THE INSTITUTE OF
Chartered Accountants
IN IRELAND

Burlington House,
Burlington Road, Dublin 4
Tel: +353 1 637 7200
Fax: +353 1 668 0842
Email: ca@icai.ie
Web: www.icai.ie

Project Manager
ED of proposed amendments to IAS 39
International Accounting Standards Board
1st Floor
30 Cannon Street
London EC4M 6XH
United Kingdom

12th September 2008

Response of the Accounting Committee of the Institute of Chartered Accountants in Ireland Discussion paper: Preliminary Views on Amendments to IAS 19 *Employee Benefits*

Dear Sir/Madam,

The Accounting Committee (AC) of the Institute of Chartered Accountants in Ireland welcomes the opportunity to comment on proposals in the above document.

General comments

The responses to the specific questions posed in the Discussion Paper are included in the appendix to this letter. As discussed in the response to question one therein, AC strongly believes that the Board should proceed with the elimination of corridor approach as a priority. AC is concerned that other proposals contained in the Discussion Paper, about which it may be more difficult to achieve consensus in the short-term, should not delay this key amendment.

In the response to question one, AC also proposes that the Board consider including another amendment to IAS 19, namely to the discount rate. The response discusses the current problems associated with the volatility of a discount rate applicable to a high quality corporate bond and suggests, as an alternative, the use of a risk-free rate adjusted for a risk premium or discount which is the best estimate of each individual company of the risk attaching to the pension liability, with appropriate disclosure. This would be consistent with the proposals in the document for measuring the pension obligations of a contribution-based pension.

Should you wish to contact us about any of our comments please feel free to do so.

Yours faithfully,

Mark Kenny

Secretary, Accounting Committee

Appendix

Question 1

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?

AC is of the view that the most immediate matter that should be addressed by the Board in relation to post retirement benefit accounting is the removal of the corridor approach that allows non-recognition of actuarial gains and losses, and surpluses and deficits, relating to defined benefit pension plans. AC strongly believes that removal of this corridor/non-recognition approach is a sufficiently important amendment to IAS 19 to proceed with on its own, even if the other suggested improvements are delayed on the grounds of requiring further consideration and exposure. AC believes that it is of the highest importance that all pension assets and liabilities be recognised on the balance sheet and that continuation of the current system whereby there are significant unrecognised gains and losses, and surpluses and deficits (that are merely disclosed in the notes), is such a flawed accounting model that it is unacceptable for the Board to delay amending it any longer.

However, AC is also conscious of the need to address a number of other issues with regard to retirement benefit obligations and in particular the need for guidance on accounting for 'hybrid schemes' that are not quite defined benefit and not quite defined contribution. AC agrees that the items identified by the IASB for fast-tracking in this preliminary discussion paper are those that most need to be addressed in a current climate. The AC considers that it is appropriate to make limited scope amendments to IAS 19 while at the same time undertaking a fundamental review of the underlying principles being applied in the standard.

There is one area where we believe IASB should consider a further amendment in relation to the discussion paper. This refers to the current requirement in IAS 19 to measure the liability for a defined benefit obligation at a discount rate which is the rate applicable on a high quality corporate bond. Recent events in the credit market have shown that this rate can be far more volatile than was perhaps envisaged when IAS 19 was originally drafted.

AC understands that the original intent was to use a discount rate that was perhaps slightly greater than the risk free rate which would reflect the fact that the employer had an element of discretion over the amount of the liability that was being recorded. AC concurs with this approach although the fundamental review of pensions in the future should perhaps consider whether there are other items that should be reflected in the discount rate applied to measure the pension obligation. However, recent events have shown that the credit spread applicable to high quality corporate bonds can be quite volatile. It is difficult to see why an increase in the cost of credit of other corporates should impact on the measurement of the pension liability of an entity. AC does not believe this volatility was originally intended to be reflected in the measurement of an entity's pension liability. AC believes that the IASB should consider the discount rate used for defined benefit obligations and perhaps bring it into line with that recommended for contribution based promises in the draft. In other words, a risk free rate adjusted for a risk premium or discount which should be best estimate of each individual company of the risk attaching to the liability. The quantum of this risk factor and its impact on the liability measurement should be disclosed.

In connection with this, AC has identified a number of potential items that could be included in this risk adjustment. These include the following:

i. adjustment for variability in size of ultimate liability (potentially increasing liability);
ii. adjustment for discretion of employer (potentially reducing liability);
iii. adjustment for credit risk of employer;
iv. adjustment for collateralisation of the liability.

Deferred recognition of changes in defined benefit promises (Chapter 2)

PV2	Entities should recognise all changes in the value of plan assets and in the post-employment benefit obligation in the financial statements in the period in which they occur.
PV3	Entities should not divide the return on assets into an expected return and an actuarial gain or loss.
PV4	Entities should recognise unvested past service cost in the period of a plan amendment.

Question 2

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?

AC believes the Board has considered relevant factors in arriving at its preliminary views. AC concurs with the Board that all changes in the value of plan assets and post employment benefit obligation should be recognised in the financial statements in the periods in which they occur.

AC agrees that the return on assets should not be divided into an expected return and an actuarial gain or loss.

AC finds the reasoning regarding the immediate recognition of unvested past service cost to be less than persuasive. While acknowledging that the recognition of an unvested past service cost over the vesting period is inconsistent with the fundamental measurement objective in IAS 19 of measuring in accordance with the benefit formula, AC does not see this anomaly as one which needs to be addressed at the current time. As identified in the preliminary views document, recognition over the vesting period is more consistent with the guidance currently proposed for termination benefits and the guidance existing in IFRS 2. To the extent that the current requirements in IAS 19 are consistent with these other standards (even though inconsistent with basic premise of IAS 19), AC queries whether it is appropriate to amend this principle in this short-term project.

Presentation approaches for benefit promises (Chapter 3)

PV5	The Board does not express a preliminary view on the presentation of the components of post-employment benefit cost in comprehensive income. Instead, the Board outlines three approaches to presentation that illustrate ways in which information about post-employment benefit costs could be presented. 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 (e.g. the costs of service, interest cost and interest income) in profit or loss.

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?

AC considers that the Approach 2 proposal will provide the most useful information to users of financial statements.

As explained in the response to question 3(c) below, AC considers that Approach 3 is preferable to Approach 1, in the event that Board decides against Approach 2, although AC has concerns about the estimation of interest income on plan assets.

(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?

In considering the answer to part (a) of this question, the most important consideration for AC was the need to provide disaggregated information about the fair value movements during the period. AC believes that it is important to users of financial statements to understand clearly the reasons for changes in both the pension assets and defined benefit obligations during the accounting period.

AC regards the desire to present some components in other comprehensive income as a less important consideration.

The reason that AC opted on balance for approach 2 was that this approach best prevents the distortion of Operating Profit by the effects of external market factors outside the control of the entity. The approach results in the unwinding of the discount of the liability being excluded from the profit for the year, however, on balance, AC considered that this is more preferable than showing the unwinding of the discount in the financing section of the income statement without being able to show a corresponding revenue item from assets in this portion of the income statement. AC believes that any analysis of movement in asset value between a ‘realised’ return and an ‘unrealised’ return (or a revenue / capital split) is artificial. AC does not believe that it is meaningful to divide the change in value of the assets into constituent parts which are presented separately in the income statement.

In this regard, one concern that AC has regarding service cost relates to a change in the remeasurement of the defined benefit obligation of inactive members as a result of changes in mortality rates. In some respects, where mortality or longevity of a population changes, this is also an impact that is outside the control of the company and should perhaps best be reflected outside of the operating results for the period. AC acknowledges that if mortality and longevity rates are correctly identified from the beginning, then the impact of this is a service cost which should be recognised against operating profit. Consequently, AC would not recommend that changes in these assumptions in relation to active members should be reflected anywhere other than as part of the service cost in operating profit. AC, however, has some sympathy for the fact that best estimates made in the past in relation to mortality and longevity of inactive members are subject to changes arising from external factors which are outside the control of the company and that reflecting these costs against operating profit may distort the Operating Profit inappropriately. AC would suggest that the Board should consider making an exception for the impact of changes in these actuarial assumptions in relation to inactive members and permitting these to be also included in other comprehensive income.

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

AC did not support Approach 1 because of the inappropriate level of volatility that would be introduced into operating profit. AC believes that it is not appropriate to show long term, highly volatile measurement gains or losses that derive predominantly from market movements outside the control of the company in operating profit.

AC did not favour Approach 3 on the basis of the difficulty of identifying a return on assets to be included in the financing section. However, in this regard, should the Board reject Approach 2, based on the proposals in paragraph 3.29, AC would prefer Approach 3 of using the discount rate applicable to the liabilities and applying this to the assets outstanding during the period.

AC anticipates that views on the controversial issue of presentation are likely to be wide-ranging and strongly held, and consequently that it may take quite some time for the Board to conclude on the matter. AC strongly believes that any such delay should not interfere with the vital urgency to prohibit non-recognition of pension assets and liabilities, as discussed in the response to question 1 above.

Question 4

(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?***

As highlighted above, AC suggests that consideration should be given to looking at the impact of mortality and longevity changes in the measurement of the obligation to inactive members separately from the measurement for active members.

AC believes that the service cost shown in operating profit should best reflect the service cost of the services being received from current employees and increases in pensions to former employees that are granted by the employer during the period. However, to the extent that the obligation to past employees is impacted by external shifts in mortality and longevity measurements, AC considers it is more appropriate to exclude these amounts from the operating results of the period.

Definition of contribution based promises

PV6 The definitions of post-employment benefits and defined benefit plans in IAS 19 should be revised as follows (new text is underlined and deleted text is struck through):

Post-employment benefits ***promises*** **are formal or informal arrangements under which an entity is obliged to provide employee benefits (other than termination benefits)** **~~which are~~** **payable after the completion of employment.**

A ***defined benefit promise*** **is a** ***~~plans~~*** **~~are~~** **post-employment benefit promise that is not a contribution-based promise** **~~plans other than defined contribution plans~~.**

PV7 A definition of contribution-based promises should be introduced as follows:

A ***contribution-based promise*** **is a post-employment benefit promise in which, during the accumulation phase, the benefit can be expressed as:**

(a) the accumulation of actual or notional contributions that, for any reporting period, would be known at the end of that period, except for the effect of any vesting or demographic risk; and

(b) any promised return on the actual or notional contributions is linked to the return from an asset, group of assets or an index. A contribution-based promise need not include a promised return.

PV8 The definitions of 'post-employment benefit plans' and 'defined contribution plans' in IAS 19 should be deleted.

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?

In defining the contribution based promises, the Board has concentrated on the expression of the benefit during the accumulation phase of the benefit promise. AC considers that it is also appropriate to consider the terms of the promise during the period after the accumulation phase (i.e. the payout phase). To this extent, AC considers that in addition to the requirements set out in the standard, a "contribution based promise" should also result in either a known amount being paid to the employee at the end of the accumulation phase or the purchase by the company at then market rates of an annuity at the end of the accumulation phase. To the extent that the employer retains demographic risk after the accumulation phase, AC believes that the accounting requirements of the defined benefit promise is a more appropriate methodology than that proposed for contribution based promises.

AC concurs with the Board that in many contribution based scenarios, demographic risk will not be significant, however, AC considers that where it is a significant risk that this should lead to a promise being more appropriately classified as a defined benefit promise than a defined contribution based promise.

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?

AC is conscious that the majority of defined benefit promises in existence in this jurisdiction are final salary promises and consequently that few existing arrangements would change from defined benefit to contribution based under the Board's proposal. However, AC considers it likely that employers will continue to review their defined benefit promises and may change the terms of those promises to meet the definition of a contribution based promise.

Question 7

The Board did not intend to have a significant impact on the accounting for plans that meet the current definition of a defined contribution plan. Do the proposals achieve that goal? If not, why not?

AC believes that the requirements of this standard would not result in any significant change in the accounting for defined contribution plans as currently defined in IAS 19.

Recognition issues related to contribution based promises

PV9	An entity should recognise both vested and unvested contribution-based promises as a liability.
PV10	An entity should allocate the benefits earned under a contribution-based promise to periods of service in accordance with the benefit formula.
PV11	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.

Question 8

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

AC concurs with the preliminary views set out in PV9, PV10 and PV11.

Measurement of the contribution based promise

PV12 An entity should measure its liability for a contribution-based promise at fair value assuming the terms of the benefit promise do not change.

The Board's preliminary view is that entities should measure the liability for a contribution-based promise at fair value assuming the terms of the benefit promise do not change. The Board reasons that fair value assuming the terms of the benefit promise do not change meets the measurement objectives described in this paper, i.e. it is based on:

(a) explicit, unbiased, market-consistent, probability-weighted and current estimates of the cash flows;
(b) current market discount rates that adjust the estimated future cash flows for the time value of money; and
(c) the effect of risk, other than the risk that the terms of the benefit change.

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.

(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?

AC concurs with the Board's recommendation regarding the measurement of contribution based promises. AC does not suggest that any different approach should be taken to measuring the liability.

As regards the effect of risk, AC concurs that this should not include the risk that the terms of the benefit change in the future; however, they should include all other risks associated with the measurement of the liability. AC believes that it is important that the Board provide a discussion of the various risks including the impact that these risks could have on the measurement of the liability and that the entities be required to disclose the risk adjustment included against the discount rate and the impact of that risk adjustment on the measurement of the contribution based liability.

In considering the risk adjustment that should be made, there are a number of factors which AC believes could be taken into account in arriving at this risk adjusted rate. These include the exposure of the liability to variability (this would include variability driven by perhaps demographic risks, movements in an index to which a return is tied, etc). It is likely that the impact of these risks would be to increase the measurement of the liability. To the extent that the employer has an element of discretion regarding amendments to the plan this could also be reflected in the discount rate (this could potentially have the impact of reducing the liability).

AC refers to the answer to question 1 above in relation to some of the factors that should be recognized in arriving at the appropriate discount rate. For your convenience they are repeated here:

i. adjustment for variability in size of ultimate liability (potentially increasing liability);
ii. adjustment for discretion of employer (potentially reducing liability);
iii. adjustment for credit risk of employer;
iv. adjustment for extent of collateralisation of the liability.

There are also other elements that perhaps should be included such as the credit risk of the employer or the extent of collateralisation of the liability through ‘matching’ assets (i.e. assets with the same risk profile) in a segregated fund. AC believes that these and other potential impacts on the risk free rate should be discussed by the Board and that employers should decide on the appropriate risk adjustment to make in measuring the liability and then provide disclosure of the impact of that adjustment. Practice will develop over time and variations to the risk free rate will become more or less acceptable to the capital markets.

PV13	An entity should measure the liability for benefits in the payment and deferment phases in the same way as it measures them in the accumulation phase.

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?***

(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?***

AC agrees that the liability for benefits should be measured in the same way during the payout and deferment phases as they are in the accumulation phase.

AC does not believe there are any more practical difficulties associated with the measurement of the liability during the payout phase at fair value than during the accumulation phase.

Disaggregation, presentation and disclosure of contribution based promises

PV14	An entity should disaggregate changes in the value of the liability for a contribution-based promise into a service cost and other value changes.
PV15	An entity should present in profit or loss all changes in the value of the liability for a contribution-based promise and all changes in the fair value of any plan assets.

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?***

(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?***

AC concurs with the disaggregation of the movement in the liability for contribution based promises between amounts relating to service cost and amounts relating to changes in valuation relating to financial variables. Consistent with the Approach 2 proposed for defined benefit obligations, AC would support a consistent approach to the measurement and presentation of changes in the liability for contribution based promises.

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?

AC considers that changes in the liability for contribution based promises should mirror the presentation of changes in the liability for defined benefit promises to the extent possible. The reason for this is that some contribution based promises are similar in substance to defined benefit promises based on the definitions in the Board's preliminary views. It would be inconsistent to apply different disaggregation requirements to similar type arrangements. For the normal defined contribution arrangement, there will only be a service cost and this will be reflected in operating profit.

Benefit promises with a 'higher of' option

PV16 When a post-employment benefit promise is the higher of a defined benefit promise and a contribution-based promise, an entity should recognise and account for the 'host' defined benefit promise in the same way as a defined benefit promise. The entity should recognise separately the 'higher of' option.

PV17 An entity should measure the 'higher of' option that is recognised separately from a host defined benefit promise at fair value assuming the terms of the benefit promise do not change.

PV18 An entity should disaggregate changes in the liability for a 'higher of' option that is recognised separately from a host defined benefit promise into a service cost and other changes in value, with both components recognised in profit or loss.

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?***

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

As promises with a 'higher of' option are not common in this jurisdiction, AC has little experience of this type of arrangement. AC has considered, from a technical point of view, the proposed accounting in the document and considers that it has merit. However, AC has no views at present on the practical difficulties that may arise.

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.

Question 14

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

AC considers that it is important that disclosures are provided about the demographic assumptions made in measuring the associated liability. The assumptions made by the employer in this regard can have a significant impact on the amount disclosed for the liability and, in order to compare companies, it is necessary to know the assumptions that underlie the measurement of the obligation.

As stated earlier, AC considers that there should be disclosure of the impact of the risk margin added to and subtracted from the risk free rate on the measurement of the liability and that the company should explain their reasoning for adopting that risk margin.

AC would suggest that sensitivities be given for the major assumptions underlying the preparation or measurement of the defined benefit obligation. AC also believes that there can be other significant actuarial assumptions, for example, assumptions regarding the proportion of people that would take a lump-sum on retirement and those that will opt for an annuity, the proportion of people that will opt to retire early, the proportion of people that will require a spouse's pension, etc. To the extent that these assumptions are significant in arriving at the measurement of the liability, they should be disclosed in the financial statements. AC also considers that mortality assumption should be given for active and pensioners separately.

Question 15

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

AC has no further comments.