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Ms Anne McGeachin
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Dear Ms McGeachin

DISCUSSION PAPER *PRELIMINARY VIEWS ON AMENDMENTS TO IAS 19 EMPLOYEE BENEFITS*

The Heads of Treasuries Accounting and Reporting Advisory Committee welcomes the opportunity to provide comments on International Accounting Standards Board Discussion Paper: *Preliminary Views on Amendments to IAS 19 Employee Benefits*.

HoTARAC is of the opinion that the IASB did not provide enough information in the Discussion Paper to justify the need for change in accounting for post-employment benefits. The IASB should have provided greater detail on the current issues, rather than simply stating that anecdotal evidence and academic research suggests that many users of financial statements do not fully understand the information that entities provide about post-employment benefit promises. Greater detail would have allowed HoTARAC to determine if the changes suggested in the Paper will address the current issues.

HoTARAC is also of the opinion that the IASB would achieve greater improvements in accounting for post-employment benefits if it took a principles-based approach to the Standard rather than the rules-based approach, as set out in the Discussion Paper. The IASB needs to explore why post-employment benefits needs a rules-based accounting Standard when accounting standards for other types of assets and liabilities are principles-based.

Given the two issues stated above, HoTARAC does not support the IASB in its undertaking of this Project. Nevertheless, HoTARAC has provided comment on the specific issues to assist the IASB in its consideration. HoTARAC supports the following individual proposals as set out in the Paper:

- the recognition of all changes in the value of plan assets and in the post-employment benefit obligations in the period in which they occur;
- the recognition of unvested past service cost in the period of the plan amendment;

- the recognition of both vested and unvested contribution-based promises as a liability;
- the allocation of benefits earned under a contribution-based promise to periods of services in accordance with the benefit formula;
- the liability for benefits in the payout and deferment phases should be measured in the same way as they are in the accumulation phase; and
- the liability for contribution-based promises should mirror the presentation of changes in the liability for defined benefit promises.

A consensus could not be achieved amongst HoTARAC members in regards to the presentation of changes in post-employment benefits. The majority of members support Approach 1, presenting all changes in the value of plan assets and obligation in the Profit and Loss. Supporters of Approach 1 are of the opinion that this approach provides the most useful information to users of financial statements and is best aligned to the *Framework*. All of the supporters of Approach 1, currently recognise actuarial gains and losses through the Profit and Loss.

A minority of HoTARAC members supported Approach 3, presenting remeasurements that arise from changes in financial assumptions in other comprehensive income and all other changes in the Profit and Loss. Supporters of Approach 3 believe that this approach will reduce the volatility in the Profit and Loss associated with revaluations, allow users of financial statements to assess the stewardship of management without taking into account factors, which to some extent are outside the control of management and to estimate future cash flows on information that is not distorted by unrealised gains/losses.

HoTARAC does not support the introduction of the new unit of measurement "promises". It is HoTARACs opinion that the IASB did not adequately explain or justify this new unit of measurement in the Paper to allow constituents to determine its full implications. In particular, the IASB did not detail the level of disclosure required or if assets will need to be allocated to a promise.

Australian Governments currently report on a plan level in accordance with AASB 119 *Employee Benefits*. If the concept of promises is introduced, Australian Governments plans will need to be broken down and reported on a promise level. Based on the limited material on promises in the Discussion Paper, HoTARAC has estimated that the Australian Government military plan consists of at least nine promises and that other plans consist of at least two or three promises. HoTARAC does not see any benefits in this lower level of reporting, especially in regards to plan assets.

Detailed comments by HoTARAC on the Discussion Paper are attached.

If you have any queries regarding HoTARAC's comments, please contact Peter Gibson from the Australian Government Department of Finance and Deregulation on +61 2 6215 3551.

Yours sincerely



D W Challen

CHAIR

HEADS OF TREASURIES ACCOUNTING AND REPORTING ADVISORY COMMITTEE

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Encl

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Preliminary Views on Amendments to International Accounting Standard (IAS) 19 *Employee Benefits*

Question 1 – Given the objective of the IASB project to address specific issues in a limited timeframe, 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 purpose of the Project, as set out in the Discussion Paper, is to provide both users and preparers of financial statements with higher quality transparent information about post-employment benefit (superannuation) promises. Given this purpose, HoTARAC is of the opinion that the Project should not be finalised until the completion of the IASB's Fair Value Measurement and Conceptual Framework Projects. HoTARAC is also of the opinion that the IASB cannot ignore disclosure until a later stage of the overall Project. The changes proposed will have little impact on transparency if the information is not disclosed at a relevant level.

For example, the IASB has proposed a change in the "unit of account" by introducing the concept of "promises". The IASB needs to provide details on the level of disclosure that will be required at this lower level of unit of account, to determine if this change will improve transparency and relevance to users. It is HoTARAC's opinion that in the Australian public sector context the disclosing of assets to a promise level will have no benefits (refer to question five for further information).

Question 2 – Are there any 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?

Preliminary View 2 - Entities should recognise all changes in the value of plan assets and in the post-employment benefit obligations in the financial statements in the period in which they occur.

HoTARAC supports PV2 and believes the IASB has considered all factors in arriving at this view.

HoTARAC considers immediate recognition of changes in the value of plan assets and post-employment benefit obligations to be consistent with other IFRS, the *Framework* and also faithfully represents the entity's financial position.

PV 3 - Entities should not divide the return on assets into expected return and an actuarial gain or loss.

HoTARAC does not support the proposal to remove the split between expected return on assets and actuarial gains and losses. HoTARAC is of the opinion that the IASB did not provide sufficient information on how it formed the view that the return on assets should not be divided into expected return on assets and actuarial gains or losses.

HoTARAC considers the split between actuarial gains and losses and expected return on assets to provide greater transparency than an aggregated figure. HoTARAC also considers recent amendments to IAS 19 disclosure requirements relating to assumptions in estimating expected return on assets will reduce entities ability to manipulate profit and loss.

PV 4 - Entities should recognise unvested past service cost in the period of plan amendment.

HoTARAC supports PV4 and considers all factors have been considered in arriving at this view. HoTARAC considers this approach to faithfully represent the entity's financial position and provides consistency with immediate recognition of all gains and losses arising from defined benefit plans.

Question 3(a) – Which approach to the presentation of changes in defined benefit costs provides the most useful information to users of financial statements? Why?

A consensus could not be achieved amongst HoTARAC members in regards to the presentation of changes in post-employment benefits. The majority of members support Approach 1, presenting all changes in the value of plan assets and obligation in Profit and Loss. Supporters of Approach 1 are of the opinion that this approach provides the most useful information to users of financial statements and is best aligned to the *Framework*. All of the supporters of Approach 1 currently recognise actuarial gains and losses through Profit and Loss.

The minority of HoTARAC members supported Approach 3, presenting remeasurements that arise from changes in financial assumptions in other comprehensive income and all other changes in Profit and Loss. Supporters of Approach 3 believe that this approach will reduce the volatility in Profit and Loss associated with revaluations, allow users of financial statements to assess the stewardship of management without taking into account factors which to some extent are outside the control of management, and to estimate future cash flows on information that is not distorted by unrealised gains/losses.

Question 3(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?

The majority of HoTARAC members do not consider there to be any basis to split the superannuation expense between components recognised in Profit and Loss and components recognised in "other comprehensive income". In contrast, the remaining HoTARAC members consider the presentation of some components of defined benefit cost in other comprehensive income is important to users is as to not distort the financial statements with period-to-period changes and avoid the volatility associated with recognising changes in assumptions or remeasurements in Profit and Loss.

HoTARAC is of the opinion that providing disaggregated information about fair value provides users of financial statements with greater transparency when the concepts used to determine the fair value are coherent and do not need significant disclosure to explain how fair value was determined. As discussed previously, HoTARAC considers disaggregation of information should include the concept of expected return on assets.

Question 3(c) – What would be the difficulties in applying each of the presentation approaches?

Australian Governments must also report on a Government Finance Statistics basis which requires price revaluations or volume changes in asset and liabilities to be recognised in “other economic flows” (somewhat similar to other comprehensive income). HoTARAC considers both presentation Approaches 1 and 3 to be consistent with GFS, while Approach 2 is not consistent with GFS.

Question 4(a) – How could the Board improve the approaches discussed in this paper to provide more useful information to users of financial statements?

HoTARAC considers presentation Approaches 1 and 3 to adequately address all issues noted. However, it is suggested that the superannuation expense includes a disaggregated expected return on plan assets.

Question 4(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?

HoTARAC considers presentation Approach 1 and 3 to address all of HoTARAC’s issues.

Question 5 – 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?

HoTARAC is of the opinion that the IASB did not provide enough information in the Discussion Paper to justify the introduction of the new unit of measurement, “promises”, or adequately explain the level of disclosure required at a promise level.

It appears from the Paper that the IASB is seeking to address cash balance schemes which provide specified returns on actual or notional employer contributions. Whilst these schemes are common in the United States of America they are relatively rare in Australia.

Australian superannuation legislation does not require the assets backing superannuation liabilities to be allocated to a specific promise. HoTARAC is of the opinion that reporting at a promises level is not pertinent to the Australian Governments. The introduction of promises will significantly increase the level of reporting of superannuation obligations in Australia.

Currently, Australian Governments report on a plan level, with both defined benefit promises and contribution based promises being reported and disclosed as Defined Benefit Plans. With the introduction of promises, the Australian Governments will have to break the plans down and report on a promise level. Based on the limited information in the Discussion Paper, HoTARAC has determined that some plans could consist of approximately nine promises. HoTARAC cannot see any benefit in the Australian Governments context to report at this level when the underlying assets are not attributed to promises in a plan.

In addition, HoTARAC believes that the accounting requirements for contribution based promises and defined benefit promises should not be reviewed in isolation. HoTARAC also believes that the introduction of this concept should not pre-empt the IASB's other long term projects on Fair Value Measurement and the Conceptual Framework.

Question 6 – 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?

HoTARAC believes that some components of defined benefit plans will be reclassified under the Board's proposals as contribution based promises.

HoTARAC notes, that there would be minimal practical difficulties in relation to liabilities but the separation of assets between the promises would be difficult particularly when not attributed. Please also refer to comments under Question 5.

Question 7 – Do the proposals achieve that goal? If not, why not?

The goal being that the Board makes amendments without leading to significant changes in the accounting for most promises that meet the definition of defined contribution plans in IAS 19.

HoTARAC believes that the proposals may lead to significant changes in accounting for contribution based promises. HoTARAC believes that there is no need for the new concept, and insufficient information has been provided to determine possible accounting implications. As mentioned previously, HoTARAC suggests the IASB provides information of the implications of the change in the unit of account.

Question 8 – Do you have any comments on those preliminary views? If so, what are they?

Preliminary View 9 - An entity should recognise both vested and unvested contribution-based promises as a liability.

HoTARAC notes the basis for conclusions for IAS 19, which states "an obligation exists even if a benefit is not vested", that this treatment would be consistent with the current treatment of defined benefit plans. HoTARAC also

notes that the question of whether unvested benefits are a liability is outside the scope of the Project.

PV 10 - An entity should allocate the benefits earned under a contribution-based promise to periods of service in accordance with the benefit formula.

HoTARAC supports the allocation of benefits in accordance with the benefits formula and notes that this view is consistent with current accounting requirements for defined benefit plans in IAS 19.

HoTARAC does not consider this to be a major issue as the majority of Australian Governments are required to pay the benefits to the administrator of the plan on a fortnightly basis and there is no further liability. Employers, therefore, often do not book a liability for these benefits as they pay them out in the period in which the employee renders the service.

PV 11 - There should be 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.

HoTARAC considers the requirement to recognise an additional amount to be inconsistent with the definition of a liability, as no present obligation to pay those amounts exists. HoTARAC also doubts that users will find this information useful; rather it will lead to confusion.

In addition, under the Australian superannuation environment, entities generally pay the benefits into another fund on a fortnightly basis with no further liability, and therefore this would not be relevant to Australian Government entities.

Question 9(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.

HoTARAC believes that adopting “fair value assuming the terms of the benefit promise do not change” as the measurement approach for contribution based promises is premature and pre-empts the IASB’s long term Projects on Fair Value Measurement and the Conceptual Framework. HoTARAC also considers this to be a fundamental change which will result in different measurement to defined benefit promises, even though the obligation may be of the same nature.

HoTARAC believes the IASB should consider the measurement methods in IAS 39 *Financial Instruments: Recognition and Measurement* prior to introducing a new method of measurement. The introduction of the new measurement approach “fair value assuming the terms of the benefit promise do not change” may lead to confusion amongst users of financial statements, who may consider this to be the same measurement as fair value. HoTARAC also believes this new method needs to be defined by the Board if it is to be understood by users of financial statements.

Question 9(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? Should this be done?

HoTARAC is of the opinion that risk should be included in the measurement of promises. Risk and uncertainty surround many events and to reach the best estimate or measurement of the liabilities risk and uncertainty should be taken into account as per the requirements of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. HoTARAC considers the exclusion of credit risk may need to be further explored.

Question 10(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 not?

HoTARAC agrees 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. HoTARAC believes that the substance of the obligation has not changed, only its legal form changes through the deferment and payout phases.

While HoTARAC members agree with this view, they also believe that the same obligation should be accounted for in the same way, regardless of whether it is a defined benefit or contribution based promises.

Question 10(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?

HoTARAC does not believe that the liability for a contribution-based promise during the payout phase should be measured at fair value, assuming the terms of the benefit promise do not change. For the reasons stated in the response to question 9(a), HoTARAC believes this measurement approach is premature and pre-empted the IASB’s long term Projects on Fair Value Measurement and the Conceptual Framework.

Question 11(a) – What level of disaggregation of information about changes in the liability for contribution-based promises is useful to users of financial statements? Why?

The majority of HoTARAC members consider the best way to disaggregate information about changes in the liability for contribution-based promises are into service costs and other fair value changes. This disclosure would avoid combining information with different implications to users.

The remainder of HoTARAC members do not believe it is necessary to disaggregate the expense. It is argued that disaggregation would only appear relevant for defined benefit promises.

Question 11(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?

HoTARAC does not agree that it is difficult. However, HoTARAC does note that additional disclosure for contribution based promises would add a certain level of complexity that is probably not warranted.

Question 12 – 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?

HoTARAC considers the liability for contribution-based promises should mirror the presentation of changes in the liability for defined benefit promises. However, there are varying views on the best presentation approach for defined benefit promises as discussed in Question 3(a).

Question 13(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?

HoTARAC does not see any practical difficulties in indentifying and measuring the “higher of” option. Actuarial techniques could adequately measure these options.

Question 13(b) – Do you have any other comments on the proposals for benefit promises with a ‘higher of’ option? If so, what are they?

HoTARAC does not have any other comments on the proposals for benefit promises with a higher of option.

Question 14 – What disclosures should the Board consider as part of that review?

HoTARAC considers the change in the unit of account “promises” to have implications on disclosure. HoTARAC believes the Board should provide information on whether entities will be required to split assets, as well as liabilities, where promises are currently pooled but will be separately accounted for under the new Standard.

HoTARAC also believes that the current IAS 19 disclosure requirements are excessive in comparison to other standards. It is HoTARAC’s view that disclosure for post-employment benefits should be simplified.

Question 15 – Do you have any other comments on this paper? If so, what are they?

HoTARAC does not have any additional comments on the Discussion Paper.