EFRAG
European Financial Reporting Advisory Group

IASB
30 Cannon Street
London EC4M 6XH
UK

XX September 2008

Dear Sir/Madam

DRAFT COMMENT LETTER

Comments should be sent to Commentletter@efrag.org or uploaded via our website by 24 September 2008

Discussion Paper Preliminary Views on Amendments to IAS19 *Employee Benefits*

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on the Discussion Paper *Preliminary Views on Amendments to IAS19 Employee Benefits*. This letter is submitted in EFRAG's capacity of contributing to IASB's and IFRIC's due process and does not necessarily indicate the conclusions that would be reached in its capacity of advising the European Commission on endorsement of the definitive IFRS on the issue.

EFRAG welcomes the publication of the DP and believes that IAS 19 could benefit from short-term improvements given the various inconsistencies and implementation difficulties encountered to date in applying it.

Our detailed responses to the questions raised by the IASB are set out in the appendix to this letter. Our key messages are summarised below.

- EFRAG is generally supportive of eliminating options in accounting standards and concurs with the Board's preliminary views that the value of the plan assets and post-employment benefit obligations should be recognised in full and immediately. No corridor approach should be used.

- However, EFRAG does not believe the existing requirements on the presentation of changes in the value of plan assets and of post-employment benefit obligations in the performance statement(s) should be changed through this short-term project. The issues involved are complex and are best dealt within the context of a comprehensive presentation project, after long-term decisions have been taken about the presentation of gains and losses. In the mean-time, we believe that entities should be allowed to

present actuarial gains and losses either in other comprehensive income or with other gains and losses.

- EFRAG does not agree with the inclusion of what are defined as contribution-based benefit promises in the scope of the project. We are not convinced that the proposal is actually the best approach to addressing the issues that are behind them, we do not think the proposal draws the line between contribution-based promises and defined benefit promises in the right line, and we think the effect of the proposal will be that this quick-fix project will have a radical effect on existing practice.

- We are uncertain about the exact meaning of the measurement attribute being assigned to contribution-based promises (i.e. fair value assuming no change in the benefit promise), and have concerns over the inclusion of credit risk in the measurement of such promises;

- Finally, given that this project is intended to address items which require improvement in the short term we think that the objective of publishing a final standard in 2011 is not ambitious enough; we think a final standard in 2010 should be the target. As far as we can tell, the only part of the project that is likely to be difficult to complete by then relates to the definition of contribution-based promises, and we think it should be dealt with as part of the long-term comprehensive project rather than allow it to delay the short-term project.

If you would like further clarification of the points raised in this letter, I would be happy to discuss these further with you.

Yours sincerely

Stig Enevoldsen
EFRAG, Chairman

Appendix
EFRAG's response to the questions raised in the Invitation to Comment

Note that the references below to paragraphs PV1 to PV18 are references to paragraphs on pages 10 to 12 of the Discussion Paper Preliminary Views on Amendments to IAS 19 Employee Benefits *(the DP) on which the IASB's preliminary views are summarised*

Question 1 - Scope of the project

Given the objective of the IASB project 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?

Issues being dealt with in this project

1 We agree with the Board's view that accounting for post-employment benefits is a very complex area which now requires a fundamental review. Indeed, EFRAG has contributed to this debate as a sponsor of the PAAinE discussion paper *The Financial Reporting of Pensions* (PAAinE on Pensions). We also agree with the Board that such a review would take a number of years to complete and that, in the mean time, there is a limited number of issues which would benefit from improvement in the short term.

2 We agree with the inclusion in this short-term project of the issue of the deferred recognition of gains and losses arising from defined benefit plans. EFRAG is generally supportive of eliminating options in accounting standards and believes that the range of options available currently in IAS 19 hinders comparability between entities. We also agree with the inclusion in the project of benefit promises with a "higher of" option as there is a lack of guidance in this area at present. However:

   (a) although the scope of the project as described in the DP is to address "major flaws" that can be remedied in a short-term project, the project encompasses items which we do not believe cause major difficulties for users or preparers at present. For example, we are not aware of any major issues in respect of the definition of defined contribution promises that require immediate attention. We discuss this further in our response to question 5; and

   (b) we are not convinced that the presentation of the change in defined benefit liabilities is an issue which requires immediate resolution. Furthermore, in our view it is not an issue that should be resolved before a comprehensive debate on financial statement presentation has taken place. In the mean time, the two approaches to the immediate recognition of actuarial gains and losses set out in existing IAS 1 and IAS 19 (paragraphs 93A and 93B and 116 to 120) should be retained. We discuss this further in our response to question 3.

Issues not being dealt with in this project

3 We are aware that some commentators think the burden for some preparers could be reduced if a simplified approach could be found to the measurement of defined contribution schemes with a guarantee of a minimum return (which are currently classified as defined benefit promises). We consider the solution proposed in the DP to be too complex and to create the unintended consequence of an additional burden

in respect of the many existing defined benefit promises which are accounted for today without difficulty but would be categorised as 'contribution-based' under the DP's proposals. Their suggestion would be to isolate the financial guarantees embedded in the defined contribution and defined benefit plans and account for them separately with changes in value being presented in the income statement. If a simple solution cannot be found, we believe the whole issue should be excluded from this short-term project.

Questions to constituents

In paragraph 2(a) above, EFRAG states that it is not aware of any major issues in respect of the definition of defined contribution promises that require immediate attention. Are you aware of any such problems? If you are, what are they?

Are there any other areas which you believe could be improved in a short-term project?

Question 2 - Recognition and presentation of defined benefit promises

Chapter 2 describes the Board's deliberations on the recognition of defined benefit promises. The Board's preliminary views are summarised in paragraphs PV2–PV4. 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?

Recognising the value of the plan assets and post-employment benefit obligation in full

4 EFRAG is generally supportive of eliminating options in accounting standards and believes that the range of options available currently in IAS 19 greatly hinders comparability between entities. Furthermore, we cannot find any conceptual basis for the deferral or smoothing of actuarial gains and losses. We therefore concur with the Board's preliminary view (PV2) that all changes in the value of the post-employment benefit obligation and plan assets should be recognised in the period in which they occur, with the proviso that the measurement of the plan assets and the pension obligation must take into account the long-term nature of the items. We agree with the arguments and advantages discussed in paragraphs 2.10 and 2.11 of the DP, and would lay particular emphasis on the lack of transparency caused by the use of the corridor approach and other deferral mechanisms, and the sometimes illogical measurements that result from these.

5 In expressing the proviso above, we refer both to:

(a) the need to present the resulting changes appropriately in a performance statement, and

(b) the need to measure the obligation using a basis which is consistent with the way the obligation will be extinguished from the point of view of the reporting entity.

6 We deal with the question of presentation in response to question 3 below. The second point, on the consistency of the basis of measurement with the method of extinguishing the obligation is, of course, the issue of whether fair value is an appropriate measurement basis for a deferred benefit liability. We think that no decision should be taken on this matter in the context of a short-term project. This is

further discussed in question 7 in respect of contribution-based promises.

Dividing the return on assets into an expected return and an actuarial gain or loss

7 As explained in PV3, the IASB's preliminary view is that the return on assets should not be divided between the expected return and an actuarial gain or loss. We agree with this preliminary view; the expected return on assets does not represent a transaction or event of the period and should not be reported in the financial statements. On the other hand, we believe that, in practice, the management of pension funds, including funding decisions, is frequently based on the expected return on assets over the long term. Although we think that actual returns can give an indication of the potential future gap in earnings, we understand that some users think a single line item representing actual returns is of little help in forecasting future investment returns and hence the potential for future cash contributions to the pension fund. Those holding this view find expected returns more relevant and useful as a tool for prediction than the volatility induced by the use of actual gains and losses alone. We therefore suggest that information about the expected returns and the funding strategy of the pension funds should be disclosed in the notes.

8 Having said the above, in our response to question 3 below we recommend that the current approach of IAS 19 to the presentation of actuarial gains and losses in the statement of comprehensive income should be retained in the short term. This would mean that the expected return on assets would also be permitted to continue to be presented in the profit or loss. Although we do not believe that this is appropriate for the long term, we do think that it is an acceptable short-term expedient. We discuss this further below.

Recognition of unvested past service cost

9 PV4 explains that the IASB's preliminary view is that unvested past service costs should be recognised in their entirety in the period in which a plan amendment is made. As the Board points out in paragraph 2.20 of the DP, this is inconsistent with IFRS 2 *Share-based Payment* (paragraphs 27 and B43 of which require increases in benefits made within the vesting period to be attributed to each period of employees' services from the time of the modification until the vesting date is reached). However, the preliminary view of the DP maintains the approach of existing IAS 19 and is consistent both with the proposal for immediate recognition of gains and losses in the period in which they arise and with the retained requirement to base the allocation of benefits to periods of service using the benefit formula. On balance, we believe in this instance that internal consistency within IAS 19 is more important than consistency in this one aspect between IAS 19 and IFRS 2. We agree with the Board's preliminary view that unvested past service costs should be recognised immediately and in full.

Question 3 - Recognition and presentation of defined benefit promises

Chapter 3 sets out alternative approaches for the presentation of components of the defined benefit cost and analyses the relative merits of each approach. These approaches are summarised in paragraph PV5.

EFRAG note: The approaches are

Approach 1: An entity presents all changes in the defined benefit obligation and in the value of plan assets in profit or loss in the period in which they occur.

Approach 2: An entity presents the costs of service in profit or loss. Entities present all other costs in other comprehensive income.

Approach 3: An entity presents remeasurements that arise from changes in financial assumptions in other comprehensive income. Remeasurements arising from changes in financial assumptions are prompted by changes in the discount rate and in the value of plan assets. An entity presents changes in the amount of post-employment benefit cost other than those arising from changes in financial assumptions (eg the costs of service, interest cost and interest income) in profit or loss.

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

(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?

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

10 In thinking about the various approaches to the presentation of defined benefit promises, EFRAG has taken into account a number of considerations, including:

(a) a preliminary view of what the “right” long-term solution might be, as discussed in PAAinE on Pensions,

(b) the direction taken by other relevant current projects and the least disruptive route to the long-term position, that is, does the chosen approach differ significantly from what is currently permitted and will future decisions differ significantly from the short-term approach? Consistency over time is an important aspect of financial reporting and we believe it is not helpful to users and preparers if there is a series of significant changes in approaches over a relatively short period. In our view, this leads to confusion and frustration.

11 We find it difficult to comment on the alternative approaches for the presentation of components of the defined benefit cost in isolation from the work the Boards are carrying out in their Financial Statement Presentation (FSP) project to develop a long-term approach to the presentation of gains and losses in the performance statement (or statements). Although a decision has been taken recently to reduce significantly

the scope of the work being carried out on FSP over the next few years, we strongly believe that it is important that the IASB address as soon as possible the fundamental performance statement issues it was planning to address before the re-scoping. Only then should the IASB, we believe, take its long-term decision on the presentation of actuarial gains and losses—because only then will the IASB be in full possession of all the analysis and context needed to take the decisions.

12 Therefore, in this short-term project we believe two presentation approaches currently allowed by IAS 19 should continue to be allowed for the short-term.

(a) Presenting all actuarial gains and losses in OCI—Existing IAS 19.93A permits the recognition of actuarial gains and losses in the period in which they occur as elements of other comprehensive income (OCI) in the statement of comprehensive income.

(b) Presenting all changes in the value of the obligation and assets in profit or loss—IAS 19 also permits the alternative treatment of actuarial gains and losses being recognised within the profit or loss. The latter treatment corresponds to approach 1 of the DP.

Presenting all actuarial gains and losses in OCI

13 In paragraph 3.32, the Board states its reasons for its rejection of the approach of IAS 19.93A, which are that:

(a) it allows the effect of changes in assumptions on the service cost to be taken to OCI and,

(b) it requires the determination of an expected return on assets, which the Board believes is too subjective.

14 In respect of (a), we accept it is true that the permitted treatment, in conjunction with the absence of recycling, means that some items which are, or will be, valid expenses or income may never be recognised in profit and loss and this is inconsistent with the treatment of changes in estimates required by other IFRSs. However, we note that current IAS 19's recognition of actuarial gains and losses is entirely consistent with the definition of OCI in the revised IAS 1. In respect of (b), as discussed above, EFRAG agrees that an expected return should not be reported, not because a relatively high degree of judgement is required in arriving at it, but rather because it does not represent a real event or transaction of the period.

15 However, we think that the IAS 19 approach should be considered as a potential intermediate step as part of the short-term project. We think that it is acceptable to make such a compromise in order to ensure that the evolution towards a long-term solution does not result in confusion and incomprehension for users and preparers alike. One of the primary objectives of the long-term project should be full convergence of accounting for benefits under IFRS and US GAAP.

Presenting all changes in value of the obligation and assets in profit or loss (ie Approach 1)

16 In its requirement for all elements to be included in profit or loss, approach 1 is seen by some as better representing the economic reality of providing for pension costs. Under this view, the volatility and the cost are the economic consequences of the risks that the management of the entity has exposed it to, and are thus an element of the entity's performance which should be included in profit or loss. This approach also has the virtue of simplicity, in that all changes appear in the same part of comprehensive income.

17 The principal difficulty we see with this approach is that a single-figure presentation does not help users understanding of the trends in performance. This is not unique to this approach and discussed further below.

Approaches 2 and 3

18 Of the two remaining approaches proposed in the DP, we think approach 2 (changes in the value of the obligation and asset are split into the cost of service and the effect of deferred settlement of that cost, with the former being presented in profit or loss and the latter in OCI) should be ruled out for a number of reasons.

(a) Its treatment of the interest cost as an element of OCI is inconsistent with other areas of IFRS, notably IAS 37 and IFRIC 1, and we can see no justification for introducing such an inconsistency.

(b) All income and gains and losses from plan assets are removed from profit or loss, resulting in the loss of what many see as an appropriate offset in profit or loss between the costs of providing post-employment benefits and the benefit of setting aside funding for these.

(c) With the exclusion of both interest income and expense from profit or loss, entities which have chosen not to fund the plans will reflect the benefit from the alternative use of that funding in profit or loss, thus apparently being more profitable than entities with funded plans.

19 Approach 3 involves presenting remeasurements that arise from changes in financial assumptions in OCI and all other changes in the value of the obligation and assets in the income statement. This approach is more complex than the others, in that it requires an appropriate method of estimating income on plan assets which has to reflect the mix of financial instruments between interest-bearing, dividend-bearing and capital-growth assets. Like approach 2, it also has the disadvantage of being inconsistent with IAS 37 in its treatment of changes in the discount rate, in that these are taken to OCI instead of profit or loss.

Disaggregation and presentation

20 Whichever approach is adopted, we believe that a single figure aggregating all gains and losses that pass through comprehensive income (that is, profit or loss and other comprehensive income) is of little help to users because it would contain elements that are very different in nature that would evolve in different ways, and hence are of different predictive value. In our view, users require detailed information that allows

them to understand the causes behind the pension-related figures and therefore allows them to predict how the figures will vary given specified changes in the variables and assumptions used.

21 For example, we think it would be useful, as a minimum, to segregate the items that represent employment costs (current service cost, past service cost and other one-off changes such as settlements, curtailments and actuarial gains and losses) from interest income (including gains and losses) and from interest expense, and to include these in appropriate parts of the statement of comprehensive income. In this respect, existing IAS 1 and IAS 19 and the latest thinking in the project on Financial Statement Presentation (in its preliminary split of the statement of comprehensive income into business, financing and OCI sections) provide an indication of the type of approach that would be useful.

22 We think that the more detailed disclosure currently required under IAS 19.120A (g) and (h) provides a good indication of the level of detail that is required, but we have not yet formed a view as to the most appropriate way of incorporating this in the statement of comprehensive income.

23 The analysis of the elements making up the change in the plan assets and liabilities described in paragraph 23 above seems to correspond to the presentation of comprehensive income in the latest thinking of the project on Financial Statement Presentation, which includes a section for OCI. However, the correlation with the balance sheet presentation is more problematic, as it would be difficult to disaggregate the plan assets and liabilities into elements which correspond to the business or financing sections of the balance sheet.

Question 4 - Recognition and presentation of defined benefit promises

(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?

24 As discussed in our response to question 3 above, we think that in the short-term the two presentation approaches allowed by IAS 1 and IAS 19 should continue to be permitted. We believe however that both need to be improved by disaggregation of the net total and grouping into elements of similar predictive value.

25 If approach 3 is chosen by the Board, then quite detailed guidance would need to be provided on how to calculate the interest income component and separate it from the total change in the value of the assets. As already mentioned, we believe that, in the event that the Board decides to require companies to report the actual return on assets (and we would agree with such a decision in this approach), it should also require the disclosure of the expected return of assets in the notes. The expected return provides users with relevant information about what the entity considers to be the requisite funding levels for the plans.

Question 5 - Definition of contribution-based promises

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?

26 EFRAG does not agree with the inclusion of what are defined as contribution-based benefit promises in the scope of the project. We believe that existing IAS 19 deals adequately with such promises and we do not agree with the reasons for the changes that the Board lays out in the DP. The definition of contribution-based promises in the DP is well drafted and clear and should be easy to apply in most situations, but EFRAG has concerns over whether the dividing line between contribution-based promises and defined benefit promises has been drawn in the right place. We are also concerned that the proposed change might represent a radical change in accounting for certain post-employment benefits which may have implications for accounting for all post-employment benefits.

27 Existing IAS 19 has a straightforward definition of defined-contribution schemes based on the premise that contributions representing the entity's obligation are paid into a separate fund. That existing definition and the resulting accounting requirements appear to us to be clear and simple.

28 The issue is that the new definition scopes into the classification 'contribution-based promises' certain plans which intuitively sound like, and are currently identified as, defined benefit plans, and changes in the measurement attribute accompany this. As an example, career-average salary promises (which incorporate an element of salary risk in that future salaries are uncertain) do not appear to us to be very different from final salary schemes in that both contain uncertainty about the final cash flows that the promise will provide. Both contain vesting risk, demographic risk, credit risk and the risk that the terms of the benefit promise change. The distinction that is being used as the dividing line is that in the case of contribution-based promises the amount of the contribution or notional contribution is known at the end of the period in which the service has been rendered. It is true that the initial contribution is known. In the case of a promise based entirely on a fixed percentage of a current salary with no promise of returns on top of that, there will be no further contribution. However, where there is a promise of a return on the initial contribution, the final contribution (in other words, the amount of cash that will be required to settle the promise) will not be known until the period over which the benefits are earned has been completed. This requires an estimate to be made by projecting the asset returns forward using appropriate assumptions. While we agree that asset-return risk in an asset-based scheme is not exactly the same as salary risk in a final salary scheme, we wonder whether the difference in the type of risk is sufficient to justify different categorisation and measurement, given that similar estimating assumptions and techniques have to be used in both cases.

29 Some of the promises that will become contribution-based promises are explicitly referred to as defined-benefit schemes in existing IAS 19.26, such as where there is the guarantee of a specified return on contributions. We wonder why such promises have been scoped into this new category, given that we do not think that this type of promise poses measurement difficulties under the current IAS19 (although we do recognise that some preparers find the current requirement onerous).

30 In paragraph 4.9, the DP identifies problems raised with the IFRIC in relation to promises that meet the definition of defined-benefit promises in IAS 19.26. As stated in paragraph 4.10 of the DP, these do not appear to be issues of interpretation, because the definitions and requirements of IAS 19 seem clear to us. They seem instead to be perceived problems with the accounting requirements of IAS 19 and are the reason for the inclusion of these promises in the project. The two problems to which the revised definition of contribution-based promises relates are the attribution of benefit to periods of service and the measurement of any benefit that depends upon future returns on assets.

(a) Attribution of benefits to periods of service—Under existing IAS 19.67 an entity must attribute benefit to periods of service under the plan's benefit formula, unless service in later years will result in a materially higher level of benefit than in earlier years, in which case benefits are attributed to periods on a prescribed straight-line basis. The question is raised in the DP as to whether entities whose promise is expressed in terms of a guaranteed return on contributions based on a current salary should take into account expected future salary increases in determining whether materially higher benefits are allocated to later periods of service. What is not explicit in existing IAS 19 is what type of events are envisaged by the phrase "service in later years will lead to a materially higher level of benefit than in earlier years". We do not believe that this envisages the case of a benefit expressed in a fixed percentage of a reference salary. For example, under a final salary scheme each year's service earns x% of the final salary. On an undiscounted basis the same amount of benefit is therefore attributed to each year of service based on the estimated final salary. IAS 19.71 and examples 3 and 4 (which illustrate IAS 19.70) also imply that it is a material step-change in the formula for the attribution of benefits that leads to the requirement to use the alternative attribution approach and not just the effect of salary increases. We think, therefore, that this requirement is aimed primarily at schemes where there is a condition which leads to a material increase in the benefits because of a change in the formula, other than as a result of salary increases, once it has been triggered. An example of a scheme which would trigger the provision of IAS 19.67 would be a current salary scheme where each of the first twenty years' of service earns 1% of current salary and the final fifteen years each earns 5% of current salary. If our understanding is correct, then there is no need to take into account future salary increases in the absence of such a step-change in the benefit formula. We assume that where there is a step-change it is necessary to arrive at a method which attributes the same percentage to each year's service, but that percentage is applied to the current salary. If our understanding is correct, then what we believe is required is a clarification of the current requirements rather than the creation of a new category of promise.

(b) Measurement of any benefit that depends upon future returns on assets—In our view, the objective here is to measure the present value of the obligation the entity has, not to measure the present value of the assets as is implied by the views cited in the DP. The forward-projection of the assets at their expected rate of return is used to arrive at the best estimate of the cash flows that will be required to settle the entity's benefit promise. The resulting cash flows are discounted using the appropriate high-quality corporate-bond rate because it is a liability that is being valued. The approach of IAS 19 appears consistent with that

of IAS 37 and appropriate to the valuation of a liability, and we do not share the concern expressed in paragraphs 4.14 and 4.15 of the DP. It is true that where there are real assets involved, these will be measured at a fair value which will be different from the value of the liability at a given point in time because the measurement attribute is different. This, however, is also an issue for funded defined-benefit promises which would not qualify as contribution-based benefit promises. We do not believe that this issue should be remedied just for a subset of defined-benefit promises.

31 We believe that the two problems cited above are applicable to all defined-benefit promises and can be dealt with under existing IAS 19. If our understanding is correct, then what might be helpful as part of the short-term project is some application guidance and examples to clarify this. We do not believe that to change the categories of defined-contribution and defined benefit plans of current IAS 19 and to look for remedies in respect of only one of these is the appropriate solution.

32 As a final point, we welcome the adoption of the term "promise" instead of "plan" as we think that this makes it clear that entities need to look at the detail of the elements in a post-employment benefit plan and to account for each separate promise appropriately rather than just to apply one method to the whole plan.

Question 6 - Definition of contribution-based promises

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?

33 We believe that many promises may be reclassified. We expect that promises that are associated with a specified return on contributions or other guarantee, career-average promises and promises with 'higher of' options will be affected.

Question to constituents

Do you have any views on how many plans might be reclassified under these proposals? What are the practical difficulties that companies might face as a result?

Question 7 - Definition of contribution-based promises

Contribution-based promises, as defined in this paper, include promises that IAS 19 classifies as defined contribution plans. The Board does not intend this proposal to lead to significant changes in the accounting for most promises that meet the definition of defined contribution plans in IAS 19. Do the proposals achieve that goal? If not, why not?

34 We agree that the proposal should have no effect on current defined-contribution promises where there is no guarantee and the contribution is paid in full very soon after the end of the period in which the service is rendered and is not recoverable by the entity. However, we suspect that the use of the three building blocks (estimated future cash flows, the effect of the time value of money and the effect of risk) may in practice change the values and timing of the recognition of some defined–contribution promises.

Question to constituents

Do you concur with the above comment? If not, please provide your views with examples.

Question 8 - Recognition issues related to contribution-based promises

Chapter 6 discusses recognition issues related to contribution-based promises. The Board's preliminary views are summarised in paragraphs PV9–PV11. Do you have any comments on those preliminary views? If so, what are they?

35 PV9 suggests that both vested and unvested contribution-based promises should be recognised as a liability. Furthermore, the Board has made a commitment not to make any changes to this conclusion and simply to maintain the current requirements of IAS19 (i.e. treat unvested contribution-based promises as a liability). Our view is that, although the principle of treating unvested benefits as a liability has proved to be contentious in the past, we concur with the Board's decision to exclude this from the short-term project.

36 PV10 suggests that benefits should be allocated to periods of service based upon the benefit formula, with no departure from this allowed even if the formula assigns materially higher benefits to later periods of service: This proposal means that promises reclassified from defined benefit to contribution-based will be accounted for differently from at present if they currently require allocation on a straight-line basis. As discussed below, we are not convinced that *fair value assuming the terms of the benefit do not change* is the most appropriate measurement for such promises and we do not think that a different allocation method is suitable at this time for promises which are very similar to defined-benefit promises.

37 PV11 suggests that there should be no change to current IAS 19's requirement not to recognise the additional liability that would be payable if an employee left immediately after the reporting date. We agree with the Board's view that this should not be changed at this time, even though there is an inconsistency with IAS 39.

Question 9- Measurement of contribution-based promises

(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?

38 Paragraph 7.7 of the DP states that the measurement attribute should give users useful information about the amount, timing and uncertainty of future cash flows which result from the contribution-based promise. It explains that the Board believes that a measurement basis that comprises the following three building blocks would meet that objective:

(a) An estimate of future cash flows

(b) The effect of the time value of money

(c) The effect of risk.

The Board's preliminary view is that *fair value assuming the terms of the benefit do not change* is the appropriate measurement attribute.

39 We agree the above characteristics would meet the objective but we note that all of these elements are also generally incorporated in an actuarial computation of a defined-benefit obligation, albeit with the exception of credit risk. Given the similarity of the objective and the variables that are used for the proposed contribution-based promises with those required for a defined-benefit promise, it would appear to be difficult to justify using different measurement attributes for the different categories of promise. Indeed, we note that PAAinE on Pensions suggests only one measurement attribute for <u>all</u> pension liabilities: current value.

40 The DP states that *fair value assuming the terms of the benefit do not change* may not be fair value. We believe that there needs to be a comprehensive debate about whether post-employment benefits are financial liabilities (and measured at fair value or current value) or whether they are provisions (and therefore are to be measured at the best estimate of the cost of settlement). A decision on this for only one type of benefit promise appears to be premature and could be disruptive.

41 We believe, therefore, that the question of the appropriate measurement attribute should be pursued only as part of the long-term benefits project in order to allow full consideration of all the aspects of the accounting for benefits.

42 Although we do not believe that the measurement aspect should be pursued in this project, we have some comments about the DP's proposals:

(a) While most would agree that some measure of risk should be reflected in the measurement of the liability it begs the question as to how exactly one should quantify such risk. In particular, we believe that the DP lacks clear explanation of what is meant by asset-based risk, and how this could be reflected.

(b) It would seem logical to consider the risk of changes in demographic assumptions. The question arises as to whether the risk should be taken into account in arriving at the projected cash flows or reflected in the discount rate. The current approach in an actuarial computation of including this risk in the estimate of cash flows seems appropriate to us and simpler to estimate.

(c) In EFRAG's comment letter to the IASB on its Fair Value Measurement discussion paper, we voiced concerns over incorporating changes in credit risk when measuring the fair value of a liability. More specifically we mentioned that "our primary concern about allowing changes in own credit risk to affect measures that are used in the primary financial statements is that users will generally look to reverse out of the income statement gains and losses arising from changes in own credit risk, and for many purposes the balance sheet numbers are adjusted too. In other words, it is our understanding that users do not generally find the information useful". We still have the same concern.

(d) We have explained on previous occasions our concerns about including changes in credit risk in the measurement of liabilities. Regardless of the technical arguments, if users will reverse the resulting entries out of the primary financial statements—which is what we understand they will do—it cannot have been appropriate to include those effects in the primary financial statements in the first place.

(e) We note also that the DP does not make it clear whether it is the credit risk of the promise or the credit risk of the company that was being addressed in the proposals by the Board. Paragraph 7.26 states that credit risk is the risk that one party will cause a financial loss for the other party, implying that it is the entity's credit risk. However, paragraph 7.27 gives the principle that it is the credit risk specific to the liability that is relevant. It appears to us that if the entity still holds the obligation for the benefit contributions then its ability to pay is the more relevant risk.

(f) In addition to its contribution to PAAinE on Pensions, EFRAG has previously commented on the IASB's Fair Value Measurement discussion paper and the Insurance project discussion paper. It has not yet reached a view on whether measurement should be consistent in all respects across these different areas of accounting or whether slightly different approaches to measurement are justified.

Question 10 - Measurement of contribution-based promises

(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?

43 Regarding (a): The DP states that the definitions of the benefit promises rely on the nature of the benefit promise during the period during which the employee accumulates benefits. After employment has ceased the liability to pay benefits does not depend on the way in which the liability arose. The Board's preliminary view is that the liability should be measured in the same way during the deferment and payment phases as during the accumulation phase. We agree with this view because we do not think that it is helpful for there to be a change in measurement as employees pass into the deferment or payment phase of the promise. However, as stated above, we do not agree with the introduction of the new category of promise and its accompanying variant of fair value, and believe that it is the use of different measurement attributes for the different new categories of benefit promise which is leading to this question being raised.

44 Regarding (b): We do not believe that *fair value assuming the terms of the benefit do not change* should be adopted as a measurement basis at this point, as discussed above. Having said that, we do not see any particular difficulties in measuring the liability during the payout phase which do not exist during the accumulation phase.

Question to constituents

Do you have any views on the practical difficulties that companies might face in view of these proposals?

Question 11 - Disaggregation, presentation and disclosure of contribution-based promises

(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?

45 As stated above in our response to question 5, we are not in favour of the introduction of the new category of contribution-based promises.

46 Regarding (a): The IASB's proposal in Chapter 9 is to disaggregate changes into a service cost and other value changes arising from a contribution-based promise, as well as disclosing all changes in plan assets. We think this proposal is a start and that the dis-aggregation proposed will provide some useful information. We do not believe however that the disaggregation proposed is sufficient.

47 Regarding (b): We agree that it would be difficult to analyse the changes in the liability for contribution-based payments in the same way as those for defined benefit promises. We think that this raises the question of whether the new definition of contribution-based and the new measurement attribute result in information that is as useful to users of financial statements as that for defined-benefit promises.

Question 12 - Disaggregation, presentation and disclosure of contribution-based promises

Should changes in the liability for contribution-based promises:

(a) be presented in profit or 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)?

Why?

48 Option (a) has the advantage of being simple to implement. Presentation of the changes in the assets and the liabilities separately would facilitate users' understanding. However, we believe that option (b) would lead to greater consistency in the presentation of defined-benefit and those contribution-based promises that are currently treated as defined-benefit promises, and therefore would be more useful.

Question 13 - Benefit promises with a 'higher of' option

(a) What are the practical difficulties, if any, in identifying and measuring the 'higher of' option that an entity recognizes 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?

49 The Board's preliminary views are summarised in PV16 – PV18. It suggests that the 'host' defined benefit promise should be accounted for in the same way as a defined benefit promise with separate recognition of the 'higher of' option at fair value, assuming the terms of the benefit promise do not change.

50 Regarding (a): We believe that the proposed accounting makes sense intuitively, and it is consistent with the treatment of financial options in IAS 39. However, we wonder about the ease with which such options can be valued in practice. For entities which have no other involvement with options this may present a burden.

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

Question to constituents
Do you have any views on the practical difficulties that might arise when identifying and measuring the 'higher of' option that an entity would, under the proposals, recognise separately from a host defined benefit promise?

Question 14 – Other matters

The Board intends to review the disclosures required about post-employment benefit promises in a later stage of this project. As part of that review, the Board intends to consider best practice disclosures in various jurisdictions. For example, explicit requirements to disclose information about the mortality rates used to measure post-employment benefit liabilities could be introduced to allow users to understand the inherent uncertainties affecting the measurement of those liabilities. What disclosures should the Board consider as part of that review?

52 We believe that the disclosure requirements of existing IAS 19 are useful. The preliminary views expressed in the DP will effectively make some of the current disclosures redundant. We think careful consideration should be given to each of the existing requirements and their usefulness assessed. For example, under PV3 the expected return will no longer be disclosed as an element of profit or loss. We think that this is useful and relevant information that should continue to be disclosed.

53 We have the following suggestions for potential further disclosures:

(a) Details of the assumptions used to measure liabilities, for example mortality rates as mentioned above as well as an explanation of why assumptions have changed from previous periods.

(b) Sensitivity of the measurement of pension liabilities to the principal assumptions

used (for example discount rates, mortality rates, increase in salaries, inflation rates). We recognise that these are often a burden for preparers to provide.

(c) Alternative measures of liabilities, for example buy-out amounts or ABO, if these are readily available. It would be particularly important to consider carefully the costs and benefits involved here.

(d) A description of the investment strategies adopted, including the expected return on assets and target allocation percentages or ranges for each major category of plan assets.

54 The suggestions above are discussed at greater length in PAAinE on Pensions.

55 We believe that in all cases it is important that all existing and proposed disclosures be carefully considered and required only if necessary for the user to understand the circumstances and risks inherent in the pension provisions.

Question 15 – Other matters

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

56 We are concerned about the apparent implication of some of the language in the DP that anti-abuse concerns should influence the development of accounting standards. Examples of this are the reference to the "misestimation of service costs to achieve an accounting result" in paragraph 3.14 and "the subjectivity inherent in determining the expected rate of return provides entities with an opportunity to choose a rate with a view to manipulating profit or loss" in paragraph 2.15. The choice of the accounting treatment should be based on the Framework and should be aimed at providing the most useful information for users of financial statements.

57 We do not believe that there are problems or uncertainties with the accounting for those promises that the Board believes need to be improved by the creation of contribution-based promises and the related measurement attribute. We would encourage the Board not to include these in a short-term project but to consider these in a comprehensive project. This would help ensure that a consistent approach to defined benefit promises can be developed without hindrance from decisions taken prematurely. We think it is important not to create different measurement attributes and allocation methods for different types of benefit promise, but rather to try to define one approach which can be applied to all promises, as reflected in PAAinE on Pensions. This would facilitate the users' understanding of the accounting, enhance comparability and should ease the burden on the preparer.

58 Although we think that existing IAS 19 is clear, the comments in the DP lead us to think that an area where guidance might be helpful is that of the required departure from the use of the benefit formula to attribute benefit to periods of service (paragraphs 67 to 71 of IAS 19). Specifically, clarification of whether higher benefits resulting solely from the application of an unchanged benefit percentage to much higher salaries in later years are the type of "materially higher benefit" that the standard envisages, or whether it is necessary for some other factor to come into play, such as a step-change in the benefit percentage. In conjunction with this, a definition and more examples of what is meant would be useful.

59 Finally, given that this project is intended to address items which require improvement in the short term we think that the objective of publishing a final standard in 2011 is not ambitious enough. We think a final standard in 2010 should be the target. As far as we can tell, the only part of the project that is likely to be difficult to complete by then relates to the definition of contribution-based promises. In our view if that part of the project is preventing a standard from being issued in 2010, it should be dealt with as part of the long-term comprehensive project rather than be allowed to delay the short-term project.