

September 2, 2010

Submitted electronically

International Accounting Standards Board
30 Cannon Street,
London EC4M 6XH
United Kingdom

Dear Sirs:

Re: April 2010 Exposure Draft, *Defined Benefit Plans (Proposed amendments to IAS 19)*

The following comprises the response of the staff of the Canadian Accounting Standards Board (AcSB) to the IASB's Exposure Draft, *Defined Benefit Plans (Proposed amendments to IAS 19)*, dated April 2010.

In developing this response, the AcSB's staff consulted with its User Advisory Council, its Employee Benefits Advisory Group (which comprises accountants, actuaries, a financial statement user, and an academic, and which supports the Canadian member appointed to the IASB's Employee Benefits Working Group), several AcSB members, and a member of its Academic Advisory Council. The views expressed in this letter take into account comments and perspectives raised by these stakeholders, although they do not necessarily represent a common view of the AcSB, its committees or its staff. Views of the AcSB are developed only through due process.

We continue to be highly supportive of the recognition of all changes in the value of plan assets and in the defined benefit obligation in the financial statements in the period in which they occur. We think that this proposal would result in a significant improvement in financial reporting for defined benefit plans by increasing transparency, understandability and comparability. We support the improvements to the presentation of the changes in plan assets and the defined benefit obligation, but have concerns with some aspects of the Exposure Draft proposals. We are not convinced that the net interest approach is the only practical alternative to determining the finance cost component and suggest that further consideration be given to the use of an expected return on plan assets.

Although we agree with the disclosure objectives, we are concerned that if the specific disclosure requirements are complied with literally they will continue to result in voluminous disclosures that do not highlight the risks of these plans. We agree with the view expressed in the Snapshot for this project that current disclosure results in precisely this problem. We recognize that there is no easy solution to this issue, as each of the required disclosures could be important in specific circumstances. However, we urge the IASB to step back and reconsider how the disclosure requirements could be focused on meeting the disclosure objectives in an effective and efficient manner.

In terms of the practice issues that the proposals set out to address, we are concerned that significant practice issues with IFRIC 14 have not been addressed and urge the IASB to resolve them as part of finalizing the amendments.

The appendix to this response addresses the questions asked in the Exposure Draft, including identifying areas where the proposals require clarification and elaboration to prevent diversity in practice, and also providing more details on our overall comments above.

We would be pleased to elaborate on any of our comments in more detail if you require. If so, please contact Peter Martin, Director, Accounting Standards, at +1 416 204-3276 (e-mail peter.martin@cica.ca), Mark Walsh, Principal, Accounting Standards, at + 416 204-3453 (e-mail mark.walsh@cica.ca), or Nancy Estey, Principal, Accounting Standards, at +1 416 204-3271 (e-mail nancy.estey@cica.ca).

Yours truly,

A handwritten signature in black ink that reads "Peter Martin". The signature is written in a cursive, slightly slanted style.

Peter Martin, CA
Director
Accounting Standards

Appendix – Responses to questions asked in Exposure Draft, *Defined Benefit Plans (Proposed amendments to IAS 19)****Question 1 – Recognition of changes when they occur***

We strongly support recognizing all changes in the present value of the defined benefit obligation and in the fair value of plan assets when they occur. We also agree with the IASB's rationale for this recognition as discussed in paragraphs BC9-12, including that such recognition represents a significant improvement in the usefulness of the financial statements. This proposal is also consistent with the views expressed by members of the Canadian Accounting Standards Board, its User Advisory Council and its Academic Advisory Council, as noted in our September 2008 comment letter on the Discussion Paper, *Preliminary Views on Amendments to IAS 19 Employee Benefits*.

Question 2 – Recognition of unvested past service cost when related amendment occurs

We agree with recognizing unvested past service cost when the related amendment occurs. We note that this recognition treatment would result in consistent recognition of all unvested costs (both current service and past service) and thus, we suggest that this rationale be added to paragraph BC12.

Question 3 – Disaggregation of defined benefit costs into three components

We support the disaggregation of defined benefit costs into components to enhance the transparency and thus the usefulness of the information.

Members of the AcSB's User Advisory Council stressed the importance of separately identifying all components of other comprehensive income, either on the face of the statement of comprehensive income or in the notes to the financial statements. Accordingly, they welcomed the proposals to require separate disclosure of the remeasurements of the net defined benefit liability (asset) in paragraphs 125E(c)-(d). They did not see a distinction between other comprehensive income and profit or loss as being important provided all key components are separately identifiable.

The disaggregation of defined benefit costs into components is supported by recent research on the value relevance of fair value pension information. Hann, Heflin and Subramanyam (Journal of Accounting and Economics, 2007) conclude that fair value pension accounting, as compared to a smoothed model, can actually impair the equity and credit value relevance of income statement information unless gains and losses are separated from other income components. They argue that disaggregation is important as it allows more persistent components, for example, service cost, to be valued separately from less persistent components, for example, gains and losses.

We suggest that the amended standard clarify the following points:

- Paragraph 61 states that “an entity shall recognize changes in the net defined benefit liability (asset) in the statement of comprehensive income, except to the extent that another Standard requires or permits their inclusion in the cost of an asset”.
 - The amendments to this paragraph removed the list of items to be included in comprehensive income (e.g. current service cost, past service cost). The proposed wording implies that all changes in the net defined liability (asset) are included in comprehensive income – including changes due to contributions and to payments to plan beneficiaries. The drafting needs to be amended to exclude changes that are not part of comprehensive income.
 - Under IAS 23 *Borrowing Costs*, interest cannot be included in the cost of a qualifying asset unless it is directly attributable to the acquisition, construction or production of that asset. Is the net financing cost considered to be a borrowing cost for the purposes of IAS 23?
 - Under IAS 16 *Property, Plant and Equipment*, only directly attributable costs can be included in the cost of an asset. IAS 16.17(a) specifically includes, as an example of directly attributable costs, “costs of employee benefits (as defined in IAS 19 *Employee Benefits*) arising directly from the construction or acquisition of the item of property, plant and equipment.” We note that this paragraph was written in the context of the current version of IAS 19, i.e., when defined benefit costs were presented as a single amount, and the Exposure Draft does not propose consequential amendments to IAS 16. It is unclear which elements of pension costs are directly attributable for purposes of IAS 16. Is the remeasurement component considered directly attributable? If the net financing cost is not considered to be a borrowing cost for purposes of IAS 23, then is it considered to be a directly attributable employee benefit cost?
- Is the net defined benefit liability (asset) a monetary item for purposes of IAS 21? We note that the Insurance Contracts exposure draft specifies that an insurer shall treat an insurance contract that results in cash flows in a foreign currency as a monetary item in its entirety.

Question 4 – Defining the service cost component

We agree that the service cost component should exclude changes in the defined benefit obligation resulting from changes in demographic assumptions. We think that such changes should be treated in the same manner as changes in economic assumptions and differences between actual and expected assumptions, and thus, all belong in the same component.

Given the different presentation of service costs and remeasurements, it is important that which category applies to different events is clear. For example, an entity may amend a defined benefit plan in such a way that its assumption about the expected retirement age for unreduced retirement benefits changes from age 62 to age 60. One view is that the amendment is a plan enhancement that results in a past service cost (included in profit or loss). An alternative view is that the entity now expects that some employees will chose to retire earlier than they would otherwise have done. This is considered to be a change in the retirement age assumption whose effect on the defined benefit obligation is a remeasurement that is included in OCI.

Question 5 – Defining the finance cost component

We agree that the net interest approach is a practical expedient that eliminates subjectivity in determining the finance cost component. Although we understand the Board's concern about the application problems of the existing requirement for entities to estimate a return on plan assets, we think that the result of the proposals is to make unlike things look the same.

We are concerned that the net interest approach does not take into account the different economic drivers of the obligation and plan assets and does not reflect the investment strategy of the plan. Indeed, the net interest approach is likely to systemically understate profit and loss since, over the long term, the return on plan assets can be expected to exceed the discount rate. If this were not so, then pension plans would consistently invest only in high quality corporate bonds.

By requiring the return on plan assets to be assumed to be the return on high quality corporate bonds, the Board is treating this assumption differently from the others required for measurement of the pension cost and obligation. That is, in all other cases, the amount is determined based on the entity's best estimate assumption and variations from the assumption are included as remeasurements in OCI. In this case, the finance component will not fairly represent the entity's assumption of the finance impact of the pension liability (asset) and the plan's investment strategy on profit or loss. This makes it more difficult for users to relate the risks inherent in the plan assets to the entity's performance.

Pension plans must comply with a variety of regulatory requirements around the world . These requirements may affect the potential return on plan assets but may not be appropriately reflected in the net interest approach. For example, in Canada retirement compensation arrangements (RCAs) enable employers to provide supplemental pension benefits to owner managers and key employees in addition to the benefits generated from the contributions to registered pension plans permitted by income tax law. Contributions are subject to a tax of 50% on receipt by a plan but the tax is recoverable (without interest) when benefits are paid

out and taxed in the recipients' hands. If a company contributes CU100 to a RCA, then the RCA will have investment assets of CU50 and a tax receivable of CU50. The net interest approach would result in the finance cost component including income on the CU100 although income is actually only earned on CU50 (since no income is earned on the tax receivable). This overstatement of profit or loss would be offset by a "remeasurement" loss in OCI.

The Basis states that the disadvantage of using an expected return is that management's subjective determination of that return will influence earnings. However, this is less of a concern under the proposals in the ED than under existing IAS 19. Currently, an entity can overstate its expected return on assets [e(ROA)], immediately boosting operating income, and only bear the consequences through increased amortization of unrecognized experience losses spread over 10-15 years. Under the model proposed in the exposure draft, an overstated e(ROA) in income would be offset by the recognition of experience losses in other comprehensive income in the same period. There would be no impact on the amount of the net defined liability (asset) recognized in the statement of financial position. Therefore, concerns about subjectivity and manipulation are mitigated. Further, the detailed disclosures required about investment strategy, asset mix, the rationale for e(ROA) estimates and an explanation of variation in actual returns from e(ROA) help to hold entities accountable for the estimates they use. We suggest that the IASB give further consideration to the use of the expected return on plan assets in determining the finance cost component.

Question 6 – Presentation

We agree with the proposals in the ED for the presentation of the benefit cost in comprehensive income.

We note that the subjectivity in determining the service cost, finance cost and remeasurement components provides management the opportunity to shift costs from profit or loss to other comprehensive income. For example, management may select assumptions such as the discount rate, salary escalation rate, etc. that reduce the elements of defined benefit costs that are included in profit or loss. While this would be offset in OCI, most financial statement users attach greater significance to profit or loss (and earnings per share is calculated on this amount). The reconciliation from opening to closing balance of plan assets and the defined benefit obligation in the detail required by paragraphs 125D and 125E together with information about actuarial assumptions required by paragraph 125G should provide the information for users to monitor this. We suggest that the Basis refer to this issue.

Question 7 – Settlements and Curtailments

We agree that gains and losses on routine and non-routine settlements should be treated in the same way as actuarial gains and losses, and also that curtailments should be treated in the same way as plan amendments (both those that reduce benefits under the plan (negative past service costs) and those that increase benefits under the plan).

However, treating settlements and curtailments differently does raise certain issues. Some transactions result in both a settlement and a curtailment. For example, a conversion of a defined benefit plan into a defined contribution plan results in a curtailment as a result of eliminating future service, and a settlement as the existing defined benefit obligation is replaced with the defined contribution plan. Often the settlement would result in a loss. The result would be a (curtailment) gain in profit or loss and a settlement loss in OCI. In this circumstance it might be more transparent and understandable if all the implications of the transaction were reported together in profit or loss. If this is not done, a further issue is whether the settlement or curtailment is calculated first as this may affect the measurement of the curtailment gain (recorded in profit or loss) and of the settlement loss (recorded in OCI).

Paragraph 119D specifies that the net defined benefit liability (asset) is remeasured prior to determining the effect of a settlement. However no guidance is given for other remeasurements such as a curtailment. We think that the net defined liability (asset) should be remeasured prior to determining the effect of a curtailment. That remeasurement and the effect of the curtailment should use current actuarial assumptions at the date of the curtailment. The net interest on the defined liability (asset) for the remainder of the reporting period following the curtailment should be determined using the discount rate used in the measurements at the curtailment date. We suggest that this be clarified in the final amendments to IAS 19.

We agree that the proposals should continue to require entities to disclose a narrative description of any plan amendments, curtailments and non-routine settlements and their effects on the statement of comprehensive income. This disclosure enables financial statement users to understand the effects of those events.

Question 8 – Disclosure Objectives

We agree with the disclosure objectives.

Question 9 – Disclosure Requirements – New disclosure requirements

We support the IASB's approach to determining disclosure requirements as explained in paragraph BC 53 but are concerned that the disclosures included in the exposure draft will continue to result in disclosure overload. The proposals add many disclosures such as information about risk, including sensitivity analysis, and information about the process used to determine demographic actuarial assumptions, but eliminate only a few current requirements such as the expected return on plan assets. We also think that some of the disclosure requirements may lead to boilerplate disclosures, for example, a description of "the process used to determine demographic actuarial assumptions" will lead to "the actuary used table XYZ" (paragraph 125G(b)).

We note that the IASB's Exposure Draft *Revenue from Contracts with Customers* similarly includes significant detailed disclosure requirements. However, those proposals also include, in paragraph 70, an explicit requirement for the entity to "consider the level of detail necessary to satisfy the disclosure requirements and how much emphasis to place on each of the various requirements." We think this type of discussion, focusing attention on the disclosure objectives and encouraging entities to "aggregate or disaggregate disclosures so that useful information is not obscured" would be extremely helpful in alleviating our concerns about disclosure overload. Entities apparently believe they require explicit permission from the standards to use judgement regarding disclosures.

We question the information value of the new requirement in paragraph 125H to disclose the present value of the defined benefit obligation, modified to exclude the effect of projected salary growth. It is not clear how this relates to the disclosure objectives in paragraph 125A. We find the rationale in BC60(f) to be weak. We do not support requiring disclosures because some users believe the information is relevant. Others disagree with the Board's conclusion that the appropriate measurement of the obligation is incorrect or that the disclosure is not costly. Disclosure overload and the cost of disclosure are based on cumulative disclosures, not on each individual disclosure. If a disclosure is not *essential* to achieving the disclosure objectives it should not be required.

Paragraph 125K requires disclosure of information about factors that could cause contributions to differ from service cost, but does not require disclosure of the expected future contributions. (Current paragraph 120 (q) does require disclosure of contributions to be paid to the plan in the subsequent year. This disclosure has not been included in the exposure draft.) Financial statement users consistently tell us that among the most important information they are looking for is the expected future benefit plan contributions. Pension plan funding requirements are usually set over several years in accordance with the requirements of

regulators. Specific information about future plan funding, when available, would provide significant benefit to all users and would not be onerous for preparers. This information could be in the form of a range if a specific amount cannot be reasonably determined.

In our comment letter on the Discussion Paper, *Preliminary Views on Amendments to IAS 19 Employee Benefits*, we suggested the disclosure of the effective date of the most recent actuarial valuation for funding purposes and the effective date of the next required actuarial valuation for funding purposes. Financial statement users consider whether future cash outflows for employee future benefits might be significantly different than those for the current year. Accordingly, financial statement users find the effective date of the last actuarial valuation for funding purposes important in understanding the current required funding, while the effective date of the next valuation determines when the required annual funding amount is likely to change.

We note that some IFRSs and some proposed IFRSs include a final disclosure paragraph about disclosing additional information necessary to meet the objectives in the standard, for example, paragraph 71 in the IASB's June 2010 Exposure Draft, *Revenue from Contracts with Customers* and paragraph 63 in IFRS 3 *Business Combinations*. However, this exposure draft and certain other standards do not include this. We suggest that the IASB consider its policy for including this type of "stand back" requirement to ensure consistency.

Question 10 – Disclosure Requirements – Multi-employer plans

We support the disclosure requirements for multi-employer plans.

Question 11 – Disclosure Requirements – State plans and defined benefit plans that share risks between various entries under common control

We have no comments on this question.

Question 12 – Disclosure Requirements – Other comments

We have no further comments.

Question 13 – Other issues

We have comments on some of the practice issues addressed in the proposals.

(a) Incorporation of IFRIC 14 into IAS 19

There are a number of issues arising in practice regarding the limit and the minimum funding requirements. See our comment letter dated July 28, 2009 on the Exposure Draft, *Prepayments of a Minimum Funding Requirement (Proposed amendments to IFRIC 14)*, dated May 2009 in

which we suggested, for example, clarifying the word "requirements" as it relates to the minimum funding requirement. We noted different views on the meaning of "requirements."

We recommend that the IASB resolve the issues arising in practice as part of finalizing the amendments.

(b) Mortality assumptions

Some actuaries confirmed that their estimates of expected mortality would include their estimates of changes in mortality in the future as well as an update of current mortality rates in the same way insurers take into account mortality assumptions. However, we suggest clarifying paragraph 73(i) as follows to ensure this understanding:

Best Current estimates of the expected mortality rates of plan members both during and after employment, allowing for projected future changes in life expectancy;

Question 14 – Multi-employer plans

We are not aware of any situations in which a defined benefit multi-employer plan has a consistent and reliable basis for allocating the obligation, plan assets and cost to the individual entities participating in the plan.

Question 15 – Transition

In general, we agree that entities should apply amendments to a standard retrospectively, subject to practicability. We are not aware of any practicability issues with applying these proposals retrospectively.

Question 16 – Benefits and costs

We agree in part with the IASB's assessment of the benefits and costs. We agree with reporting changes in the carrying amount of defined benefit obligations and changes in the fair value of plan assets in a more understandable way and eliminating some presentation options currently allowed by IAS 19, thus improving comparability. However, we do not agree that the proposals clarify the requirements that have resulted in diverse practices because we think that important issues arising in practice regarding the limit and the minimum funding requirements have not been addressed (see comments on Question 13(a)) In addition, although we agree with the disclosure objectives, we do not agree that the detailed disclosure package will solve the problem of voluminous disclosures that do not clearly highlight the risks of the plans (see comments on Questions 8-12).

Question 17 – Other commentsCommunicating the proposals

We recognize that the IASB has improved its communications regarding Exposure Drafts with the use of vehicles such as Snapshot summaries, web presentations and Frequently Asked Questions documents. However, we think that the Defined Benefit Plans Exposure Draft fell short in terms of its packaging, especially given that it is a very difficult topic for most people even in ideal circumstances. We think that presenting only the headings and paragraphs that changed or are new makes it extremely difficult to assess the proposed changes. Even with the current text of IAS 19 in hand, we found it confusing and frustrating. In the future, we suggest that the IASB provide an additional complete document, i.e., either the existing IFRS in its entirety showing all additions, deletions and changes in mark-up form or a clean version of the complete revised standard.

Furthermore, we suggest a rigorous review of the entire text when the proposed material is finalized to ensure that all changes in terminology, etc, have been identified and to catch any errors, for example, see “Other long-term benefits” below for our suggestion to reinstate the last sentence of paragraph 130.

Interim reporting

We think that clarification is needed on whether interim reporting would entail a new full valuation or an update to the most recent valuation on a quarterly basis. We foresee some difficulties with determining the fair value of non-market assets, especially with Canadian entities registered with the US Securities and Exchange Commission that adhere to accelerated deadlines for filing periodic reports. We do not expect any difficulties with determining the amount of the defined benefit obligation at an interim date as it would simply be a roll-forward of the obligation from the end of the previous reporting period.

Other long-term benefits

We think that the last sentence of paragraph 130 should be reinstated because it was likely deleted in error with the deletion of paragraphs 126-13. It reads: “If the level of benefits is the same for any disabled employee regardless of service, the expected cost of those benefits is recognized when an event occurs that causes a long-term disability.” Furthermore the sentence provides the necessary guidance to support proposed examples 3 and 4 that distinguish between the two types of long-term disability plans.