Memo

FirstRand Banking Group

Group Finance : Technical Accounting

To: International Accounting Standards Board
From: Technical Accounting
Date: September 2008

COMMENT LETTER: PRELIMINARY VIEWS ON AMENDMENTS TO IAS 19 EMPLOYEE BENEFITS

1 Introduction

We are pleased to present our responses to the specific questions posed by the Board in the invitation to comment which accompanied the *Discussion Paper: Preliminary views on amendments to IAS 19 Employee Benefits* ("DP").

2 Response to specific questions

2.1 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?

An entity may structure its post employment benefit promises in a number of ways, the list below provides a description of the ways that we have identified:

- The entity is directly responsible for payment of the benefits;
- The entity transfers some of the risk for payment to an insurer;
- The entity establishes a fund which it controls;
- The entity establishes a fund which it does not control; or
- The entity is part of a multi employer plan which provides benefits to the employees of a number of unrelated entities.

The manner in which the promise is structured has a significant effect on the type and extent of the risks to which the entity is exposed. One of the current shortcomings of IAS 19 is that all of these structures are treated in the same or a similar manner which does not provide specific information on the specific risks that arise from the structure of the promise. We note that the IASB has decided not to specifically consider the treatment of separate funds or multi employer plans. It seems therefore that the DP proposes changes to the “blanket approach” currently in IAS 19 without changing the accounting for the different structures. The result will be improved accounting on a blanket approach without necessarily reflecting the risks which arise from the structure of the promise. We also note that while excluding the structure of defined benefit projects from the scope of this project the IASB has included items such as contribution-based benefit promises in the scope of this project and we believe that these would be better suited to a long term project than the short term project.

We agree with the IASB that should this discussion paper be implemented the achievement will not result in the best possible long term accounting model for these promises but rather a “half way mark”, improving information relating to the amount, timing and uncertainty of an entities future cash flows slightly but not significantly. We believe that this scenario is very similar to that relating to insurance contracts prior to the issuance of the current *IFRS 4 Insurance Contracts* (“IFRS 4”), where there was a desperate need for some accounting guidance and insufficient time to develop the ideal accounting model. IFRS 4 addressed some of these issues by proposing limited amendments to recognition and measurement and significant improvements to the disclosure requirements. This effectively resulted in the disclosures provided giving information relating to the amount, timing and uncertainty of future cash flows which was not provided in the numbers themselves. We notice that disclosures required by IAS 19 have not been included as a specific item in the scope of this project but rather as an “other matter” to be considered. We believe that the a few succinct improvements in measurement accompanied by a critical review of the disclosures required by IAS 19 would provide a better “half way mark” than the a limited number of fundamental measurement attributes being considered in isolation from the disclosures as proposed in the DP. We refer to our response to Question 14 for our proposed disclosure improvements.

2.2 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 have not identified any factors which the IASB has not considered in arriving at the preliminary views but would like to voice our opinion on the IASB's preliminary views.

Deferred recognition of changes in the liability for defined benefit promises

We agree with the IASB's view that the changes in the liability for defined benefit promises should not be deferred. We provide comment on our suggestions for presentation in our detail response to Question 3 below.

Expected return on plan assets

We agree that the actual return on plan assets provides more realistic information about the defined benefit promises than the expected return and we therefore agree that the actual return is the return which should be disclosed. However, we agree that the return on assets is generally a volatile phenomenon for all entities and we therefore refer to our response to Question 14 where we recommend disclosure relating to risks inherent in the defined benefit promise.

Past service costs

We do not agree with the IASB's proposal for past service costs.

We note that paragraph 2.20 of the DP indicates that the treatment would *"result in an approach that is not consistent with what the Board thinks is the best conceptual answer".* We question the value of an amendment which would be a significant change from current practice where the effect is actually a move away from where the IASB sees the long term solutions. The effect would be that there would be a fundamental change in accounting now and then when the IASB concludes on a long term project, which would be conceptually correct, another fundamental change. It seems that by moving away from the conceptually correct answer that accounting would be taking a step back rather than a step forward.

We would recommend that in an instance like this where a conceptually correct approach can not be agreed upon in the short term that it is preferable to maintain the current accounting treatment which everybody understands than to replace it with a conceptually incorrect approach for an interim period.

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?

(a) We don't believe that any of the approaches on their own would provide the ideal presentation solution.

Approach 1

We agree in principal with recognising the full amount in profit or loss. However, this approach does not provide any information on the composition of the net amount included in profit of loss and we believe that the split between costs incurred as a result of employee service and costs incurred as a result of deferring remuneration is useful for decision making.

Approach 2

We agree with Approach 2 to the extent that it splits the total defined benefit costs between those costs which relate to employees service in the current period and those costs which relate to the deferral of those payments. We however disagree with the approach of including interest costs in Other Comprehensive Income ("OCI") as no other IFRS allows for the deferral of interest costs outside of profit or loss. We are also concerned that it can not be conceptually correct to defer interest costs to OCI when there is no agreement on how or when these should be recycled through profit or loss.

Approach 3

We believe that splitting the amounts between financial and non financial changes to determine whether they should be included in profit or loss or OCI, is an arbitrary rule and would result in interest cost on the liability being included in profit or loss and the gain or loss on plan assets used to offset that liability being included in OCI. We don't believe that such a split would provide useful information to the users of the financial statements and would remove volatility in the assets from profit or loss but any offsetting volatility in the liability would be recognised in profit or loss.

Our suggestion

We believe that a combination of Approach 1 and Approach 2 would result in the most useful information to users of the financial statements. Approach 1 requires all changes in the defined benefit obligation in profit or loss while Approach 2 splits the changes into those changes which result from the cost of service and those which result from deferring the settlement of those changes. We believe that those costs which relate to the employee's service should be included in the employee benefits disclosure required by *IAS 1 Presentation of Financial Statements* ("IAS 1") paragraph 104 to the extent that they are not included in the cost of inventory or property, plant and equipment. Additionally, the costs relating to the deferral of such payments should be included in finance costs as per IAS 1.82(b) and those gains or losses as a result of investing the assets should be presented as a component of income on investments.

(b)

i. While excluding certain items from profit or loss and including them in OCI has the effect of removing a significant amount of volatility from the profit and loss for the period, in reality that volatility is a real volatility which the entity is exposed to and should be reflected in the entitiy's performance for the period.
ii. We have not attached significant importance to information relating to the disaggregation of fair value changes in the income statement as recommended by Approach 3. We don't believe it is important whether the change is as a result of interest or other market movements. What we believe is important is that the full change is recognised in profit or loss for the period.

(c) We believe that our preferred approach is very similar to the current approach which differentiates between current service cost and other movements. We don't therefore believe that the approach which we recommend would result in any presentation difficulties not already present in the presentation of these benefit promises.

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?

(a) We have described our proposals to provide decision useful information in our response to Question 3 (a).
(b) We have described our proposals and rationale in our responses to Questions 3 (a) and (b).

2.3 Definition of contribution based promises

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 agree that the IASB has identified the appropriate promises to be addressed in the scope of this project however we note that currently IAS 19 has accounting rules for only two types of post employment benefit plans and adding these categories of post employment promises would result in rules for four different types of benefits, being the existing two and the contribution-based promises and “higher-of” options. We note that adding rules for very specific circumstances generally increases rather than decreases complexity. In this regard we refer to the EFRAG’s discussion paper “The Financial Reporting of Pensions” which proposes a single set of principles for all post employment plans. We believe that such an approach would result in a more encompassing accounting treatment which provides guidance on accounting for all types of post employment benefits. We also note that the addition of this new category is not mirrored in US GAAP and believe that these short term changes may result in divergence rather than convergence and that in time when a converged standard is issued the accounting for these types of plans may change dramatically again.

We also note that these type of promises have very similar characteristics to insurance contracts with minimum benefit guarantees and we recommend that the IASB does not create divergent accounting treatment between IFRS 4 Phase II which is expected to be published in 2011 and the revised IAS 19, also expected in 2011, in the medium term in order to achieve a relatively short term goal.

We also note that the DP proposes to change the terms relating to post employment benefits to post employment promises. We note that no where else in IFRS is the term "promise" used or defined. We would therefore urge the IASB to use terminology which is generally accepted and understood by preparers, auditors and users such as "obligations" rather than to create additional terminology for purposes of an intermediate step.

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 have no comment on this.

Question 7

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

We believe that the goal should be to simplify accounting rather than complicate it for a very limited period for a very limited purpose.

2.4 Recognition issues related to contribution-based promises

Question 8

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

We have no comments on this.

2.5 Measurement of contribution-based promises

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 have no comments on this.

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?

We have no comments on this.

2.6 Disaggregation, presentation and disclosure of contribution-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?

We have no comments on this.

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 have no comments on this.

2.7 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 have no comments on this.

2.8 Other matters

Question 14

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

As described in our response to Question 1 we believe that a detailed review of the disclosures would provide a much more valuable improvement to the current reporting of defined benefit promises than fundamental changes to the measurement of these promises.

We believe that the following disclosures would make a considerable difference to the user's understandability of the amount, timing and uncertainty of future cash flows:

- Disclosures relating to risks inherent in the post employment benefit promises; and
- A sensitivity analysis based on reasonably possible changes similar to those required by IFRS 4 and *IFRS 7 Financial Instruments: Disclosures* ("IFRS 7") rather than a sensitivity analysis based on an prescribed amount which may not accurately reflect the risks within the particular scheme.

Question 15

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

We have no other comments on this DP.