MORNEAU SOBECO

SERVICES-CONSEILS EN RESSOURCES HUMAINES ET SOLUTIONS ADMINISTRATIVES
HUMAN RESOURCE CONSULTING AND ADMINISTRATIVE SOLUTIONS
Calgary • Fredericton • Halifax • Kitchener • London • Montréal • Ottawa • Pittsburgh • Québec • St. John's • Toronto • Vancouver
www.morneausobeco.com

Tour de la Bourse — Place Victoria
800, rue du Square-Victoria, bureau 4000
C.P. 211
Montréal QC H4Z 0A4
tél. : 514.878.9090 • téléc. : 514.875.2673

September 26, 2008

International Accounting Standards Board
Discussion paper on IAS19

RE : Employee benefits – amendments to IAS19
Comments on the March 2008 discussion paper

The following comments come from Canadian actuarial firms that among other things support employers in their accounting for pension and benefits. You will find enclosed our comments on some of the questions raised in the discussion paper:

Questions 1 and 2: Scope and additional issues?

We understand that the timeframe has limited the IASB scope for this project. Still, we feel that it would have been a good opportunity to review the definition (and calculation) of what constitutes an obligation with regards to pension and benefits.

A funded status is only a calculation at a certain point in time that depends on many items such as the assumptions used and the returns on assets that change from year to year and even day to day. This measure will fluctuate constantly. ***In particular, we are questioning the fact that the funded status be calculated based on a projected benefit obligation with salary projection. Is this the correct measure for a "marked-to-market" liability on the balance sheet?*** We acknowledge that this question will be part of FASB phase 2 on employee future benefits review. It is a major issue that is not yet resolved. We understand that there is a need to get more consensus on the obligation issue and that working with FASB is an interesting option at the moment.

As many employers may face important change to their balance sheet following this discussion paper, it would have been a good idea to also include review of the obligation even if it means delayed implementation of the current proposed discussion paper. For one thing, it may provide relief to the current changes if the definition of obligation is reviewed and reduces the present value of obligation. Even if it increases, it will still be a one-time hit for both issues. Doing this in different phases may result in significant and possibly offsetting impacts in two different years.

The IASB feels that immediate recognition for gains and losses as well as unvested past service costs can now be achieved with clarification of the appropriate presentation to the financial statement. We feel that the definition and measurement of what constitutes an obligation at balance sheet date should also be resolved before implementing immediate recognition.

Questions 3 and 4: Which approach for presentation of changes in defined benefit costs?

Among the approaches presented in the discussion paper, we think that approach 3 provides the more useful information, with the use of an expected return for interest income measurement. Defined benefits are long term in nature and depend on many future unforeseeable events. They may be volatile in the short term. We feel that much of this short term volatility should be identified distinctly through other comprehensive income. Many of the changes in the benefit obligation tend to cancel out over the years due to difference between the estimates and actual experience. Among the approaches proposed, number 3 achieves this better. But we feel that approach 3 should be slightly adjusted with regards to how some impacts on benefit obligation will be treated. Our approach below precisely includes into other comprehensive income the experience gains and losses on obligation and changes in all assumptions, that is including demographic assumptions.

We understand that the IASB would like to treat the return on plan assets as one component instead of an expected return and a gain (loss) on asset component. Still, we feel that gain (loss) on plan assets should also be identified as a component of other comprehensive income as it will fluctuate (up and down) greatly over the years and may not provide useful information if included in the profit and loss. This item may cancel out over few years and so would be better treated as part of the other comprehensive income.

As such, profit and loss should include the year current service cost and the past service costs – operating cost. This should provide useful information and cost should be generally stable except for years of benefit improvements that will induce a past service cost. This should give highly visible information on the company decision to improve employee benefits. Interest costs (interest on obligation net of expected return) would be financing cost. This should also provide a generally stable cost by being calculated on an expected return.

Other components such as 1) gains and losses on asset returns or experience on benefit obligation and 2) impact of all changes in actuarial assumptions should be recorded in the other comprehensive income section as it reflects either very short term experience or very long term estimates that will need constant reassessment. These are non-routine considerations and have a difficult predictive value.

We feel that for many employers, the use of other comprehensive income for these “distortions” in value of benefit obligation and asset return is very important and that reflecting all the components through profit and loss would combine predictive items with non predictive items. We also feel that having every component reflected in the profit and loss would give information that is difficult to understand to financial statement readers. There may be differences in the year to year comparison just from an experience loss one year that is offset by a gain the following year.

Questions 5 to 13: Contribution-based promises

These benefits are not really seen in the Canadian pension environment. Probably some supplementary retirement plans that provide benefits above regulatory limits may be of this nature.

As such, we do not express any particular view on this. There is significant attention in the discussion paper on the issue with very little practical illustration of it . We would suggest that the IASB comes up with specific examples comparing the current treatment and the proposed treatment so that we could get a better feeling of the kind of impact the changes would have.

Questions 14, 15: Additional disclosures

We feel that disclosures are already pretty comprehensive for employee benefits. If the IASB wants to include additional disclosure for instance on the mortality assumption used, it should first look at other current disclosures to see if it is all necessary information. Too much information is sometimes confusing. Actuaries do use many assumptions in their work and some, such as retirement age, may have more sizeable impact than the mortality table.

Why specifically this assumption? It is possible that some people may like to compare with publicly available information on mortality to assess the reasonableness of the employer choice for this assumption. Still, very few financial statement readers will be able to understand names of mortality tables (from various countries also). Maybe one alternative if additional disclosure on this issue is still desired, it could take the form of average life expectancy of an individual (male vs female) for example currently at age 40 and 60. This would give information on assumed life expectancies that could be compared between different employers.

Nevertheless, we are opposed to additional disclosures that may not provide added value to financial statement readers for whom pension and benefit notes are already comprehensive. Mortality information appears to us as a less important issue and therefore we do not see the need for disclosure.

As requested, we have provided specific comments on items identified in the IASB discussion paper. ***We also have few general comments to add to the IASB specific request***. As pension and benefits consulting actuaries, we are consistently being asked questions by our clients and we receive comments from them on various issues. Many comments relate to changes to pension legislation and pension accounting.

Years ago, measurement of the benefit obligation was adjusted to be more restrictive with the calculation based on a discount rate that followed high quality corporate bonds, even if plan assets are often invested at least in part in equities that have higher potential for returns than bonds. Employers have suffered significant impact and volatility over the years as the accounting expense has been influenced by generally decreasing discount rates (now at very low level).

Employers do not like volatility. Most of the comments we receive on employee benefit accounting are:

- ***Why mandate so much volatility*** by requiring full recognition of funded status every year? This volatility will probably even out over a number of years, but meanwhile, employers must cope with it when they offer benefits to their employees. This should be considered when selecting the approach on how to recognize defined benefits and especially non predictive components such as all gains and losses that occur annually.

- ***Why put so much attention on an item (funded status) that for most employers will represent only a few percentage points of the company liability?*** There are so many other company assets or liabilities that are either estimated or amortized and that represent a much higher stake on the balance sheet. Employee benefits take so much effort in accounting compared to other more sizeable items they have.

Defined pension benefits and post-retirement benefits in Canada are an important part of the overall employee remuneration. They consist of benefits that are of "long-term" nature and they are part of the employees need to plan and live comfortably in their future retirement. We feel that any changes to accounting for these benefits should be considered carefully, because it would be counter-productive to see employers opting out of these long-term benefits due only to short-term financial considerations that will probably even out over the years.

Should you have any question or wish to discuss some of the responses covered in this document, you can reach the undersigned at (514) 392-7831.

Martin Raymond, FSA, FCIA
Principal
:cl