Accounting Standards Board

Aldwych House, 71-91 Aldwych, London WC2B 4HN
Telephone: 020 7492 2300 Fax: 020 7492 2399
www.frc.org.uk/asb

Stig Enevoldsen
Chairman
EFRAG
13-14 Avenue des Arts
B-1210 Brussels
Belgium

26 September 2008

Dear Stig

Re: Discussion Paper 'Preliminary Views on Amendments to IAS 19 Employee Benefits'

1 This letter sets out the Accounting Standards Board's (ASB's) comments on the EFRAG draft comment letter to the above discussion paper (DP).

2 The ASB would like to congratulate EFRAG on a very thoughtful and thorough proposed response. We agree with many of the points that are made in it, as may be seen from our own response to IASB, a copy of which is enclosed.

3 We would highlight the following differences between our response and the EFRAG draft comment letter:

- We are questioning the adoption of the term 'promises', and disagree with the welcome given to it in paragraph 32 of the Appendix to the draft response. The ASB's reasoning for this is set out in paragraph 3 of our response to the IASB.
- We are urging the IASB to undertake a review, as part of its short term project, of the disclosures required by IAS 19. We note that the disclosure proposals in the PAAinE discussion paper have been welcomed by many respondents.
- We are not suggesting to IASB that it should adopt a target of a final standard by 2010. While the ASB would naturally favour the early issue of a final standard, we think it should be for the IASB to consider what is achievable.

4 As a general comment, the EFRAG draft comment letter is quite lengthy and it may be possible, especially where EFRAG is in agreement with the IASB,

to shorten the length of the responses. This might put more emphasis on the points where EFRAG disagrees with the proposals.

5 The ASB welcomes the references in the draft comment letter to the PAAinE DP, which strengthens the credibility of our shared concerns. In the ASB's response to the IASB, we have also referred to the PAAinE paper in answering questions 3, 8, and 9. EFRAG may wish to consider adding similar references into its response to the IASB.

6 We do not agree with the suggestion in paragraph 30(b) of the Appendix that measurement of benefits that depend on future returns on assets is appropriately addressed by discounting at a bond rate the future returns on those assets. This will result in a net deficit being reported even if the assets in question are held by the entity and so no contributions will be required. We believe the liability for benefits that depend on future returns on assets should not exceed the cost to acquire the relevant assets.

7 The second sentence of the answer to question 7 (paragraph 34 of the Appendix) states that there may be some changes to accounting for some defined-contribution promises. The question is concerned with plans that currently meet the definition of defined contribution plans. We are not sure that the promises for which the accounting will change would currently meet the definition of defined contribution plans.

8 We have reviewed the questions to constituents set out in the draft comment letter. These mainly refer to practical implications and we have no further specific insights to add on these.

9 With the exception of the matters referred to above, we are in agreement with the draft comment letter.

10 If you wish us to expand on any aspect of this response, please contact myself or Jennifer Guest j.guest@frc-asb.org.uk

Yours sincerely

Ian Mackintosh
Chairman
DDI: 020 7492 2434
i.mackintosh@frc-asb.org.uk

Accounting Standards Board
Aldwych House, 71-91 Aldwych, London WC2B 4HN
Telephone: 020 7492 2300 Fax: 020 7492 2399
www.frc.org.uk/asb

International Accounting Standards Board
30 Cannon Street
London. EC4M 6XH

26 September 2008

Dear Sirs,

Re: Discussion Paper 'Preliminary Views on Amendments to IAS 19 Employee Benefits'

1 This letter sets out the Accounting Standards Board's (ASB's) comments on the above discussion paper (DP). The ASB welcomes the IASB initiative of updating and amending IAS 19 'Employee Benefits' and believes that a number of the proposed amendments to the standard would improve and clarify the existing IAS 19.

2 In particular, we welcome the proposal that all changes in the value of plan assets and in the post-employment benefit obligation should be recognised in the financial statements in the period in which they occur. The PAAinE Discussion Paper 'The Financial Reporting of Pensions' (the PAAinE DP) made a similar proposal which was supported by a majority of respondents.

3 The ASB notes that the IASB is seeking to address in this project 'major flaws' in the recognition and measurement of an entity's liability for post employment benefits (paragraph 1.5 of the DP). However, for the following reasons, the ASB questions whether this is being achieved:

- The ASB does not agree with the introduction of contribution-based promises into the scope of the project and the way in which the IASB has drawn the line between contribution-based and defined benefit promises. We are not aware of major problems with hybrid plans (other than those containing 'higher of' feature) in the UK, but understand that in some countries where they are more common there is a concern as to whether the proposed changes effectively deal with the issues. The proposals would cause significant change for some schemes that are currently accounted for as defined benefit plans, and it seems questionable whether it is worth incurring this cost if the proposals do not meet their objectives. We do, however, believe that greater clarity on accounting for schemes with a ‘higher of’ feature under IAS 19 would be welcome, but think this might be achieved within the general principles of the existing standard. We believe that in the longer term a solution is needed that applies the same principles to all types of scheme, as attempted in the PAAinE DP, but accept that this cannot be achieved in the context of the current review.

- The use of the term ‘promises’ with regard to pensions. This term has been used throughout the DP, despite the fact that it was not used in the original version of IAS 19. It is the view of the ASB that the term ‘promise’ might be taken to include situations where there is merely an expectation rather than an entitlement. We question the impact arising from the use of the term which might imply recognition of a pension promise in advance of the criteria for recognition of a liability being achieved. In our view it would be preferable to use the term ‘commitments’.

4 Although we agree that the current review should be limited in its scope, we believe that it provides an opportunity to improve on the required disclosures in respect of employee benefits. We expand upon this in our answers to questions 1 and 14.

5 We are firmly of the view that, in the longer-term, the financial reporting of pensions would benefit greatly from a fundamental review. We are currently considering the responses to the PAAinE DP and preparing a final report. We hope that this work will be useful to the IASB in its long term review. In the meantime, certain of the issues, and respondents’ views on them, are relevant to proposals in the Discussion Paper, and we note these in this letter.

6 Please refer to the Appendix to this letter for answers to the questions set out in the Invitation to Comment. If you wish us to expand on any aspect of this response, please contact myself or Jennifer Guest j.guest@frc-asb.org.uk

Yours sincerely

Ian Mackintosh
Chairman
DDI: 020 7492 2434
email: i.mackintosh@frc-asb.org.uk

APPENDIX-
RESPONSE TO SPECIFIC QUESTIONS IN IASB DISCUSSION PAPER 'Preliminary Views on Amendments to IAS 19 Employee Benefits'

Scope of the project

Q1. Given the objective of the IASB to address specific issues in a limited time frame, are there additional issues which you think should be addressed by the Board as part of this project. If so, why do you regard these issues as a matter of priority?

> The ASB has sympathy for the rationale behind restricting the scope of the DP, and in general does not recommend that any additional issues should be addressed as part of this project. However, as noted in the response to question 14, the ASB believes that the IASB could make short-term improvements to disclosures, which could be built on the proposals set out in the ASB's Reporting Statement on Pensions Disclosures (issued in January 2007) (which was developed in response to a specific request from users) and the proposals for improved disclosures set out in Chapter 9 of the PAAinE DP.

Chapter 2 – Deferred recognition of changes in the liability for defined benefit promises

Q2. Are there factors that the Board has not considered in arriving at its preliminary views? If so, what are those factors? Do those factors provide sufficient reason for the Board to reconsider its preliminary views? If so, why?

> The ASB supports the IASB's deliberations on the recognition of defined benefit promises. It shares the IASB's preliminary views (PV2-4) and welcomes in particular the abolition of the corridor approach.
>
> We also support the proposal not to divide the return on assets into an expected return and an actuarial gain or loss. Our main concern with the expected return is that it does not represent an economic event of the period. However, we note that many users find the expected return useful information and it might be worth considering whether it should be continued to be reported, as a disclosure.

Chapter 3 - Presentation approaches for defined benefit promises

Q3. (a) Which approach to the presentation of changes in defined benefit costs provides the most useful information to users of financial statements? Why?

We consider Approach 2 to be unacceptable because interest cost is presented in other comprehensive income which is inconsistent with the requirements of other IFRS. It would lead to a misleading and unjustifiable difference in the reporting of interest expense between companies with funded and unfunded schemes.

Although we understand the attractions of Approach 3, we note that it requires a method of establishing 'income on plan assets' that will differ from the actual return. Any such approach would be arbitrary and would not present fairly an economic event of the period.

We therefore consider that, of the three approaches presented in the Discussion Paper, Approach 1 should be considered further in the first instance.

However, we consider that, for the short term, the IASB might consider retaining the approach permitted under IAS 19 under which all actuarial gains and losses are reported in other comprehensive income. The DP provides two reasons why this has been rejected by the IASB, but we believe that the concern that it permits changes in assumption in respect of service cost to be reported as an actuarial gain or loss is overstated, since it often will not relate wholly to services provided in the period. We also note that it would require continuing to report the expected return in profit or loss: although we believe this is not ideal (as reflected in our answer to question 2) it might be acceptable to retain it as an interim measure.

(b) In assessing the usefulness of information to users, what importance do you attach to each of the following factors, and why:

(i) presentation of some components of defined benefit cost in other comprehensive income; and

(ii) disaggregation of information about fair value?

(b) In the PAAinE DP, the ASB concluded that:

(i) there is no conceptual justification for the presentation of some components of defined benefit cost in other comprehensive income (OCI). This might suggest that presentation of some components of the defined benefit cost in OCI is not useful. However, we note that, given the absence of clarity on the role of OCI, some users of financial statements may view the OCI as a means of segregating some of the more volatile elements of pension expense and argue that it is useful for this purpose, but we do not agree that volatility in and of itself provides sufficient grounds for an item to be reported there.

(ii) In developing the DP it was noted that users find the expected return on assets a good predictive tool and hence this information should be retained. (That is, the PAAinE DP recommends the expected return on assets is disclosed).

(c) What would be the difficulties in applying each of the presentation approaches?

Please refer to our answer to part (a) of the question. The ASB agrees with the IASB view (in paragraph 3.27 of the DP) that Approach 1 is the least complex of the three approaches to implement and understand.

Q4. (a) How could the Board improve the approaches discussed in this paper to provide more useful information to users of financial statements?

(b) Please explain any alternative approach to presentation that provides more useful information to users of financial statements. In what way does your approach provide more useful information to users of financial statements?

Whatever approach is adopted, in our view the IASB should consider what are the most useful line items that should be presented, irrespective of whether they are reported in income or in other comprehensive income. To assist users, the IASB should consider specifying which elements of pension cost should be classified as operating items and which should be classified as financial income or expense. In addition, the IASB should consider requiring disaggregation into defined elements of actuarial gains and losses.

Chapter 5 - Definition of contribution-based promises

Q5. Do you agree that the Board has identified the appropriate promises to be addressed in the scope of this project? If not which promises should be included or excluded from the scope of the project and why?

The ASB does not agree with the inclusion of a definition of contribution-based promises within the scope of the project. The ASB considers that there is no conceptual basis to separate an employer's commitment to a fixed return from that of a variable return. Indeed this is very similar to the conclusion reached by the IASB Board in paragraph 5.32 of the DP. The ASB perceives that many of the difficulties with the existing pension standard is that it draws a sharp distinction between defined contribution and defined benefit plans, when pension plans increasingly have elements of both types. The PAAinE DP adopts the approach of considering fundamental principles which are common to all pension plans.

The suggestion of a new definition for contribution-based promises is confusing and complex and does not appear to address the real issue. It may be possible to analyse all hybrid plans into defined contribution and defined benefit components, thus allowing the existing definitions to be retained, with explanation and some modification of their application to hybrid plans.

A consequence of the proposals is that 'contribution-based promises' will include plans where mortality risk is retained by the employer. Furthermore the new definition of 'contribution-based promises' appears to scope in certain plans which intuitively sound like, and are currently identified as, defined benefit plans, such as plans with a guarantee of specified return on contributions.

Q6. Would many promises be reclassified from defined benefit to contribution-based under the Board's proposals? What are the practical difficulties, if any, facing entities affected by these proposals?

The ASB considers that some promises would be reclassified from defined benefit to contribution-based under the Board's proposals, including, for example, promises that are associated with a specified return on contributions or other guarantee. We would expect the change in measurement basis to have significant implications.

Q7. Do the proposals achieve that goal? If not, why not?

The goal seems to be to avoid significant changes in the accounting for most promises that meet the definition of defined contribution plans in IAS 19. We agree with the views expressed in the DP at paragraphs 7.41-7.43 and accordingly believe that many plans presently classified as defined contribution would not have to make big changes to the way they are accounted for under the new proposals.

Chapter 6 – Recognition issues relating to contribution-based promises

Q8. Do you have any comments on these preliminary views? If so what are they?

Since the ASB does not agree with the proposed new definition for contribution-based promises, our comments relating to recognition issues should be taken in that light. The ASB agrees with the preliminary view expressed in PV9 that an entity would recognise both vested and unvested defined contribution promises as a liability.

PV10 suggests that an entity should allocate the benefits earned under a defined contribution promise to periods of service in accordance with the benefit formula. The ASB is in agreement with this. (Chapter 2 section 6.35 of PAAinE DP considers how to allocate according to period of service.)

PV11, which refers to there being no requirement to recognise an additional amount, determined by the benefit that an employer would have to pay when an employee leaves employment immediately after the reporting date, is also a view shared by the ASB. As noted in the DP, this is consistent with the existing requirements of IAS 19 and a change is not necessary as part of the current limited review. We also note that the requirement to recognise an additional amount would result in different accounting depending on whether the benefits are vested or unvested and believe that there should be consistent accounting for vested and unvested benefits.

Chapter 7 – Measurement of contribution-based promise – core issues

Q9. (a) Are there alternative measurement approaches that better meet the measurement objectives described in this paper? Please describe the approaches and explain how they better meet the measurement objectives?

(b) To what extent should the effect of risk be included as a component of the measurement approach at this stage of the Board's post employment benefit promises project? How should this be done?

Our main concerns on measurement are (i) the use of the term 'fair value assuming the terms of the benefit promise do not change', which is inappropriate given the current debate on the meaning of fair value and (ii) the requirement to include the effect of risk.

(a) The IASB uses the term 'fair value assuming the terms of the benefit promise do not change' and recommends that it meets the measurement objectives described in the DP, but also acknowledges (paragraph 7.40 of the DP) that it may not be fair value. In the ASB's view there needs to be a debate about whether post-employment benefits overall should be measured at fair value or on some other measurement basis. It is difficult to come to a view on this until the measurement debate is much further progressed. The IASB has not yet reached final conclusions on the definition of fair value.

In the PAAinE DP (Chapter 5), the ASB uses the term current value, but it is not (yet) possible to compare that with 'fair value assuming the terms of the benefit promise do not change' in the IASB DP, or the IASB's overall view on fair value. The choice of measurement basis is particularly relevant when liabilities are not traded in an active market and the market for transferring pension liabilities is still in its infancy and cannot yet be considered active (Chapter 6 6.3 PAAinE DP). The ASB believes that the liability in respect of future pensions should be measured at current value and that the measure will be a settlement amount. If alternative means of settling a liability are normally available to an entity then the liability should be reported at the lowest amount of the available alternatives. The ASB considers that current value measures meet the measurement objectives described in the IASB DP. Indeed current value measure is consistent with the approach taken in other accounting standards such as IAS 37 and IFRS 2 that address liabilities that are uncertain and of long duration.

(b) The ASB has indentified in the PAAinE DP risks associated with the size of the claim (demographic risk and risk that the terms of the benefit promise will change) and addressed them in chapter 2 section 4, which concludes that, 'only benefits that the entity is presently committed to pay should be reflected in the liability' (paragraph 4.24). Credit risk is a settlement risk and the ASB would like to draw attention to the PAAinE DP (chapter 7 section 5) which discusses in detail the arguments for and against including credit risk. The conclusion that the ASB has come to is that, on balance, the arguments against including credit risk were more convincing and hence it is inappropriate for an entity's liability for pensions to be reduced to reflect its credit risk. The three main reasons for not including credit risk are different to those identified in the IASB DP and are:

(a) The going concern concept requires the assumption to be made that an entity will settle its liabilities in full.

(b) Reducing an entity's pension liability to reflect the credit risk of the liability is not useful information for users who wish to assess the entity's cash flow prospects as it does not help them to assess the amounts, timing and uncertainty of the cash outflows from its obligations.

(c) Including credit risk may convey the misleading impression that an entity has an option to default on its obligations.

Q10. (a) Do you agree that the liability for benefits in the payout and deferment phases should be measured in the same way as they are in the accumulation phase? If not, why?

(b) What are the practical difficulties, if any, of measuring the liability for a contribution-based promise during the payout phase at fair value assuming the terms of the benefit promise do not change?

(a) As noted in paragraphs 8.5–8.6 of the IASB DP, the proposals lead to different amounts for identical obligations. However, the ASB believes that it is reasonable, as part of a short-term solution, to require the liability for benefits in the payout and deferment phases to be measured in the same way as they are in the accumulation phase. Any alternative would seem to require, in some cases, a change in measurement when an employee leaves or retires. It would be expected that the anomaly that economically identical liabilities would be measured at different amounts would be resolved as a consequence of a fundamental long-term review and, the dilemma that arises from paragraphs 8.5-8.6 of the IASB DP would not arise.

(b) We do not see major practical problems in the proposed measurement during the payout phase additional to those that will arise during the accumulation phase.

Chapter 9 – Disaggregation, presentation and disclosure of contribution-based promises

Q11. (a) What level of disaggregation of information about changes in the liability for contribution-based promises is useful to users of financial statements? Why?

(b) Do you agree that it is difficult to disaggregate changes in the contribution based promise liability into components similar to those required for defined benefit promises? If not, why not?

(a) Not-withstanding the fact that the ASB is not in favour of the introduction of the new category of contribution-based promises; it would like to outline that in the PAAinE DP the service cost would be reported in operating activities and that the unwinding of the liability for pensions would be presented within financing costs as it represents the interest cost (time value of money) arising on the liability to pay pension benefits at a future date. This therefore indicates the level of disaggregation of information that the ASB considers is appropriate.

The ASB considers that changes in assets and liabilities relating to the provision of pension benefits should be disaggregated to the extent that they arise from different economic drivers in the underlying assets and liabilities and hence have different predictive values.

(b) We agree that it is difficult to disaggregate changes in the contribution based promise liability into further components. We would add that the information content of any further disaggregation is likely to be limited.

Q12. Should changes in the liability for contribution-based promises:

(a) be presented in the profit and loss, along with all changes in the value of any plan assets; or

(b) mirror the presentation of changes in the liability for defined benefit promises (see chapter 3)?

Although the question implies that (a) and (b) are incompatible, we do not believe this is the case if Approach 1 in Chapter 3 is preferred. We agree with the proposal in (a) which, under Approach 1, would be consistent with the presentation of changes in the liability for defined benefit plans. In the event that an alternative presentation is adopted for defined benefit promises, we would favour a similar presentation for contribution-based promises.

Chapter 10 – Benefit promises with a 'higher of' option

Q13. (a) What are the practical difficulties, if any, in identifying and measuring the 'higher of' option that an entity recognises separately from a host defined benefit promise?

(b) Do you have any other comments on the proposals for benefit promises with a 'higher of' option? If so, what are they?

(a) The principles behind the rationale for identifying and measuring the 'higher of' option seem sound and consistent with the treatment of financial options in IAS 39 and, the 'higher of' option should be recognised separately from a host defined benefit promise. There may however be difficulties in reaching a fair value because it may not be separable. However, we believe it reasonable to assume that if an entity chooses to offer employees optional arrangements it should have the ability to measure them.

(b) We have no further comments on this issue.

Other matters

Q14. What disclosures should the Board consider as part of that review?

The IASB should identify its disclosure objectives and then attempt to determine the requirements. In responding to this question the ASB would like draw the IASB's attention to the ASB Reporting Statement: 'Retirement Benefits - Disclosures', issued in January 2007 and the PAAinE DP, Chapter 9, 'Disclosures in the employer's financial statements'. The Summary of Chapter 9 of the PAAinE (on pages 13 and 14 of that document) states that:

'Disclosures should provide information that explains the risks and rewards arising from the provision of pension benefits, having regard to materiality of the amounts involved, such that:

(a) financial statements contain adequate disclosure of the cost of providing pension benefits and any related gains, losses, assets and liabilities;

(b) users of financial statements are able to obtain a clear view of the risks and rewards arising from liabilities to pay pension benefits and the assets held to fund those benefits; and

(c) the funding obligations of the entity, in relation to liabilities to pay pension benefits, are clearly identified.

An accounting standard would have to permit an employer to provide disclosure of information relating to its plans in aggregate; however, it would be reasonable to require separate information about surpluses and deficits. There is also a case for requiring specific disclosures for individual plans that are material to the group as a whole.'

Appendix A to the chapter details specifically the proposed disclosures in the financial statements and the ASB would suggest that these should be part of the IASB review.

Q15. Do you have any other comments on this paper? If so what are they?

We reiterate that we do not believe the introduction of the new 'contribution-based promise' improves or clarifies the issues the IASB have sought to address and we would encourage the Board not to include them in the short-term project.

As stated in the covering letter, we believe that the financial reporting of pensions would benefit from a fundamental review and that this should be undertaken in the longer term.