MAZARS

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Preliminary Views on Amendments to IAS 19 ***Employee Benefits***

Dear Ms. McGeachin,

Mazars welcomes the opportunity to comment on the Discussion Paper relating to "Preliminary Views on Amendments to IAS 19 *Employee Benefits*". While detailed comments and answers to the Board's questions are attached to this letter, we present our general views in the following paragraphs.

- The Discussion Paper addresses the recognition and presentation of defined benefit promises. In particular, The Board proposes to eliminate deferred recognition of actuarial gains and losses and non-vested past service costs and analyses various possibilities for the presentation of the change in value of assets and liabilities. We do not feel that there is an urgent need for such a change even though we acknowledge the reality of the issue. We believe that this issue should have been addressed at a later stage, taking into consideration the conclusions of the Performance Reporting project.

- The Discussion Paper introduces a new category of pension promises named « contribution-based promises »:

  ✓ We agree that IAS 19 should be amended to address the accounting for some post-employment promises, for which the current IAS 19 valuation methodology (known as the Projected Unit Credit Method) has caused problems in practice as it deals only with actuarial risks, not taking into account other promises, such as a specified return on contributions.

  ✓ However, we do not believe that the introduction of the contribution-based promises category proposed by the Board is appropriate as this new category would mix several kinds of benefits with very different risks: benefits with no actuarial risk that are classified now as defined contribution plans, some defined benefits bearing actuarial risks which would look like plans currently classified as defined benefits plans, and schemes with financial risks.

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- ✓ We would rather favour an approach based on the valuation and accounting for an embedded financial derivative in a host post-employment benefit scheme, while maintaining the current classification of defined benefit and defined contribution plans for the host scheme.

- The Discussion Paper excludes important consideration such as the measurement of defined benefit obligations. While we agree that measurement should not be included in a short-term project, we encourage the Board to address the issue of discount rate, consistently with the approach used for other projects.

Should you wish to discuss further some of our comments we would be pleased to give you any additional information at your convenience.

Yours sincerely,

Michel Barbet-Massin
Head of Financial Reporting Technical Support

Appendix : detailed comments

Scope of the project

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 support the Board's decision to deal with issues relating to the existence of guaranteed returns on contribution within post-employment benefit plans. The financial crisis during years 2002 and 2003 pointed out the inability of IAS 19 to capture this kind of obligation through the Projected Unit Credit Method. This had led some companies to significant additional contributions due to the gap between promised and actual returns.

However, we consider that the discussion on the elimination of deferral mechanisms should be addressed at a later stage. We feel such a discussion should only occur once the project on Performance Reporting has come to a more mature stage. We also think that it could be interesting to explore the possibility of recycling through profit or loss some items that were first accounted for under "other comprehensive income".

We also encourage the Board to address the issue of the discount rate, consistently with the Discussion Paper relating to Insurance Contracts and with the goal to reduce differences in practice.

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 think that the factors pointed out by the Board in chapter 2 are relevant.

However, we consider that the disclosures provided in accordance with the current standard easily permit the comparison of financial statements. We do not think that users of financial statements have difficulties to deal with deferred elements because the obligation and assets value clearly appear in the notes to the financial statements, and net periodic pension cost presents clearly the impact of deferral mechanisms. We consider that complexity resulting from IAS 19 is due to the various items to be considered in the analysis of the variation of obligation, more than to the way they are recognised. Problems with understanding these items will remain even if the deferral mechanisms are eliminated.

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?

(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 ?

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

We consider that users of financial statements should be provided on the face of the balance sheet with:

- The total present value of the obligation
- The fair value of plan assets and reimburment rights

while the presentation of net periodic pension cost should distinguish clearly « current » (service cost, interest cost) and « non current » items (actuarial gains/losses, impacts of plan amendements,...).

Thus we consider that recognition of non current elements in other comprehensive income with recycling through profit or loss at a later stage could meet that goal.

We also suggest not to divide actuarial gains/losses into two different items, such a split being artificial due to the interaction between the different components of actuarial gains/losses.

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 mentionned above, we believe that the recognition of the full variation of net asset/liability with non current items recognised through other comprehensive income and recycled at a later stage through profit and loss would give useful information to the users of the financial statements.

This approach would lead to:

- A clear presentation of funded status at each reporting date,
- An economic presentation of employee costs excluding the impact of some variation that are not part of the period service cost,
- A presentation consistent with IFRS 2 for the recognition of non-vested benefits when a share-based plan is amended.

Definition of contribution-based promised

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 do not agree with the introduction of the contribution-based promises category proposed by the Board as we believe that this proposal:

- Introduces useless complexity,
- Creates a new category that mixes schemes bearing different types of risk (no risk / actuarial risks / financial risks).

We acknowledge that the current wording of IAS 19 creates practical problems when dealing with some schemes such as defined contribution plans with a guaranteed asset-based return. However we do not think the solution proposed by the Board addresses adequately this issue. We consider this goal could be achieved by introducing specific changes to current IAS 19 on measurement and accounting for financial derivatives embedded in pension schemes, that could be separated from the host scheme.

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?

We consider that the new category proposed by the Board could lead to significant impact on classification for some countries, for instance in countries where defined contribution plans with guaranteed returns exist such as Switzerland or Belgium, among others.

Moreover, we consider that the distinction between defined benefit promises and contribution-based promises is unclear in some cases, for example when the promises is based on an average of a defined number of years at the end of the career, so that the scheme can't be considered as based on final salary nor on a career average if the number of years taken into account is limited. This could create practical difficulties in applying the classification proposed by the Board.

Question 7

Contribution-based promises, as defined in this paper, include promises that IAS 19 classifies as defined contribution plans. 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 consider that the new category proposed by the Board would not lead to significant changes in accounting for promises classified as defined contribution benefits under IAS 19.

Question 8

Chapter 6 discusses recognition issues related to contribution-based promises. The Board's preliminary views are summarised in paragraphs PV9–PV11.

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

As stated in § 6.9, the Board decided not to allow entities to depart from the benefit formula. This introduces a difference with the benefit allocation for defined benefit promises, which is recognised on a straight-line basis when the formula assigns materially higher benefits to later periods of service. As some contribution-based promises are, in substance, very close to defined benefit schemes we feel that this difference in the accounting treatment would sometimes be difficult to justify.
Thus we favour a different solution to cope with accounting for pension schemes including clauses such as an asset-based guaranteed return (see answer to question 5): maintaining the present categories while identifying and measuring an embedded derivative.

Measurement of contribution-based promised

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 agree that entities should measure their obligation at fair value assuming the terms of the benefits promise do not change.

In our view, were the amendment to IAS 19 limited to recognising and measuring a derivative embedded in a defined contribution plan, the fair value measurement of such a derivative could be achieved by:

- Modelling the evolution of the population at valuation date with assumptions consistent with current standard
- Valuating derivatives using financial models, including an assumption regarding volatility to capture the risk

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?

It is difficult to identify them all as the contribution-based category, as defined, is very broad and includes many different types of pension schemes bearing different types of risk.

Disaggregation, presentation and disclosure ofcontribution-based promises

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?

The Board's preliminary views as disaggregation is that entities should present changes in the value of the liability split between a service cost and other value changes.
We agree that the separation of interest cost would be difficult, particularly for promises including financial guarantees and options. Nevertheless we would appreciate that the Board considers the solution we propose in our answer to question 5.

We agree that the separation of interest cost would be difficult, particularly for promises including financial guarantees and options. Nevertheless we would appreciate that the Board considers the solution we propose in our answer to question 5.

We also consider that the Board should give guidance on presentation of changes in the liability taking into account the impact of cash-flows because of the quite different mechanism between the various categories of promises: in the case of promises including financial guarantees and option, payments from employer may result from activation of the guarantee or option and could not necessarily lead to a proportionate decrease of the liability as for a classical defined benefit promise.

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?

We consider that changes in the liability for contribution-based promises should mirror as far as possible the presentation of changes in the liability for defined benefit promises.

We are nevertheless concerned that differences could result from the difference in the nature of the risks included in the promises, which could imply the necessity to create new categories of changes.

Benefit promises with a 'higher of' option

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 agree to separate the 'higher of' from the host defined benefit promise. This is consistent with our response to question 5 (separation of embedded derivative from the host defined benefit promise).

Other matters

Question 14

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

We would appreciate that the Board proposes requirements regarding defined benefit promises where costs are shared between employers, employees and former employees. This is the case for example for post-employment medical care where the risk sharing can be very different from one scheme to another. Users of financial statement should understand what are the practical aspects of risk-sharing, and be provided with sensitivity analyses consistent with those aspects.

Question 15

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

We don't have any other comments on this paper.