ASSOCIATION OF CONSULTING ACTUARIES

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International Accounting Standards Board
30 Cannon Street
London EC4M 6XH

Dear Sirs

Discussion Paper - Preliminary views on amendments to IAS 19 (Employee benefits)

We are responding to your invitation to comment on the above Discussion Paper on behalf of the Association of Consulting Actuaries.

Members of the Association are all qualified actuaries and are subject to the code of professional conduct of the Faculty and the Institute of Actuaries. Advice given to clients is independent and impartial. ACA members include the scheme actuaries to schemes covering the vast majority of members of defined benefit pension schemes.

The ACA is the representative body for consulting actuaries, whilst the Faculty and Institute of Actuaries are the professional bodies.

We welcome the opportunity to comment on the discussion paper. We agree with the Board that it is appropriate to review the accounting treatment of post employment benefit obligations and we agree that there are a number of practical difficulties and inconsistencies that arise from the guidance in IAS 19 “Employee benefits” (IAS 19).

We support the Board’s intention to undertake a more wide ranging review of IAS 19 and would encourage them to proceed with this second phase of their project as soon as possible.

Recognition and presentation of changes in pension obligations

We agree with the Board that immediate recognition of changes in the measurement of plan assets and the defined benefit obligation on the balance sheet provides a clearer picture of the entity’s financial position. The current situation where, because of the deferred recognition of losses, a plan which is in deficit may present an asset on the balance sheet makes the balance sheet numbers meaningless.

We therefore support the Board’s preliminary view that changes in the measurement of plan assets and the defined benefit obligation should be reflected in the period in which they occur. However, we have significant concerns regarding the presentation of these changes which may be driven by a number of different factors.

We also agree with the Board that the users of the financial statements need to receive relevant and reliable information that will help them assess the amount, timing and uncertainty of the entity's future cash flows. Pensions is an area where those potential cash flows extend many years into the future which brings with it inherent uncertainty. Users of financial statements must able to understand the information provided in connection with employee benefits and in particular the way in which the information is presented should allow them to apply it to projections of the future and to reflect differences of view regarding actuarial assumptions.

BC 41 of IAS 19 notes that although the Board found immediate recognition attractive they believed "that it is not feasible to use this approach for actuarial gains and losses until the Board resolves substantial issues about performance reporting". Relatively little progress has been made on those issues in the last 10 years. We agree that having significant pension liabilities (or assets) off the balance sheet is not helpful to users. However, we feel that the questions regarding the performance statement should not, in effect, be taken piecemeal in individual standards but can only be considered as a whole in the Financial Statement Presentation project revisions to IAS 1. We therefore believe that the existing options in IAS 19 for the immediate recognition of actuarial gains and losses (either in the income statement or in other comprehensive income) should be retained at this stage. The broader changes proposed in the discussion paper should be deferred until the Financial Statement Presentation project has set an appropriate framework for where and how different types of item should be presented.

Contribution Based Promises

We believe that the current proposals will impact too wide a range of plans, many of which do not give rise to any problems with the current Defined Benefit accounting, eg career average salary plans, flat dollar plans and certain cash balance plans. We also believe that constraining the changes so that they do not impact Defined Contribution plans has forced the decision to attribute benefits in accordance with the plan benefit formula without an adequate debate of whether or not this is appropriate. As an illustration Promise 13 considered in the Discussion Paper could equally be expressed as the employer agrees to pay a contribution of 100,000 on the last day of service; this would provide an identical benefit but attributing the benefit in accordance with these two alternative benefit formulae would result in very different accounting.

One minor clarification which would help to reduce diversity in practice is whether or not the impact of future salary increases in a career average plan means that "an employee's service in later years will lead to a materially higher level of benefit than in earlier years". Some believe that IAS 19.67 requires the attribution of benefits in such plans to be on a straight-line basis because, in pound terms, the benefit earned in later years will be higher. Others argue that because the benefit is a constant percentage of the salary in each year the benefit earned is the same and therefore it should be attributed in accordance with the plan benefit formula.

Higher of benefit promises

We agree that IAS 19 Defined Benefit accounting does not provide a particularly good answer for plans which, for example, would be Defined Contribution if not for the existence of a minimum return guarantee. However, for the vast majority of such plans we believe that the proposals represent an approach where the cost of the additional complexity in reporting would outweigh the benefits and that a simpler approach, based on the work done by the IFRIC in D9, would be more cost effective.

Risk sharing plans

The ACA has taken a leading role in the development of plans which share the risks associated with defined benefit plans between the sponsoring employer(s) and the participating employees. The majority of these plans would fall within the proposed definition of Contribution Based Plans. Whilst we believe that the proposed measurement basis of fair value assuming no change in the benefit promise could address the issues raised by these plans considerable guidance will almost certainly be required to achieve consistency of application.

Our answers to the specific questions in the discussion paper are attached in the Appendix to this letter.

If you have any questions in relation to this letter please do not hesitate to contact Richard Davis on 0207 212 4565 or at Richard.davis@uk.pwc.com

Yours faithfully

Richard Davis
Chairman
ACA Accounting Standards Committee

APPENDIX
Detailed responses to the questions in the discussion paper

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 agree that accounting for post employment benefits is a complex area that would benefit from a wide ranging review. However, our view is that the principles applied to accounting for post employment benefits should be considered in their entirety, taking into account the projects dealing with the presentation of the performance statement, recognition and measurement of insurance obligations and financial and other liabilities and the measurement of fair value, to ensure consistency. Significant changes to IAS 19 should be deferred until this work has progressed. The changes proposed in the short term project should therefore be made in the context of the principles that already exist in IAS 19.

There are some practical difficulties with applying IAS 19 which can lead to diversity of practice. We support the Board's efforts to reduce these. We recommend that, in this stage of the project, this is best achieved by clarifying the existing IAS 19 rather than by introducing new concepts and principles into the standard.

We suggest that the project should incorporate issues considered by the IFRIC into any revised standard. Even where the IFRIC has rejected a request to consider a particular topic the fact that they have been asked to consider it suggests that greater clarity in the standard may be helpful.

Question 2- Recognition and presentation of defined benefit promises

Chapter 2 describes the Boards deliberations on the recognition of defined benefit promises. The Board's preliminary views are summarised in PV2-PV4. 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 with the Board's preliminary view that changes in the measurement of plan assets and the defined benefit obligation as a result of actuarial gains and losses should be recognised in the period in which they occur.

The position regarding unvested past service costs is less clear cut. On balance we support the Board's preliminary view that all past service costs should be recognised in the period in which the benefit change is made.

Had the revised benefit formula always been in place the past service cost would have been attributed to past service whether or not the benefit would be vested, this supports an argument for immediate recognition. However, the principle in IAS 19 and IFRS 2 is that benefit is accrued over the period that it is earned and that if it is not vested it is not yet earned (IAS 19 BC 14). IFRS 2 is clear that any incremental value in respect of the modification of a share based payment is recognised over the balance of the vesting period, even though it could reasonably be argued that this is in part a past service cost.

Question 3 – Recognition and presentation of defined benefit promises

Chapter 3 sets out the alternative approaches for the presentation of the components of the defined benefit cost and analyses the relative merits of each approach. These approaches and summarised in PV 5.
(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?

In our view taking a decision on changes in the presentation of defined benefit costs before establishing a framework for the performance statement through the performance reporting project is putting the cart before the horse. It risks either prejudging the views taken in the performance reporting project, so that the conclusions match what has been done for IAS 19, or having two changes in a relatively short time.

We believe that the existing immediate recognition policy choice of either profit or loss or other comprehensive income should be maintained until the Financial Statement Presentation project has set an appropriate framework.

Question 4 – Recognition and presentation of defined benefit promises

(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?

See question 3 above and our covering letter

It is important for users of accounts that the components of employee benefit cost are disaggregated in order to provide understandable information which enables users to estimate future cash flows and performance.

Question 5 – Definition of contribution based promises

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 believe that the Board's proposals are too wide ranging and will impact many types of benefit promise where the current defined benefit accounting in IAS 19 can be applied without difficulty.

The more limited amendments considered in our covering letter will avoid adding additional complexity to an accounting standard that many consider is already complex.

The proposed accounting for contribution based promises will lead to a different measurement and attribution model being applied to plans with a similar economic effect, such as final salary and career average plans. It will also result in a different measurement method being applied to two identical pensions in payment, depending on whether the obligation is classified as a contribution based promise or a defined benefit promise. The proposed model also creates a new measurement attribute: "fair value assuming no change in the benefit promise". We are not clear how this would be applied in practice. We believe that these changes should not be implemented without a broader consideration of the measurement and attribution issues associated with accounting for all post employment benefit obligations.

Question 6 – Definition of contribution based promises

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 noted in our response to question 5 we believe that many promises would be reclassified. In some territories we believe that virtually all plans would be contribution based. In our view for many of these plans the additional time and effort required to apply the proposals will be disproportionate to the possible benefits. We do not believe that such dramatic changes are required at this time to deal with the issues the Board has indentified.

Question 7 – Definition of contribution based promises

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 agree that the proposal should not have a significant impact on the accounting for defined contribution promises where the contributions are paid shortly after the period end. However, in our view the Board has achieved this by adopting an attribution model based on the plan benefit formula rather than the straight line approach which IAS 19 requires where the benefit formula includes a "back-end load" without full consideration of the impact on plans that would change from defined benefit to contribution based.

As noted above our view is that these changes should not be implemented piecemeal but considered as part of a review of all aspects of IAS 19.

Question 8- Recognition issues related to contribution based promises

Chapter 6 discussed the recognition issues related to contribution based promises. The Board's preliminary views are summarised in PV9-PV11. Do you have any comments on those preliminary views? If so, what are they?

We do not support the introduction of the concept of contribution based promises at this time. We believe that the questions regarding recognition should be considered as part of a thorough review of IAS19 so that all types of plan are treated consistently.

Question 9 – Measurement of contribution based promises

(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 do not support the introduction of a new measurement attribute for different types of benefit obligation at this time.

In our view the measurement of all pension obligations should be considered more broadly, taking account of developments in the accounting models for financial and other liabilities and in the measurement of fair value.

The actuarial assumptions used to value defined benefits (and which would also be required to measure contribution based promises) include risks associated with a number of factors, eg inflation, mortality, morbidity and employee turnover.

Conventionally there are two ways to allow for risk in the measurement of an asset or liability, either risk adjust the cash flows and discount using a risk free rate or apply a risk adjusted discount rate to contractual cash flows. If the risk of default is also to be included in the measurement of the liability (which is a question that is open to debate, as the consideration of this point in the PAAiNE discussion paper on pensions showed) then, as the cash flows have already been risk adjusted for a number of elements and the appropriate risk adjustment to the discount rate will vary depending not only on the credit risk of the employer but also the extent and nature of any funding, a further risk adjustment to the cash flows would seem to be more appropriate than trying to establish an appropriate risk adjusted discount rate.

Question 10 –Measurement of contribution based promises

(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 agree that it would be inappropriate to have a change in measurement basis between the accumulation, deferral and payout phases. The nature of the obligation and many of the measurement uncertainties are unchanged when the accumulation phase is over, so there is no reason to change the measurement basis. However, we do not believe it is appropriate to have identical obligations measured on different bases therefore we do not support the introduction of a new measurement model at this stage.

We are not sure how the "*fair value assuming the terms of the benefit promise do not change*" should be determined given the discussion of "exit value" in the Fair Value project and the settlement options which would typically be open to a pension plan.

Question 11- Disaggregation, presentation and disclosure of contribution based promises

(*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?

We do not support the Board's proposal to introduce a new accounting model for contribution based promises.

We believe that disaggregation is necessary to enable users of the accounts to understand the financial statements and obtain decision useful information.

We believe that it is possible to disaggregate the movement in a contribution based promise into components similar to those used for defined benefit promises.

Question 12 - Disaggregation, presentation and disclosure of contribution based promises

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 do not support the Board's proposal to introduce a new accounting model for contribution based promises.

In the longer term decisions regarding the presentation for any new class of promise should be driven by the conclusions of the Financial Statement Presentation project.

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 agree with the proposal that the defined benefit promise should always be considered the host. There are many types of plan which are, in substance, defined contribution plans which include some form of defined guaranteed minimum benefit. For such plans the work involved in measuring the defined benefit and then fair valuing the uplift to the defined contribution benefit would be disproportionate and difficult.

We believe that the majority of plans which provide the higher of a defined benefit promise and a defined contribution promise (whether actual or notional) apply a variant of the approach set out in IFRIC D9 and recognise the greater of the defined contribution pot or the projected unit credit method measure of the guaranteed benefit as the DBO. For a large proportion of such plans swings between these two alternatives will be the exception rather than the rule.

This is a pragmatic and practicable approach which deals adequately with a wide range of plans. In our view the Board's proposals would represent a significant increase in the effort and complexity involved in accounting for such plans which will seldom provide additional useful information.

The proposed approach could render approximate valuation techniques, which are often used by actuaries to estimate results for accounting purposes, unacceptable. Estimating the fair value of the embedded derivative can only really be done at the level of the individual member, or an aggregation of similar members, rather than as a roll forward of overall results. This is likely to present resource problems in meeting the tight reporting deadlines which often apply for listed companies as liability values will be very dependent on asset values as at the reporting date.

Question 14

The Board intends to review the disclosures required about post-employment benefits in a later stage of this project. What disclosures should the Board consider as part of that review?

IAS19 currently requires extensive disclosures many of which are often presented in a way which is less helpful than it could be. It is sometimes the case that the meaning is lost in too much detail.

The objective of the disclosures should be to enable users to understand the impact of pension obligations on the financial statements and their implications for future cash flows. This requires clear disclosure of the balances and components of the movements. It is also important that users are able to understand the underlying assumptions and the risks and uncertainties that affect the estimates so that they are able to reflect different views of the future.

Question 15

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

We have no further comments.

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