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Sir David Tweedie
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Email: commentletters@iasb.org

26 September 2008

Dear Sir David,

Discussion Paper Preliminary Views on Amendments to IAS 19 Employee Benefits

Deloitte Touche Tohmatsu is pleased to respond to the International Accounting Standards Board's (the IASB's) *Discussion Paper Preliminary Views on Amendments to IAS 19 Employee Benefits* (referred to as the 'discussion paper' or 'DP').

We recognise that accounting for employee benefits has been the subject of criticism for failing to provide a clear indication of the obligation of sponsoring entities towards their employees under long-term defined benefits plans and for the failure of IAS 19 to provide a proper model to account for certain types of plan (mainly certain cash balance plans). We share many of these concerns. However, while we appreciate the desire of the IASB to address the most pressing of these issues, we are concerned that the DP's proposals go beyond the changes that should be introduced via a short-term project. In particular, we strongly discourage the Board from proceeding with its proposal to redefine employee benefit schemes into defined benefits promises and contribution-based promises. As we explain in our detailed comments, the changes proposed would have far reaching consequences and would introduce inconsistencies in accounting for plans that are similar in substance. Further we note that contribution-based promises are not clearly defined and we are not sure we understand exactly what the measurement approach is for contribution-based promises as proposed in the DP and how it differs from other measurement approaches currently used in IFRS.

Finally, while we generally support the Board's proposal to eliminate the option to defer recognition of changes in defined benefit assets and obligation, the elimination of this approach cannot be addressed without proper resolution of the issues linked to the presentation of these changes. Accordingly, we believe that the implementation of this proposal should be timed to coincide with the revised Standard dealing with the presentation of financial performance. If this enactment of the elimination of the corridor approach cannot wait completion of the Standard on presentation of financial performance, the alternative currently available under IAS 19 to recognise actuarial gains and losses (as proposed to be calculated in the DP) either in profit or loss or in other comprehensive income should be retained.

Our detailed comments and answers to your questions on the discussion paper are included in the Appendix to this letter.

If you have any questions concerning our comments, please contact Ken Wild in London at +44 (0)20 7007 0907.

Yours sincerely,

Ken Wild
Global IFRS Leader

Appendix

Response to questions on Discussion Paper Preliminary Views on Amendments to IAS 19 Employee Benefits

Scope

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?

We believe that the issues addressed within this limited scope project should include only those issues that require immediate attention because they represent a wide-spread problem and/or because they cause undue complexity in the preparation and the understanding of financial statements. Given that the IASB is considering a fundamental review of the principles applicable to employee benefits, we believe that no changes should be introduced in a limited scope project that may need to be revisited shortly afterward as part of a more comprehensive project.

Except with respect of certain changes to paragraph IAS 19.78 that we propose in our response to Question 15 related to the determination of the discount rate, we have not identified new issues that should be added to the current project; rather we believe that some of the issues currently included in the project should be deferred. We agree that the recognition of changes in defined benefit assets and obligation should be addressed in this DP, subject to the comments we make later in this letter. As we explain in more detail in response to subsequent questions, we believe that the resolution of the other issues addressed by the DP (in particular the proposed changes to the definition and measurement of contribution-based promises) should be postponed and debated as part of a fundamental revision to IAS 19. In the meantime, in response to the difficulties arising with respect to some cash balance plans, the Board should consider developing implementation guidance that addresses these specific plans.

Recognition and Presentation of Defined Benefit Promises

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?

We generally support the Board's proposal to eliminate the option to defer recognition of changes in defined benefit assets and obligations that is currently permitted under the corridor approach. The deferred recognition (the corridor approach) represents a smoothing mechanism and is without principle. Further, this option is one of the significant sources of complexity within IAS 19. Additionally, its elimination does not interact with other aspects of IAS 19 and therefore it is unlikely that the decision to eliminate the ability to defer recognition of changes in defined benefit assets and obligation would need to be revisited when the Board undertakes a comprehensive review of IAS 19. However, the elimination of the deferral option cannot be addressed without proper resolution of the issues linked to the presentation of these changes. Accordingly, we believe that the implementation of this proposal should be timed to coincide with the revised Standard dealing with the presentation of financial performance. We expand on this issue in our response to Question 3.

We also support the Board's proposal to discontinue using an expected rate to measure the return on plan assets since we believe that this also represents a smoothing mechanism that is not principle-based.

On the other hand, while we believe that the treatment of unvested past service costs needs to be reconsidered, we do not believe that this is an issue that requires immediate attention. Plans that include unvested past service costs are not widespread, they affect only a limited number of jurisdictions and they do not present significant practical issues. Further, no compelling arguments have been presented to demonstrate that the current treatment of unvested past service costs represents a significant conceptual flaw. Therefore, while we recognise that the amortisation of unvested past service costs could be considered inconsistent with the immediate recognition of other elements of defined benefit plans, we suggest that the appropriate treatment for unvested past service costs be reconsidered as part of the Board's planned fundamental review of the accounting for employee benefits.

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?

Conceptually, we believe that method 1 (requiring that all changes in defined benefit costs are recognised in profit or loss as they occur) is the most supportable approach. Given that employee benefit costs meet the definition of income and expenses as defined in the Framework, the recognition of these costs in profit or loss is justified. Further, method 1 is the least complex to implement and the easiest to understand, in particular because it eliminates the need for complex and arbitrary rules to allocate amounts between profit or loss and other comprehensive income.

However, the appropriateness of this method should be assessed as part of the IASB Financial Statement Presentation Project (FSPP) and its adoption should not be required until conclusions are reached on the FSPP. Introducing method 1 ahead of the issuance of a revised Standard resulting from the FSPP presupposes the conclusions of this project. Until completion of the FSPP, the alternative currently available under IAS 19 to recognise actuarial gains and losses (as proposed to be calculated under the DP) either in profit or loss or in other comprehensive income should be retained (except, as noted in our response to Question 2, for the discontinuance of use of the expected rate to measure return on plan assets). With respects to amounts initially recognised in other comprehensive income, we would prefer that there be no introduction of a requirement within IAS 19 to recycle amounts subsequently since this would introduce significant complexity and it is an issue to be addressed as part of the FSPP.

(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?**

We believe that these issues are better addressed by users of financial statements. When considering the user responses to question 3(b)(i), we encourage the Board to also assess those comments as part of the IASB FSPP.

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

We believe that this issue is better addressed by preparers of financial statements.

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?

We believe that these issues are better addressed by users of financial statements.

Definition of Contribution-Based Promises

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?

We disagree with the Board's proposals to redefine employee benefit schemes into defined benefits promises and contribution-based promises. The changes proposed, mainly in response to the identified issue of accounting for a certain type of cash balance plan, would have far reaching consequences and should not be addressed as part of a limited review project. The cash balance plans that cause concerns are those that provide a financial option to the employees since, for those plans, the future expenditure of the entity with respect to past service costs depends on the future performance of certain reference assets or of an index.

We are particularly concerned that the proposals will lead to significant changes to the accounting for career average plans (CARE plans) and flat benefits plans for which there is no immediate concern or difficulty in application of the Standard. Under the proposals, CARE plans and flat benefits plans would meet the definition of contribution-based promises and would be measured at fair value whereas plans such as final salary plans would be treated as defined benefit promises measured under the projected unit credit method. Also, under the proposals, the straight-line mechanism described in IAS 19.67 would apply to final salary plans but not to CARE plans and flat benefits plans. There is no apparent reason why these plans should be treated so differently given they are substantially similar, particularly since the employer retains mortality and future salary risks under both type of schemes. We do not believe that it is appropriate to introduce this inconsistency within IAS 19 as a result of the DP. The choice of a measurement attribute should be included as part of the IASB planned comprehensive review of the accounting principles applicable to employee benefits.

Furthermore, we believe that the distinction between final salary plans that are classified as contribution-based promises and those classified as defined benefit promises, on the basis of the description provided in the DP, could be perceived as arbitrary. If a final salary scheme is based on the average salary over a given number of years, would the classification change depending on whether the average is based on 3 years or 5 years? Given that the substance of final salary plans and of CARE plans and flat benefits plans is to provide a defined periodic benefit to the employees over their remaining lifetime (as opposed to providing a fixed contribution plus an earning formula), we would expect that they should fall within the same category.

While we agree that the accounting for the cash balance plans described above needs to be addressed, we do not believe that this justifies the significant changes introduced by the proposed new definitions and measurement principles. Given the limited scope of the urgent issue, rather than proceeding with the introduction of the proposed new classifications, we suggest that the Board should develop implementation guidance that addresses the practical difficulties that arise with respect to these specific plans, possibly by exploring making reference to stochastic valuations methods.

In addition, this approach changes the concept of accounting for a plan as one unit of account because it would change the unit of accounting from the "plan" to the "promise". We believe this is a very different concept from what is practiced now and produces additional complexity. For example, for certain arrangements where there is a qualified defined benefit plan and a wraparound supplemental executive retirement plan (SERP), these are currently being accounted for as two different plans. However, under the proposed views, we believe these would be considered one promise. This treatment is counterintuitive, particularly in situations where the terms of one plan are different from the other plan (e.g., vesting terms).

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?

Yes. As indicated above, the widespread CARE plans and flat benefits plans would need to be reclassified from defined benefit plans to contribution-based promises. In some jurisdictions, while the majority of the plans are currently considered defined benefit plans, if the amendments are adopted, the majority of the plans will end up being considered contribution-based promises.

Question 7
The Board does not intend this proposal to lead to significant changes in the accounting for most promises that meet the definition of defined contribution plans in IAS 19. Do the proposals achieve that goal? If not, why not?

We do not believe that the proposals would cause problems to the accounting for plans currently classified as defined contribution plans, as long as there is no significant deferral of payments. However, the DP does not address the consequences of the removal of the definition of the defined contribution category in the accounting for some multiemployer plans and state plans that currently meet the definition of defined benefit plans but are treated as defined contribution plans under IAS 19.32. In addition, it is unclear from the proposal whether other types of plans would be classified as defined benefit promises or contribution-based promises, such as some retiree medical plans that have a cap.

<u>Recognition issues related to contribution-based promises</u>

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

We agree with the proposals not to reconsider the existence of a liability for unvested benefits (PV 9) and not to introduce a requirement to recognise an additional amount determined by the benefit that an employer would have to pay when an employee leaves employment after the reporting date (PV 11). However, the proposal in PV 10 to allocate the benefits earned under a contribution-based promise to periods of service in accordance with the benefit formula creates an inconsistency within IAS 19. As mentioned in our response to Question 5, we do not believe that this is justified in the context of the DP.

<u>Measurement of Contribution-Based Promises</u>

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?

We are not sure we understand exactly what the measurement approach is for contribution-based promises as proposed in the DP and how it differs from other measurement approaches currently used in IFRS. The description of the objective of the measurement approach suitable to contribution-based promises provided in paragraph 7.7 resembles the measurement objectives currently used in IAS 19 and IAS 37, which are not described as fair value measurements. Further, we note that the measurement attribute proposed in the DP, *fair value assuming the terms of the defined benefit promise do not change*, differs from other fair value measurements currently used in IFRS. In fact, in paragraph 7.4, the Board recognises that the measurement basis proposed is not fair value. Despite all this, the Board opted to label the measurement basis as "fair value". The addition of a new definition would create further confusion on the issue of fair value measurement. If the measurement basis cannot be clearly expressed, it is likely to create confusion and uncertainty on the value of the amounts presented in the financial statements.

In addition to these concerns, we do not believe that a fair value measurement objective (defined conceptually as the transfer value of the obligation to a third party) is the most relevant measure for employee benefits. Consistent with our response letter to the IASB DP on Fair Value Measurements dated 4 May 2007, we believe that the present value of the amount that the entity will eventually pay to the employee would be a more relevant measure for such obligations.

We also disagree with the inclusion of an entity's own credit risk in the measurement of contribution-based promises. The resulting measurement is not relevant since an entity's commitment to its employees should be considered as absolute and not dependent on an entity's ability to pay. As we also noted in our letter on the IASB DP on Fair Value Measurements, inclusion of an entity's own credit risk is appropriate where the obligation can be transferred, which is generally not the case with respect to contribution-based promises. Furthermore, many employee benefit schemes are, at least partly, funded through a long-term benefit fund. In that context, the relevance of including a sponsoring entity's own credit risk component in the measurement of the pension obligation is questionable since the settlement of the benefit obligation for those funded promises ceases, partly, to be affected by the sponsor's credit risk.

For all of these reasons, we do not believe that it is appropriate to introduce a new measurement attribute within IAS 19 for schemes that meet the proposed definition of contribution-based promises.

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?

We have not identified conceptual reasons that would justify using different measurement basis at various phases during the life of a plan. The inconsistencies noted in paragraph 8.8 result directly from the introduction of a new measurement basis applicable only to some of the current defined benefit schemes. We have expressed our concerns about the proposed new classifications for promises in our responses to earlier questions.

We have not identified practical difficulties specific to the measurement of contribution-based promises during the payout phase.

<u>Disaggregation, presentation and disclosure of contribution-based promises</u>

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?

Given the similarities between many of the contribution-based and defined benefit promises, we believe that the disclosure requirements for the two types of promises should be aligned, subject to the need to provide additional information about the financial option included in the cash balance plans identified as problematic in our response to Question 5.

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?

For most contribution-based promises that are similar to defined benefit promises, we believe that the presentation of changes in the liability should follow the presentation required for defined benefit promises, since these changes are essentially of the same nature. We have no strong views with respect of the presentation of changes in liabilities related to the cash balance plans identified as problematic in our response to Question 5.

<u>Benefit promises with a "higher of" option</u>

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?

We do not believe that plans such as those described in paragraph 10.2 are widespread. Based on responses received to this DP, the Board should consider addressing concerns identified through implementation guidance.

Other matters

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

The Board should consider the disclosures included in the Proposed FASB Staff Position No. FAS 132(R)-a that requires disclosing additional information on the fair value of plan assets, including the nature and amount of concentration risks and the valuation techniques and inputs used to develop the fair value measurement of plan assets. We believe that the disclosures required by this FSP would result in more transparency in the nature, fair value, and concentration risk of plan assets.

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

IAS 19.78 imposes that, in countries where there is no deep market for high quality corporate bonds in that country, the market yields (at the balance sheet date) on government bonds in that country shall be used to discount post-employment benefit obligations. We believe that this requirement should be replaced by a principle indicating that post-employment benefit obligations should be discounted using a rate representative of "high quality corporate bonds" in that country only, without necessarily always requiring the existence of a deep market for high quality corporate bonds in that country. Where such a market does not exist, the entity would be expected to estimate an appropriate high quality corporate bonds rate and disclose how the rate has been determined. Only if an entity is not able to develop a reliable estimate of such a rate, it would be required to default to the market yield on government bonds.