Rådet för finansiell rapportering

The Swedish Financial Reporting Board

RFR-rs 2008:10

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

Dear Sirs,

Discussion Paper - Preliminary Views on Amendments to IAS 19 Employee Benefits

We appreciate the opportunity to respond to the International Accounting Standards Board's Discussion Paper Preliminary Views on Amendments to IAS 19 Employee Benefits. This letter represents the views of the Swedish Financial Reporting Board.

In summary we have the following views on the issues addressed in the Discussion Paper:

- We welcome the proposal that entities should recognise all changes in the fair value of plan assets and in the present value of defined benefit obligations in the financial statements in the period in which they occur as there is no conceptual basis for deferral of actuarial gains and losses. The removal of the corridor and spreading alternative would also reduce the options available for pension accounting and thus increase comparability.

- We object to all of the three suggested approaches in the Discussion Paper to presentation of defined benefit promises. We believe that the two methods to present actuarial gains and losses immediately either in other comprehensive income or income statement, that are currently available under IAS 19, should not be eliminated before the IASB reaches a decision on the long term position on the presentation of financial statements..

    - It would be premature to require immediate recognition of actuarial gains and losses in the profit or loss, as Approach 1 suggests, before the IASB reaches a decision on the long term position on the presentation of financial statements. It would also be premature to suggest any other approaches , such as Approaches 2 and 3, where some changes are recognized in other comprehensive income and some other changes are recognized in profit or loss, until IASB has developed guidance for which items are to be recognized in other comprehensive income. Also it would become too arbitrary to divide actuarial gains and losses into one portion that is to be recognized in other comprehensive income and one portion that is to be recognized in profit or loss when there is no conceptual basis for such an allocation.

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- The approaches proposed by the IASB lead to divergence from US GAAP.

- We do not agree that entities should not divide the return on assets into an expected return on plan assets and an actuarial gain or loss (that represents the difference between the expected and the actual return). There is no more subjectivity involved in estimating the expected return on plan assets than it is in estimating other actuarial assumptions. Furthermore, it would be inconsistent to recognise the interest cost in the income statement if we do not recognise some kind of long-term return on the plan assets that exist to secure the benefit obligation.

- In general we believe that items that are recognized through other comprehensive income should later be recycled to the income statement. Accordingly, we would support that actuarial gains and losses that have been recognised in other comprehensive income are later recycled to the income statement as US GAAP currently requires. The Discussion Paper states that the decision not to recycle actuarial gains and losses is made because of the pragmatic inability to identify a suitable basis for recycling. Since there is no general guidance in IFRSs on recycling of items, we can also accept that this matter is not dealt with in this project but later addressed when the IASB reaches a decision on the long term position on the presentation of financial statements.

- One issue that the Discussion Paper does not address is whether the liability for benefit obligations should be based on expectations of employees' pensionable salaries when they leave service or whether the liability should be based on current salaries at each reporting date. We believe that the liability for past service (and the pension expense for each period) should be based on the benefits that the employer is presently committed to provide – this would usually be benefits based on current salaries.

We have focused our comments to the questions concerning recognition and presentation of defined benefit promises, i.e., Questions 1 through 4 and Question 14, in the Discussion Paper. We have chosen not to answer Questions 5 through 13, that relate to contribution-based promises, due to the fact that such plans that will be affected by this guidance are quite rare in Sweden. Accordingly, we do not have any wide experience of whether the projected unit credit method does not work for the measurement of such promises. We believe that territories that are significantly affected by the proposal for changes relating to contribution-based promises are best suited to answer those questions.

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?

The Discussion Paper proposes that all changes in the present value of the defined benefit obligation are recognised in the financial statements in the period in which they occur. Since the present value of the defined benefit obligation always will be reflected in the statement of financial position without any deferral mechanism, the issue of measurement of the defined benefit obligation becomes even more important. One issue that the Discussion Paper does not address is whether the liability for benefit obligations should be based on expectations of employees' pensionable salaries when they leave service or whether the liability should be based on current salaries at each reporting date.

We believe that the liability for past service (and the pension expense for each period) should be based on the benefits that the employer is presently committed to provide – this would usually be benefits based on current salaries. Under this view, the pension expense of each period will reflect the extra pension liability incurred by giving increases in pensionable salaries. We disagree with the requirement in the present standard to anticipate expected future salary increases. We believe that only benefits that the entity is presently committed (by legal or constructive obligation) to pay should be reported as liabilities, not benefits to which the entity might become committed in the future. In our view, that principle should apply also to increases in pension benefits that result from salary increases because we believe it provides the clearest view to users of an entity's obligations. As employees progress through their careers the employer in addition to paying higher salaries also makes the original pension promise more valuable with each increase in pensionable salary. We believe that the current approach is inconsistent with the treatment of expected increases in other elements of remuneration – such as salaries and bonuses – which are accounted for in the periods in which they occur. We believe that the increase in value of an employee's pension benefits is in economic terms not distinguishable from the rest of the remuneration for each year of service – in effect it is a bonus in the form of additional pension benefits. Under this view the cost of promoting an employee includes an increase in the value of the employee's pension benefits (that is usually larger the longer the employee's service). That cost should be reflected as an expense of the period in which the decision to promote the employee is made, together with increases in other components of the employee's remuneration.

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 agree that entities should recognise all changes in the fair value of plan assets and in the present value of defined benefit obligations in the financial statements in the period in which they occur. There is no conceptual basis for deferral of actuarial gains and losses. By removing the deferral mechanism the resulting asset or liability represents faithfully the entity's financial position. An entity will report an asset only when a plan is in surplus and a liability only when a plan has a deficit.

We also agree that entities should recognise unvested past service cost in the period of a plan amendment. This is consistent with paragraph 69 of IAS 19 which deals with service costs as opposed to past service costs. Paragraph 69 states that employee service gives rise to an obligation under a defined benefit plan even if the benefits are conditional on future employment (in other words they are not vested). The application of paragraph 69 gives rise to a current service cost in relation to obligations that only will vest if a certain future event will occur. Accordingly, not recognising past service costs when a plan amendment occurs is inconsistent with the treatment of vesting conditions in existing benefit plans.

However, we do not agree that entities should not divide the return on assets into an expected return on plan assets and an actuarial gain or loss (that represents the difference between expected and actual return). The IASB states in paragraph 2.15 of the Discussion Paper that it is concerned that the subjectivity inherent in determining the expected rate of return provides entities with an opportunity to choose a rate with a view to manipulating profit or loss. Accordingly, the IASB states that its preliminary view is that entities should not divide the return on assets into an expected return and an actuarial gain or loss. We believe that such a statement by the IASB is not consistent with an objective to develop principles-based standards. There is no more subjectivity involved in estimating the expected return on plan assets than it is in estimating other actuarial assumptions such as future salary increases, rates of employee turnover, and discount rates and so on. The IASB has also accepted a high degree of subjectivity in other recent amendments of standards, such as valuation of intangible assets in a business combination at the benefit of providing more decision-useful information to users of financial statements. We must assume that the entities are doing a proper job when developing their best estimate of the variables that will determine the ultimate cost of providing post-employment benefits. Furthermore, it would be inconsistent to recognise the interest cost in the income statement if we do not recognise some kind of long-term return on the plan assets that exist to secure the benefit obligation. In summary, we believe that expected return on plan assets can be measured with sufficient reliability to justify its recognition. Recognition in a transparent manner of the current best estimate of the expected return on plan assets provides better information than non-recognition of such an amount even if the current best estimate involves some degree of subjectivity. We also believe that the disclosure requirements of IAS 19 with regard to the expected return on plan assets make it easy for users of financial statements to evaluate the pension expense. In this regard, it would also make sense to introduce some kind of sensitivity analysis whereby the entity is required to disclose the impact of an increase of one percentage point and a decrease of one percentage point in the expected return on plan assets on the pension expense recognized in the income statement. Such a requirement would also be consistent with paragraph 120A(o) of IAS 19.

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?

We have noted that the Discussion Paper ignores the present method of writing off actuarial gains and losses directly to other comprehensive income, and contains three different suggestions , one of which is currently available – immediate write-off to income statement – but that is hardly ever used, and two new options. We believe that the two methods to present actuarial gains and losses immediately either in other comprehensive income or income statement, that are currently available under IAS 19, should not be eliminated before the IASB reaches a decision on the long term position on the presentation of financial statements.. It would, however, offer substantial improvements to financial reporting if the IASB removes the corridor and spreading alternative, i.e., the deferred recognition approach, and just allows the immediate recognition of actuarial gains and losses, either in profit or loss or in other comprehensive income. It would reduce the options available for pension accounting and thus increase comparability.

We do not believe that any of the proposed approaches for presentation in the Discussion Paper provides more useful information to users of financial statements than an approach where all actuarial gains and losses are recognized in other comprehensive income (combined with an option to recognize these items in income), for the following reasons:

- We believe that the concerns expressed by constituents and the IASB when developing and revising IAS 19 up until 2004 are still valid. When the IASB recently added an additional option for the recognition of actuarial gains and losses in 2004, the IASB expressed that "the IASB accepts that requiring actuarial gains and losses to be recognized in full in profit or loss in the period in which they occur is not appropriate at this time because the IASB has yet to develop fully the appropriate presentation of profit or loss and other items of recognized income and expense." (refer to BC 48E of IAS 19). In BC 48K of IAS 19, the IASB stated that "it would be premature to require their immediate recognition in profit or loss before a comprehensive review of both accounting for post-employment benefits and reporting comprehensive income." We agree that it would be premature to require immediate recognition of actuarial gains and losses in the profit or loss (Approach 1) before the IASB resolves substantial issues about performance reporting. These issues include:
    - Whether financial performance includes those items that are recognized directly in equity;
    - The conceptual basis for determining whether items are recognized in the income statement or directly in equity;
    - Whether net cumulative actuarial losses should be recognized in the income statement, rather than directly in equity; and
    - Whether certain items reported initially in equity should subsequently be reported in the income statement (recycling)

  There is little point in fixing something in IAS 19 now that might be out of line with the final presentation standard. All approaches proposed by the IASB in the Discussion Paper prejudge issues relating to IAS 1 on which a long term position must be reached..

  We are concerned that a presentation approach where all changes in the fair value of plan assets as well as all changes in the present value of the defined benefit obligation are recognized in the income statement would inappropriately combine information with different predictive implications. The fair value measurement of plan assets and the present value measurement of defined benefit obligations may not reflect the underlying cash flows expected to be received or paid. Movements in fair values or present values do not predict the future cash flow performance of the assets and liabilities related to pension plans, unless the entity intends to settle the defined benefit obligation and can find a willing counterparty. Where such plan assets and benefit obligations are not intended to be settled in the short term, which normally is the case, performance information should reflect what the business actually does and how it is managed. The information received from the present approach, where all actuarial gains and losses are recognized in other comprehensive income, provides users with more relevant information on potential cash-flow performance than under Approach 1. For example, a change in the discount rate will change the present value of the defined benefit significantly, although the future cash flows will not be affected since the estimated amount of pension payments may not have changed.

Those managements that rely on earnings to understand the performance of their businesses would also find it difficult to use financial statements prepared under Approach 1 to discuss and explain how the business has or has not followed its strategy. If Approach 1 is not seen by management and its users as providing sufficient information for meaningful communication between the two groups (i.e., preparers and users), there is a danger that financial statements would be relegated to the status of a compliance document. Management and users might then feel compelled to develop alternative communication statements outside financial reporting that better meet their needs.

- Approaches 2 and 3 suggest splitting actuarial gains and losses into one portion that should be part of service costs and therefore recognized immediately in the income statement and one portion that should be recognized immediately in other comprehensive income. Under Approaches 2 and 3, actuarial gains and losses that are related to assumptions on future salary increases, mortality, rates of employee turnover, disability, early retirement, the proportion of plan members with dependants who will be eligible for benefits, claim rates for medical plans and future medical costs should be recognized immediately in the income statement as part of service cost and will create increased volatility in the income statement. Under Approaches 2 and 3, actuarial gains and losses that are related to the discount rate and the rate of return on plan assets should be recognized immediately in other comprehensive income. As mentioned above, there is no conceptual basis for treating actuarial gains and losses in different ways as proposed under those approaches. We therefore question on what conceptual basis Approaches 2 and 3 operate in order for those approaches to bifurcate actuarial gains and losses into two different portions that is accounted for differently. We object to such an allocation of actuarial gains and losses for the following reasons:
    - It is an arbitrary method of dividing actuarial gains and losses into one portion that is recognized in the income statement and one portion in other comprehensive income. Accordingly, it generates income and expense items that are arbitrary and that have questionable information content.
    - Until a conceptual basis for determining whether items are recognized in the income statement or other comprehensive income has been decided on, we prefer to treat all actuarial gains and losses in the same way, i.e., through other comprehensive income.

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- It will offer increased complexity for management to explain for users of financial statements the profitability of the business when they have to go into details why certain actuarial gains and losses are recognized as part of pension expense and why certain other actuarial gains and losses are not recognized as part of pension expense. We are afraid that this will damage the credibility of financial reporting.
- The current method to recognize all actuarial gains and losses in other comprehensive income is well established and easier to apply and understand.

Approach 2, which requires interest cost to be presented in other comprehensive income, would be inconsistent with most other IFRSs, which require interest cost to be recognized in profit or loss.

- The approaches proposed by the IASB lead to divergence from US GAAP. The FASB recently published a new standard on pension accounting were all actuarial gains and losses are immediately recognized in other comprehensive income.

We acknowledge that there is no conceptual basis for the present approach to recognize gains and losses directly in other comprehensive income, but while the present situation is not conceptually pure nor would the Discussion Paper proposals (Approaches 2 and 3) be pure either. There is no guidance anywhere how to distinguish between items that are to be reported in other comprehensive income and items that are to be reported in the income statement. There are a number of items that today are permitted to be recognized in other comprehensive income, e.g., changes in fair value of cash flow hedges and changes in fair value of available for sale financial assets (under IAS 39), exchange differences related to foreign operations (under IAS 21), and actuarial gains and losses (under IAS 19). We believe that the same reasons for allowing value changes on cash flow hedges and AFS financial assets in other comprehensive income are equally valid for allowing certain value changes related to pension plans to be recognized 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
(ii) disaggregation of information about fair value?

As discussed above under Question 3 (a) we expect that the vast majority of preparers will argue that the resulting volatility of Approach 1 will not be a realistic portrayal of the long-term nature of post-employment benefit obligations. We therefore expect that there will not be sufficient support from constituents for such a significant change in current practice at this time.

We do not agree that entities should not divide the return on assets into an expected return on plan assets and an actuarial gain or loss (that represents the difference between expected and actual return). See our response to Question 2 above.

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

Approach 1 does not entail any difficulties to apply, but we question the information content as discussed above.

It will be difficult to understand and apply an approach where actuarial gains and losses are split into two different categories as suggested in Approaches 2 and 3. We object to such an allocation of actuarial gains and losses for the reasons given on pages 5-6 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?

We believe that the present approaches where actuarial gains and losses, as defined by IAS 19, are recognised in the income statement or other comprehensive income, as currently permitted, should not be eliminated (see our discussion under Question 3(a) above).

In addition to the discussion above under Question 3 (a) above, we also support that actuarial gains and losses that have been recognised in other comprehensive income are later recycled to the income statement as US GAAP currently requires. IAS 19 does not currently permit recycling of actuarial gains and losses that are recognised directly in equity. The Discussion Paper states that the decision not to recycle actuarial gains and losses is made because of the pragmatic inability to identify a suitable basis for recycling. We argue in favour of recycling, for the reason that all income and expense related to pension plans ultimately should be recognised in profit or loss at some time. The statement that there is no suitable basis for recycling can be questioned. The FASB included a requirement of recycling of actuarial gains and losses in their standard FAS 158 that was published in 2006. The approach taken by the FASB is to recycle the actuarial gains and losses at the time when actuarial gains and losses exceed the corridor amount (10 per cent of the higher of the fair value of the plan assets and the present value of the defined benefit obligation) and where the amount above the corridor is divided by the remaining average service periods of the employees covered by the plan. Although an arbitrary method, we believe that it is preferable that all pension expenses end up in the income statement at some time. Since there is no general guidance in IFRSs on recycling of items, we can also accept that this matter is not dealt with in this project but later addressed.

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Questions 5 through 13

We have chosen not to answer Questions 5 through 13, that relate to contribution-based promises, due to the fact that such plans that will be affected by this guidance are quite rare in Sweden. Accordingly, we do not have any wide experience of whether the projected unit credit method does not work for the measurement of such promises. We believe that territories that are significantly affected by the proposal for changes relating to contribution-based promises are best suited to answer those questions without looking into these proposed changes in detail we recommend the IASB to evaluate whether this effects of these changes are so significant that they should not be dealt with in a short term convergence project.

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

It would make sense to introduce some kind of sensitivity analysis whereby the entity is required to disclose the impact, when appropriate, of a change in the following assumptions on the defined benefit obligation and pension expense:
- Expected return on plan assets
- Discount rate
- Mortality

Such a requirement would also be consistent with paragraph 120A(o) of IAS 19 that deals with medical plans. We believe sensitivity analysis is even more relevant for pension plans as they are more predominant in most countries than what medical plans are.

If the IASB chooses to take the same path as the FASB on pension accounting and continues to allow all actuarial gains and losses to be recognized in other comprehensive income, something which we support, it would be worthwhile to consider an increase in the disclosure requirements with regard to the actuarial gains and losses in a way that would enable readers of financial statements to understand the size of the actuarial gains and losses for the period that is related to each of the following assumptions, if material:
- Future salary increases;
- Mortality;
- Deviation from expected return on plan assets
- Discount rate
- Any other material actuarial assumptions used

Such a measure from the IASB would dissagregate the information about value changes and enable users of financial statements to better understand the actuarial calculations.

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Rådet för finansiell rapportering

If you have any questions concerning our comments please address our Executive member Carl-Eric Bohlin by email to: carl-eric.bohlin@radetforfinansiellrapportering.se.

Stockholm, September 22, 2008

Yours sincerely,

THE SWEDISH FINANCIAL REPORTING BOARD

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