By Appointment to
Her Majesty The Queen
Suppliers of Communications, Broadband
and Networked Services
BT
London

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IAS19 Discussion Paper
International Accounting Standards Board
30 Cannon Street
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Dear Sirs

Invitation to comment: Preliminary views on amendments to IAS 19 Employee Benefits

BT Group welcomes the opportunity to comment on the above IASB discussion paper.

BT operates one of the UK's largest private sector defined benefit pension schemes with assets of £36.8bn at 30 June 2008 and 349,000 members of whom over 50% are pensioners. This final salary scheme was closed to new entrants in 2001 from which date BT introduced a defined contribution scheme for new employees, which is little affected by the proposals in the Board's paper. As a result, our responses to the paper are focussed mainly on the impact on our current defined benefit scheme.

In summary, we have a number of concerns:-

- As the paper recognises, accounting for post retirement benefits is a complex issue which we believe deserves a comprehensive root and branch review rather than limited scope amendments to perceived shortcomings of the existing standard. We believe that a review should reconsider the funding relationship between the sponsoring company and its independently managed defined benefit pension scheme (as is common in the UK) and consider whether the accounting should reflect the actual committed cash obligations of the company rather than reflecting assets and liabilities not owned or controlled by the company.
- There is a risk that making interim changes to reporting based upon the existing standard ahead of likely further changes arising from a fuller review of pension reporting may lead to confusion amongst users. Whilst IAS19 has limitations, investors have gained an understanding of its principles and some shortcomings could be addressed by additional supplementary disclosures.
- The proposal to move to reporting an actual return on scheme assets in the profit and loss account introduces the potential for unacceptable income

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statement volatility which would further detract from the clarity of performance reporting.
- The paper addresses issues which may have a significant impact on the reported performance of companies which we believe should be addressed in conjunction with the Board's project on financial statement presentation rather than through this proposed amendment to IAS 19.

We support the removal of the corridor approach. However, due to the above concerns we believe the existing project should limit its proposals to addressing this issue only. Any other issues should be considered in conjunction with the results of the financial statements presentation project and be considered in a comprehensive, longer-term project to review the reporting of pensions.

Responses to the questions raised are set out below.

Q1. *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?*

A1. On the contrary, we believe that the scope of the paper is too broad to be dealt with in a short-term project because of the complexity of pension accounting and the significant impact that the issues have on reported company earnings.

We are concerned that the presentational issues concerning defined-benefit promises and the likely creation of significant volatility of reported earnings are being addressed before the parallel project on financial statements presentation has concluded. There is the risk that the interim adoption of amendments which may have a fundamental impact on financial statements as a stopgap measure will further add to confusion of users of financial statements.

In addition we are concerned that the project introduces new definitions for the classification of pension schemes but has had limited time to fully rationalise or eliminate contradictions created by the proposals when compared to the current IAS 19 treatment of defined benefit schemes because they have been ruled to be out of scope of the project.

We believe that the scope of the project should be restricted to the removal of the corridor approach and the Board should defer a review of other issues until they can be incorporated into a longer-term, root and branch review of post-retirement benefits.

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Q2. *Chapter 2 describes the Board's deliberations on the recognition of defined benefit promises. The Board's preliminary views are summarised in paragraph's PV2-PV4.*

Q. 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?

Although beyond the scope of the Board's current project we believe that there should be a review of post-retirement benefits that will consider the funding relationship of a sponsoring employer and its independently managed defined benefit pension scheme (as is common in the UK). For a company with a UK defined benefit scheme the relevant obligations are the cash commitments agreed in any funding recovery plan prepared to meet the statutory funding objective defined by the Pensions Act in respect of past service. We believe consideration should be given to the applicable net finance charge being based upon the net pension obligation calculated at the net present value of future cash flows agreed in the funding recovery plan.

However, in the context of the preliminary views on making short-term changes to IAS 19 expressed by the current project:

a. We support the move to eliminate use of the deferred recognition model or corridor approach to defer recognition of changes in the value of the post employment obligation.

b. We disagree with the proposal to move to reporting an actual return on scheme assets in the profit and loss account as we believe that this introduces the potential for unacceptable income statement volatility which would further detract from the clarity of performance reporting. Whilst recognising the subjectivity involved in determining the expected rate of return on assets we believe that when supported by proper disclosures this approach is transparent and well understood by users of the financial statements. There is no compelling reason to change treatment in the short-term. We therefore support the retention of the division of changes in scheme assets between expected return and an actuarial gain or loss. An issue for consideration in the longer term is why the return on assets should be reported in the company profit & loss account when the assets are not controlled by the company.

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c. We agree with the proposal that, for consistency within IAS19, unvested past service costs are recognised in full in the period in which scheme amendments are made, although recognising the Board's comments that this is inconsistent with treatment of unvested benefits in IFRS2 Share-based Payments.

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

As stated in our response above, we are concerned that making amendments to IAS 19 relating to the presentation of changes in defined benefit costs will have a significant impact on company reported earnings. As a consequence we believe that a proper review of presentational issues is beyond the scope of a short-term project. In addition, it is not possible to fully evaluate the impact of the proposals until the financial statement presentation project has concluded. Our preference is for the Board to defer this issue until it can be considered in more depth as part of a longer-term review of the accounting of post-retirement benefits in conjunction with the output from the financial statement presentation project.

Subject to the above, we comment upon each proposed approach in turn:-

Approach 1 is over simplistic and could create extreme volatility of reported company results. This may potentially lead to the unintended consequence that both companies and users of financial statements would discuss results "before pensions" ("EBITDAP") to explain results or to identify trends in underlying business performance. If wide-spread, this practice would undermine the credibility of pensions reporting under IFRS. We also believe that it is preferable to retain a relatively stable period charge representing service cost in the profit and loss account and to provide additional explanation of changes in post retirement benefits as supplementary disclosures rather than distorting reported results with the need to provide supplementary explanations in order to understand business performance.

Approach 2 requires interest cost to be treated as an element of other comprehensive income which is inconsistent with other IFRSs, which require interest cost to be reported in profit and loss. As stated in our response to Question 2, we believe that in the longer term we believe that the Board should seek consistency between standards.

Approaches 2 & 3 may result in practical anomalies, not least for some real-world transactions which have elements of curtailment and settlement but for which the paper prescribes a different treatment for each element. Also Approach 3 introduces the unnecessary complication of a new definition of

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interest income on scheme assets and proposes three possible alternative bases for deriving this measure. The paper recognises disadvantages of these alternatives the most serious of which, in our view, would encourage distortion of the investment strategies by scheme managers in order to manage the reported accounting interest income in conflict with the longer-term economic performance objectives of the scheme.

Both Approaches 2 & 3 report the effect of a change in discount rate in other comprehensive income and the effect of changes in other economic assumptions underlying the benefit assumptions in the income statement. We believe this treatment should be modified to present re-measurements due to changes in all assumptions in other comprehensive income.

(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

We believe it is important to avoid excessive profit and loss account volatility resulting from short-term market movements in asset values or discount rates which do not directly reflect changes in the actual or expected short-term funding obligations of the sponsoring entity. Therefore we believe that the approach currently allowed by IAS19 to present all actuarial gains and losses in other comprehensive income in the period in which they occur should be retained.

(ii) disaggregation of information about fair value?

We do not believe that additional information on the movements in the fair values of assets would be helpful to users as sufficient information is provided in the reconciliation of asset and liability movements in the period as required under IAS 19.

The paper has demonstrated the difficulty in agreeing definitions of the key component "interest income on scheme assets" which indicates that there would be a period of education and confusion amongst users until any new definitions are properly understood. If the project objective is to make amendments to reporting which are intended to be temporary pending the outcome of a fuller review of post-retirement benefits then we believe any confusion should be avoided.

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There is the likely real-world consequence that investment strategies will be distorted in order to give the appearance of favourable but steady performance against a specific component which may not be in the best interests of longer-term economic returns to the scheme.

We believe that the existing reconciliation of movements in the fair value of assets required by IAS19 provides sufficient granularity.

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

As stated in our responses above, the main difficulty and complexity is the requirement for a new definition of interest income on scheme assets for Approach 3.

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

As stated in our responses above, we believe that in the short-term the presentation allowed in IAS19 should continue.

(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?

In the context of a UK company with an independently managed defined benefit pension scheme we consider that the relevant obligations are the cash flow obligations for current service plus those agreed in any funding recovery plan prepared to meet the statutory funding objective defined by the Pensions Act in respect of past service. The applicable net finance charge should be based upon the net pension obligation calculated at the net present value of future cash flows agreed in the funding recovery plan.

Details of the scheme valuation and funding, together with the related risks, assumptions and sensitivities should be provided as a supplementary note disclosure.

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

As stated in our responses above we believe that the scope of a short-term project should not consider new or revised definitions of pension promises. The impact on reported results of any changes may be significant and should therefore be deferred for consideration in a longer-term project.

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

This issue is not relevant to us so we have not commented upon the preliminary views.

Q7. 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?

We agree that the proposal should have no effect on current defined-contribution schemes where there is no guarantee and the contributions are paid very soon after the end of the period. We have not considered the impact of the preliminary views on other contribution-based schemes.

Q8.- Q12.
The issues are not relevant to us so we have not considered these questions concerning the preliminary views.

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

This issue is not relevant to us so we have not commented upon the preliminary views.

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

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No other comments.

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

As it is not possible to reflect the risks and uncertainties of the defined benefit obligation as a one-line item in the profit and loss account or in other comprehensive income (or the balance sheet), users will look for supplementary disclosures in the supporting notes in order to understand the nature of the companies obligations. Current disclosures required by IAS19 are already lengthy but it would be helpful to enhance explanations of circumstances specific to the entity and the impact of varying valuation assumptions in order to allow an informed user to make comparisons between entities.
However, care should be taken regarding the volume of disclosures in relation to pension obligations and the need to ensure that the usefulness of additional information is proportional.

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

No further comments.

We trust that these comments are helpful and contribute to your deliberations. If you have any questions or would like to discuss these comments further, please do not hesitate to contact me.

Yours faithfully

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