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Discussion Paper 'Preliminary Views on Amendments to IAS 19 Employee Benefits'
International Accounting Standards Board
30 Cannon Street, London EC4M 6XH
United Kingdom

Dear Sir or Madam:

The Korea Accounting Standards Board (KASB) has finalized its comments on Discussion Paper 'Preliminary Views on Amendments to IAS 19 Employee Benefits'. I would appreciate your including our comments in your summary of analysis.

The enclosed comments represent official positions of the KASB. They have been determined after extensive due process and deliberation.

Please do not hesitate to contact us if you have any inquiries regarding our comments. You may direct your inquiries either to me(cwsuh@kasb.or.kr) or to Mr. Sung-ho Joo (sung-ho.joo@kasb.or.kr), researcher of KASB.

Yours sincerely,

Dr. Chungwoo Suh
Chairman, Korea Accounting Standards Board

Cc: Sungsoo Kwon, Director of Research Department

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We are pleased to comment on the Discussion Paper ‘Preliminary Views on Amendments to IAS 19 Employee Benefits’. Our comments include views from a public hearing and responses collected from the various associations. We finalized the comment letter through the due process established in KASB.

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?

According to the existing IAS 19, the rate used to discount post-employment benefit obligations shall be determined by reference to:

⑴the market yields on high quality corporate bonds unless there is no deep market

⑵the market yields on government bonds if there is on deep market

However, there is no objective and detailed criteria that can be used in identifying the 'high quality' and 'deep market'. This might cause the comparability among companies to be reduced.

Therefore, we believe that this project should include the guidance on determining the discount rate. This can be referred to (ii) of the paragraph 1.11.

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?

The paragraph, PV3, proposes that entities should not divide the return on assets into an expected return and an actuarial gain or loss. As a result, the expected rate of return gets useless.

Both of the expected return on plan assets and service cost (including interest cost) are conceptually separated from actuarial gains and losses. Offsetting them results in the long-term net pension cost which is free from the short-term changes in some volatile factors. Therefore, such net cost may provide meaningful information to uses of financial statements who forecast the future in the long-term perspective relying on financial statements.

Hence, the information about the expected return on plan assets need to be provided separately even though it is quite subjective.

The paragraph, PV5, proposes three approaches in respect to the presentation of retirement benefit costs. In approach 3, the concept of the expected return would be necessary in estimating interest income. Such need is inconsistent with the paragraph, PV3 (see the paragraph 3.29 of the DP).

The paragraph 2.7 introduces the criticism that deferred recognition model adds to the cost of applying IAS 19 by requiring entities to keep complex records. However, we have some doubts about the rationale. As a matter of fact, many actuaries maintain that deferred recognition model is unlikely to adds to the cost of applying IAS 19, though they acknowledge that it contributes to the complexity of the resulting accounting.

The paragraph 2.8 explains that IASB rejects the argument that the volatility resulting from immediate recognition is too great to be acceptable in financial statements, but thinks much of the faithful presentation of economic events. We believe that the faithful representation of actuarial gains and losses can be realized by recognizing them immediately in profit or loss. Though, chapter 3 proposes approach 2 and 3 as the methodologies to present the retirement cost in financial statements. According to such approaches, actuarial gains and losses are recognized partly in other comprehensive income. This is not consistent with the premise that the faithful presentation can be realized by recognizing them immediately 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?

Basically, we support 'Approach 3'. If we separate the short-term changes in value and the long-term net cost (eg. service cost, interest cost and interest income), it will provide financial statements users with additional relevant information.

If all actuarial gains and losses are recognized in profit or loss, the performance of an entity becomes affected by unexpected external factors(eg. the change in the discount rate resulted from the sub-prime mortgage crisis). That will diminish the predictive value of financial statements in the view of the users.

(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 attach equal importance to both of presentation of some components of defined benefit cost in other comprehensive income and disaggregation of information income.

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

In order to follow Approach 3, we need to divide actuarial gains and losses into remeasurements that arise from changes in financial assumptions and other changes in obligation and plan assets. In addition, the record of actuarial gains and losses should be kept for each employee. If the number of employees covered by the defined benefit plan of a company is large and the company conduct actuarial valuation by itself, it will take a great of time for the company to prepare 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?

Approach 2 and 3 differentiates between financial assumptions and demographic assumptions, but we doubt whether there are any grounds for the differentiation. The paragraph 3.32 implies that the IASB believes that the effect of changes in assumptions - they seem to represent demographic assumptions - on the service cost should not be recognized in other comprehensive income. However, there are no obvious criteria for determining what assumptions have effects on service cost.

We believe that it is necessary to make it clear that future salary increase should be included in the financial assumptions which Approach 3 refers to. We note that the paragraph 73 of current IAS 19 includes future salary increase as well as the discount rate and the expected rate of return in the financial assumptions. If future salary increase is included in the financial assumptions which Approach 3 refers to, the effect of its change will be recognized in other comprehensive income. On the other hand, according to Approach 2, the effect of change in future salary increase is recognized in profit or loss. Considering the rationale underlying approaches to financial statement presentation, we infer that Approach 3 intends to add to components recognized in profit or loss in comparison with Approach 2. However, Approach 2 proposes to recognize the effect of change in future salary increase in profit or loss, whereas Approach 3 proposes to recognize it outside profit or loss. This is contradictory to the inferred intention. In respect to this point, we request the IASB to bring its position to light. That is to say, we want to know whether the IASB considered that Approach 2 and 3 treated the effect of change in future salary increase in different ways, which are contradictory to the rationale underlying approaches, and if so, why the IASB left the matter unsettled.

According to the paragraph 3.30, the IASB noted that the distinction between dividends and other changes in fair value is not an important economic distinction. Nevertheless, why can Approach 3 be considered? We think that dividends are so essential as to include in estimated interest income.

(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 we mention in the comment on the question 3(3), we basically support Approach 3. But, we think that the IASB should consider the defects of the logic that we point out in the comment on the question 4(1).

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 think that the IASB intends to focus on addressing cash balance plans and promises with a 'higher of' option in this project. We agree with the IASB.

The measurement of the cash balance plan and the classification of the defined contribution plan with a guaranteed minimum return and the retirement benefit plan with 'higher of' option between DB and DC, were controversial for a long time in America and Europe. Therefore, we think that their priorities are high enough to address in the scope of this project.

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?

As a matter of fact, cash balance plans are popular over the world. We anticipate most of them will be reclassified from defined benefit to contribution-based according to the preliminary view of the IASB. If the cash balance plan is reclassified to a contribution-based promise, its measurement should be based fair value instead of the projected unit credit method. We think that there will be not any practical problems in measuring the fair value of the liability for a cash balance plan on condition that current actuarial valuation techniques are adapted adequately. But, there is the possibility that accounting practices will be led to some confusion with respect to determining discount rate, especially considering credit risk. It is because the measurement of the defined benefit plan does not include credit risk, whereas the measurement of the contribution-based promise includes credit risk. Therefore, we think that more detailed guidance will be necessary regarding the determination of discount rate.

We doubt that credit risk also should be taken into account in measuring the fair value of the contribution-based promise. If credit risk is taken into account in measuring the fair value of the contribution-based promise, the higher credit risk results in the smaller amount of retirement benefit obligation. This might mislead financial statement users into understanding that the company's responsibility for retirement benefit payment to employees decreases in inverse proportion to its credit risk.

In Korea, we cannot find any cash balance plans yet due to legal restrictions, whereas defined contribution plans with a guaranteed minimum return are easily found.

Question 7
Do the proposals achieve that goal? If not, why not?

We think that the proposal achieve the goal that IASB does not intend to lead to significant changes in the accounting for most promises that meet the definition of defined contribution plans in IAS 19.

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

In principle, we agree with the IASB's preliminary view on the recognition issue related to contribution-based promise.

However, we think that it the IASB needs to make it clear whether both of retirement benefit obligation and plan assets are recognized and then offset each other, or only unpaid contribution is recognized in the case of the contribution-based promise. We note that neither of retirement benefit obligation and plan assets is recognized, but only unpaid contribution is recognized in the case of the typical defined contribution plan.

According to the definition in IAS 19, Defined contribution plans are retirement benefit plans under which a company has no legal or constructive obligation to pay further contributions once it pays fixed contributions into a fund. Therefore, it is not necessary to keep the record of retirement benefit obligation and plan assets for the purpose of financial statements preparation. All that is necessary is to recognize the unpaid or prepaid contribution as a liability or a asset.

On the other hand, the definition of the contribution-based promise introduced by the Discussion Paper does not mention explicitly such characteristics as those of DC. Therefore, we infer that, in the case of the contribution-based promise, a company should keep the record of retirement benefit obligation and plan assets, and then offset them against each other for the purpose of financial statements, as in the case of the defined benefit plan.

We note that the contribution-based promise includes the existing defined contribution plan (see the paragraph 5.22). It means that the existing defined contribution plan should be also presented on the financial statements at the amount that results from deducting plan assets from retirement benefit obligation.

In respect to this point, we pay attention to D9 Employee Benefit Plans with a Promised Return on Contributions or Notional Contributions published on July 2004. The appendix of D9 illustrated the defined contribution plan with a guaranteed minimum return. The paragraph IE8 said as follows:

> *The present value of the variable component liability is the value of the plan assets at the balance sheet date...*

The paragraph seems to assume that the company keep the record of retirement benefit obligation and plan assets for the purpose of financial statements preparation. Nevertheless, the net liability presented on the balance sheet is nil, because the measure of retirement benefit obligation is always the same as the measure of plan assets. However, if it is necessary to keep the record of retirement benefit obligation and plan assets for the purpose of financial statements preparation, the details should be disclosed in a note to the financial statements. We think that this will be the significant difference between the existing IAS 19 and the Discussion Paper.

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.

We agree with the IASB's preliminary view on the measurement of contribution-based promises.

(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 think that the fair value of a contribution-based promise needs to include the effect of asset-based risk, but it seems to be problematic to include the effect of credit risk. Inclusion of the effect of credit risk might mislead financial statement users into understanding that the company's responsibility for retirement benefit payment to employees decreases in inverse proportion to its credit 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?

We agree with the IASB's preliminary view. Especially, we support the basis for the view described in the paragraph 8.8 and 8.9.

(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 think that there will be not any practical problems in measuring the liability for the contribution-based promise at fair value in the payout phase as well as in the accumulation phase, on condition that current actuarial valuation techniques are adapted adequately.

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?

We agree that the entity should disaggregate changes in the value of the liability for a contribution-based promise into only a service cost and other value changes.

(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?

We agree that it is difficult to disaggregate changes in the contribution-based promise liability into components similar to those required for defined benefit promises, and we also think that it will not be meaningful. If the IASB intends to have the current cash balance plan reclassified from a defined benefit plan to a contribution-based promise, there is no reason why the IASB should be bound to keep the consistency with accounting for the defined benefit plan.

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?

The IASB preliminarily selected the fair value as the measurement attribute for a contribution-based promise. Therefore, it is desirable to have the consistency with accounting for financial liabilities by IAS 39 rather than to keep the consistency with accounting for the defined benefit plan. We agree that changes in the liability for contribution-based promises should be presented in profit or loss.

In contribution-based promises, the changes in the liability and the changes in the value of plan assets should be treated in the same way, or else, in the case of a typical defined contribution plan, the amount recognized in profit or loss will be different from the recognition amount in accordance with the current IAS 19. This is contradictory to the fact that the IASB does not intend to change significantly the accounting for defined contribution plans.

Question 13
(a) What are the practical difficulties, if any, in identifying and measuring the 'higher of' option that an entity recognizes 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?

According to PV16, when a post-employment benefit promise is the higher of a defined benefit promise and a contribution-based promise, an entity should identify the defined benefit promise as the host and the right to choose the contribution-based promise as the option. But, conversely, it could be also alleged that an entity should identify the contribution-based promise as the host and the right to choose the defined benefit promise as the option. However, the Discussion Paper does not explain sufficiently the reason why the defined benefit promise should be identified as the host. The measurement of the promise with a 'higher of' option depends heavily on which is identified as the host. Therefore, we think that it is necessary that the IASB should make clear the criteria for identifying the host in the promise with a 'higher of' option.

In the case of the benefit promise with a 'higher of' option of a defined benefit promise or a contribution-based promise, the right to the assets in a fund is deemed to belong to employees rather than the employer. According to the paragraph 10.8 of the Discussion Paper, the host promise should be the defined benefit promise. Therefore, in terms of the defined benefit plan the right to the assets in a fund should be deemed to belong to the employer. That is to say, the assets in a fund are 'plan assets' held by the employer. This is contradictory to the fact that in reality the right to the assets in a fund belongs to employees.

We agree that 'higher of' option should be measured at fair value, because it is consistent with the fact that derivatives are measured at fair value in accordance with IAS 39.

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

Generally, we can take turnover rate, mortality, future salary increase and discount rate as the primary actuarial assumptions related to a defined benefit plan. However, the paragraph 120A of current IAS 19 specifies only future salary increase and discount rate as required disclosures. Therefore, we suggest that the IASB should also add turnover rate and mortality to required disclosures through this project.

The appendix A of the Discussion Paper illustrates various benefit promises. However, it does not include the defined contribution plan with a guaranteed minimum return which is easily found in reality. Therefore, we suggest that the IASB include such a promise in the list of benefit promises as 15th promise.

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

N/A