	16
Tomkins	X	X	X	X	10
Unilever Group	✓	✓	✓	✓	20
United Utilities	✓	✓	X	X	16
Vodafone Group	✓	✓	✓	✓	20
Whitbread	✓	✓	✓	X	18
Wolseley	✓	✓	X	X	16

