COMMENTS

26 September 2008

IASB DISCUSSION PAPER: PRELIMINARY VIEWS ON AMENDMENTS TO IAS 19 EMPLOYEE BENEFITS

General remarks

BUSINESSEUROPE believes that the IASB has rightly identified the financial reporting of employee benefits as a useful area in which to seek improvements for the advantage of both preparers and users, the primary parties involved in financial reporting. We have reviewed its Discussion Paper (DP) from the viewpoints, 'Does it make practical sense, and does it give more meaningful information to users, which is necessary for their purposes'?

BUSINESSEUROPE is pleased to have the opportunity to comment on the DP. It believes that IAS 19 could benefit from certain short-term improvements:

- The reduction in the number of presentation options through the elimination of deferred recognition of pension assets and liabilities and the consequently increased understandability and comparability of the financial statements could be of benefit particularly to users. However, we believe that the issue of the deferred recognition of gains and losses arising from defined benefit plans reflects a significant change that should not be made prior to a fundamental review of the accounting for post employee benefits and the results of the Financial Statement Presentation project;

- Although we conclude that we do not support the proposals on contribution-based promises as they stand, we do appreciate the Board's attempt to provide a solution for certain plans which currently fall between two stools and suggest a more pragmatic solution for these;

- If the opportunity presented by the DP is grasped to identify what the key elements of supplementary information are which users need to have disclosed, this could lead to a better focus in footnote disclosures which have become somewhat overgrown over the years.

BUSINESSEUROPE also welcomes the Board's intention, as stated in para 1.24, to pay particular attention in reviewing responses to the DP to the need for users of financial statements to receive relevant and reliable information for assessing the amount, timing and uncertainty of an entity's cash flows. In our opinion, nevertheless, preparers' views also need to be given proper weight in order to achieve a more balanced set of principles. In this respect we are concerned that the DP as it stands emphasizes unduly asset and liability presentation which may not be very helpful from a flows viewpoint.

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Above, we ask the Board to postpone changing the present IAS 19 in respect of the recognition of pensions assets and liabilities and the income statement presentation until two fundamental reviews have been completed. In general we have difficulty with the Board's current approach of "tinkering" with current standards and imposing changes in the knowledge that the standards are probably going to be substantially revised in only 2-3 years. This involves preparers and users in appreciable costs – not to mention – confusion – but we discern little benefit, and we hope that the Board will reconsider its approach and its agenda in this light.

Detailed comments

Question 1 - Scope of the project
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?

Accounting for post-employment benefits is a very complex area which, in the view of many constituents - requires a fundamental review. BUSINESSEUROPE agrees with the Board that, pending the outcome of such a long-term review, there is a limited number of improvements which could be achieved in the short term, such as the measurement of defined contribution schemes with a guarantee of a minimum return or other clearly circumscribed risk (currently classified as defined benefit promises). We think the burden for some preparers could be reduced if a simplified approach could be found to deal with such situations. In our opinion the solution proposed in the DP is too complex and likely to create the unintended consequence of an additional burden in respect of the many existing defined contribution promises which are accounted for today without difficulty but would be categorized as "contribution-based" under the DP. If many plans currently treated as defined benefit were reclassified as contribution-based promises as a result, this would create further problems. We would prefer to isolate the financial guarantees contained in the plans and account for them separately. If a simple solution cannot be found, however, we believe the whole issue should be excluded from this short-term project.

The issue of the deferred recognition of gains and losses arising from defined benefit plans, is perceived by many users as an issue in urgent need of resolution. However, as current approaches to the measurement of related assets and obligations do not appear to properly reflect their long-term nature – a matter which must be satisfactorily resolved in the long-term project - the sensible handling of the impact on financial performance is crucial to ensuring that the overall effect on the financial statements is indeed an improvement. We believe the proposal would mean a significant change in accounting for employee benefits, which is inextricable bound up with the measurement model adopted, that should not be made prior to a fundamental review of IAS 19 and the results of the Financial Statement Presentation project.

Furthermore, BUSINESSEUROPE would exclude from the short-term project certain areas covered in the DP which are not urgent from a preparers' and users' viewpoint, viz.

- definition of contribution-based promises;
- the presentation of the change in defined benefit liabilities.

This is closely linked to the current debate on financial statement presentation, so that the arguments emerging in both contexts must be considered in parallel. Also, if an appropriate solution for reflecting the long-term nature of the liabilities in terms of measurement can be identified in the long-term project, this could help resolve many of the presentation issues currently being addressed.

Question 2 - Recognition and presentation of defined benefit promises
Chapter 2 describes the Board's deliberations on the recognition of defined benefit promises. The Board's preliminary views are summarised in paragraphs 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?

Recognising the value of the plan assets and post-employment benefit obligation in full

The question of immediate recognition / deferral is inextricably bound up with the measurement model adopted. A model which results in pension asset and liability values which properly reflect their long-term nature could well obviate the need for any deferral mechanism or other procedure for ensuring that information on income trends and flows is not rendered meaningless by short-term capital market volatility. The current measurement bases, based on point-in-time market values, interest rates and returns, do not lend themselves well to this purpose.

BUSINESSEUROPE appreciates, however, that such an approach would require longer-term study which should first be undertaken. We would be concerned about the effect of abandoning the currently permitted deferral mechanisms in the interim without a practical approach for ensuring sensible, meaningful information on financial performance in the absence of a deferral mechanism. This would have to take into consideration that point-in-time remeasurements of pension assets and liabilities which currently arise are frequently substantially in excess of the real, underlying flows, and we ask, 'What is useful in these so-called "income / expense" amounts for the user'?

Flows and not assets/liabilities are what companies and users focus on. And, given the extremely long periods to maturity, the level of reliability of estimates of pension liabilities is by no means high, so to what extent can the information be said to meet cash flow predictability criteria? We are most concerned that the proposed presentation approaches for presenting DB promises, especially 1 and 2, combined with immediate recognition of plan assets and liabilities, would considerably undermine the usefulness of the income statement. We would also wish to avoid yet another divergence between internal and external measures rendering further non-GAAP disclosures necessary to explain performance. Therefore, we prefer the Board to carry out its fundamental review on employee benefits (and its project on Financial Statement Presentation) before "tinkering" and imposing short-lived changes.

BUSINESSEUROPE would also like to add a comment on the last bullet point of the DP's para 2.7, which is simply untrue as it stands. This remark seems to try to talk about preparers and users at the same time. From the viewpoint of the preparer, it is incorrect that the resulting accounting has reached a high level of complexity and that complex records have to be kept – and the complex calculations of fair value which would be necessitated by the proposals on contribution-based promises appear not to disturb the Board.

The complexity for users is another matter, and we hope that the Board has this point at the forefront of its discussions when it reviews the approach to presentation in the performance statement where point-in-time remeasurements threaten to confuse users even further with unhelpful data.

Dividing the return on assets into an expected return and an actuarial gain or loss

BUSINESSEUROPE is not comfortable with the IASB's preliminary view that the return on assets should not be divided between the expected return and an actuarial gain or loss and that, as implied in para 2.15, standards should be driven by anti-abuse measures. In practice, the management of pension funds, including funding decisions, is frequently based on the expected return on assets over the long term, and as many users are trying to identify underlying sustainable earnings we have doubts about the usefulness of performance information based on substantial, volatile remeasurements.

Although we think that actual returns can give an indication of the potential future gap in earnings, we understand that some users think a single line item representing actual returns is of little help in forecasting future investment returns and hence the potential for future cash contributions to the pension fund. Apparently some users also are of this opinion. Those holding this view find expected returns more relevant and useful as a tool for prediction than the volatility induced by the use of actual returns alone. We therefore see any change to the use of expected returns as part of the longer-term project and not a short-term fix. IAS 19 currently already requires a 5-year history of experience differences on plan assets, which provides a check for the users on the reliability of expected returns. Please refer also to our response to question 3 where we expand on the relationship with performance reporting.

Recognition of unvested past service cost

On the assumption of immediate recognition of plan assets and liabilities, with which we have disagreed above, we would agree with the IASB's preliminary view that unvested past service costs should be recognised in their entirety in the period in which a plan amendment is made.

Question 3 - Recognition and presentation of defined benefit promises
Chapter 3 sets out alternative approaches for the presentation of components of the defined benefit cost and analyses the relative merits of each approach. These approaches are summarised in paragraph PV5.
(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?

Apart from the matter of measurement approach, a satisfactory solution to the presentation of pensions would also be dependent on a satisfactory solution to the presentation of performance in general. A leading financial analyst recently expressed considerable regret that, through its changes in recent years, the IASB has made the income statement less and less useful for users without substantial adjustment. A key factor, for preparers as well as users, is the ability to discern “sustainable underlying earnings”.

Our overall conclusion on the various presentation proposals is that we see for the present no advantage in changing the present IAS 1/IAS 19 approaches. We would also see considerable risks in all three proposed approaches that financial statements would deteriorate in respect of understandability, meaningfulness and usefulness. If compelled to make a choice between the three proposed alternatives, we believe that, while not preferable to the present approach, alternative 3 would have the least disadvantages in terms of providing meaningful information for cash flow and earnings prediction, especially if it were modified by:

- (a) treating all remeasurements in the same way, i.e. remeasurements due to changes in non-financial assumptions would also go to OCI;
- (b) retaining expected returns on plan assets rather than the rather meaningless “interest income”.

BUSINESSEUROPE also believes that, to appropriately reflect the long-term nature of the assets and liabilities and their estimated valuations, the remeasurements first recognised in OCI should be recycled to net income. As the basis for recycling, a depreciation-like approach could be applied: experience adjustments and changes in non-financial assumptions over the period remaining till retirement, changes in the discount rate and other elements in the return on plan assets over the expected duration of the liability (or, to simplify, all over the period remaining till retirement.) So that our starting-point is unmistakable, we stress that, while the IASB apparently recognizes the elimination of OCI and recycling as a long-term goal, this is absolutely not a goal which preparers share. Indeed, its attainment would be more than likely to lead to non-GAAP information becoming the central point of communication between preparers and users, and this can surely not be in the interest of any standard setter. It would have negative consequences for relevance. We refer you also to the Basis for Conclusions of SFAS 158, "… the past practice of delaying recognition of gains and losses as a component of net periodic benefit cost, reflecting the long-term nature of post retirement benefit arrangements. Furthermore, that treatment is consistent with the practice of including in other comprehensive income certain changes in value that have not been recognized in earnings (for example, unrecognized gains or losses on available-for-sale securities)."

However, on balance, we prefer to retain the present presentation approaches until both the Financial Statement Presentation project and the long-term employee benefits project have been concluded. These provide both users and preparers with the best basic information as a starting-point for cash flow and earnings prediction without increasing complexity and reducing relevance and understandability.

With reference to the DP's para 3.27 which gives reduced complexity as an advantage of alternative 1, we would also like to add that the Board seems to be incredulously "marketing" ideas on the basis of reduced complexity or simplification – also in financial instruments, for example – in many cases where the complexity would just be shifted. In this case, one accounting entry would be simplified (possibly, see question 2 above), while preparers and users would be faced with much more complex information to have to unravel to get at the figures they feel are most relevant and useful for them.

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 our response to question 3 above.

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?

BUSIENSSEUROPE does not agree with the inclusion of "contribution-based promises" in the scope of the project. The proposal does not appear to us to distinguish between contribution-based promises and defined-benefit promises clearly and properly, and we are concerned that this otherwise limited-scope project could have a radical unfavourable effect on existing practice and involve preparers in substantial practical difficulties. Since the project is intended to address items which require improvement in the short term we think that this aspect of the proposals, which could result in considerable problems in arriving at a practical solution, should rather be dealt with as part of the long-term comprehensive project, rather than allow it to delay progress on other more urgent matters.

Existing IAS 19 has a straightforward definition of defined-contribution schemes based on the premise that contributions representing the entity's obligation are paid into a separate fund outside the control and risk of the entity. That existing definition and the resulting accounting requirements appear to us to be clear and simple, even if they sometimes lead to problems in practice.

Therefore, we wonder whether a more practical short-term approach might not be to seek, for the period until the long-term project bears fruit, a pragmatic solution by permitting plans which are basically DC plans with an added, easily circumscribed risk (e.g. minimum guaranteed return) to be valued on the basis of DC plan plus a separately valued element This could offer relief for some plans forced by the current tight definition of DC plans to carry out the complex measurements necessary for DB plans. The presentation of the changes in value of this element should follow its nature. However, if such an approach is not thought practical, we believe that the present DC/DB classification should be retained for the present.

If the Board were to decide to pursue the idea of a contribution-based plans category, there is one specific point to which we would draw their attention. The proposed criteria for selecting the discount rate for such plans would be different from those for defined benefit plans. There are many plans which contain both defined-benefit and contribution-based promises which are both funded by a single asset portfolio. This applies, for instance, to many Swiss plans which contain defined-benefit death in service and disability benefits and contribution-based retirement benefits. The CBP component is currently accounted for as DB in accepted practice. These plans would therefore be reclassified from DB to CBP under the proposals. The discount rate for the CBP liability cannot be determined without considering its funded status; however, as there is no right way of allocating undesignated plan assets between the DB promises and the CBP, comparability between preparers could only be ensured if the Board were to include an arbitrary allocation rule. If changes in DB plans are presented under Approach 2 or 3, presentation of changes in DB promises and CBP would also be inconsistent; as a result, the allocation of plan assets and hence of asset returns will affect profit or loss. Therefore, if the Board wishes to pursue the CBP idea further, we urge it to require the discount rate for both DB and CBP to be selected based on high quality corporate bond yields, at least at this stage of its post-employment benefit project. Presentation approaches should also be consistent for the two types of plan.

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?

BUSINESSEUROPE believes that very many promises presently treated as defined-benefit plans may be reclassified. Classification as contribution-based promises and subsequent measurement as proposed would not lead to significant improvements compared to the current PUCM but would create problems. We expect that promises that are associated with a specified return on contributions or other guarantee, career-average promises and promises with 'higher of' options would be affected. See also our answer to question 5 above.

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?

BUSINESSEUROPE agrees that the proposal should have no effect on current defined-contribution promises where there is no guarantee and the contribution is paid in full very soon after the end of the period in which the service is rendered and is not recoverable by the entity. However, we suspect that the requirement to determine the fair value of the promises – even if it turns out to be zero – potentially introduces a degree of complexity and expense into an area which is at present trouble-free. We therefore urge the Board rather to consider our suggestion (see Question 5 above) of a pragmatic approach in certain circumstances as a stop-gap approach to avoiding such complexity for DC plans but giving some relief on (e.g.) plans with minimum guaranteed returns. If such a stop-gap is not deemed acceptable, we would prefer the Board to make no changes at this juncture.

Question 8 - Recognition issues related to contribution-based promises
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?

BUSINESSEUROPE can accept the recognition of unvested contribution-based promises.

Allocation of benefits in accordance with the benefit formula and measurement consistent with employment status at the reporting date would, in our opinion, present the liability fairly in accordance with the actual situation at the reporting date. For these reasons, we agree with the Board's preliminary views on these issues.

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?

BUSINESSEUROPE believes that the question of the appropriate measurement attribute should be pursued only as part of the long-term benefits project in order to allow full consideration of all the aspects of the accounting for benefits and any necessary consistency with other parts of IFRS.

Although we do not believe that the measurement aspect should be pursued in this project, we have some comments about the DP's proposals:

(a) While most would agree that some measure of risk should be reflected in the measurement of the liability, how exactly should one quantify such risk? The DP lacks clear explanation of what is meant by asset-based risk, and how this could be reflected.

(b) It would seem logical to consider the risk of changes in demographic assumptions. Should the risk be taken into account in arriving at the projected cash flows or reflected in the discount rate? The current approach in an actuarial computation of including this risk in the estimate of cash flows seems appropriate to us and simpler to estimate.

(c) We have substantial concerns over incorporating changes in credit risk when measuring the fair value of a liability. Users will generally reverse out of the income statement gains and losses arising from changes in own credit risk, and for many purposes the balance sheet numbers are adjusted too. So users do not generally appear to find the information useful.

(d) In any case the DP does not make it clear whether it is the credit risk of the promise or the credit risk of the entity that is being addressed in the Board's proposals. Para 7.26 states that credit risk is the risk that one party will cause a financial loss for the other party, implying that it is the entity's credit risk. However, para 7.27 says that it is the credit risk specific to the liability that is relevant. It appears to us that if the entity still holds the obligation for the benefit contributions then its ability to pay is the more relevant risk.

(e) We are also concerned about the disconnect between discount rates to be applied to DB as opposed to CBP. See our remarks to Question 5.

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?

(a) BUSINESSEUROPE agrees with the Board's preliminary view that the liability should be measured in the same way during the deferment and payout phases as during the accumulation phase as it is not helpful for there to be a change in measurement as employees pass into the deferment or payout phase of the promise. However, we are not comfortable with the introduction of the new category of promise and its accompanying variant of fair value and believe that it is the use of different measurement attributes for the different new categories of benefit promise which leads to the question being raised.

(b) BUSINESSEUROPE does not believe that *fair value assuming the terms of the benefit do not change* should be adopted as a measurement basis at this point (see above), though we do not see any particular difficulties in measuring the liability during the payout phase which do not exist during the accumulation phase.

Markets for transferring pension liabilities are still too thin to provide a sound basis for valuing most large plans, especially since details of benefit formulae and membership profiles are unique to each plan. It is not clear how a fair value measurement should incorporate estimated future longevity trends because there is no market consensus on what those trends will be: only past mortality is known. Some “cash balance” CBP give trustees discretion over whether and how much interest is added to members’ notional account balances and over pension increases, and it is not clear how this discretion would be reflected in the fair value measurement: probably market participants would anticipate some level of interest and pension increase, but the discretionary feature makes this difficult to assess. We also draw your attention again to our concerns about the disconnect between discount rates applicable for DB and CBP plans (see Question 5 above.)

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?

The following comments should be read in the light of our overall disagreement with the introduction of the proposed category of contribution-based promises.

(a) We think the proposal to disaggregate changes into a service cost and other value changes arising from a contribution-based promise, as well as disclosing all changes in plan assets, is a reasonable starting-point.

(b) We agree that it could be difficult to analyse the changes in the liability for contribution-based promises in the same way as those for defined benefit promises. (For instance, supplementary guidance would be needed on how to disaggregate changes for promises where a higher-of option exists.) This further calls into question whether the new category and its new measurement attribute result in information that is as useful to users of financial statements as that 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?

To achieve comparability in the presentation of different types of promise, changes in CBP liabilities would have to be presented in a way consistent with DB liabilities. Inconsistent presentation would create particular problems for plans which contain both DB promises and CBP, funded by a single portfolio of assets (see our answer to question 10 above on the difficulty of allocating plan assets between the two types of promise.) The actual return on plan assets would also need to be allocated. The allocation chosen would alter total reported earnings if DB benefit costs were presented in accordance with Approaches 2 or 3 as proposed in the DP, because the return allocated to CBP would be presented totally in profit or loss, but the return allocated to the DB promise would be presented in part or in full within other comprehensive income. It does not seem to us difficult to allow a CBP presentation consistent with Approach 2, while we think a CBP presentation consistent with Approach 3 could be achieved by dividing returns on assets in some manner.

Question 13 - Benefit promises with a 'higher of' option
(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?

The proposed accounting makes sense intuitively and is consistent with the treatment of financial options in IAS 39. However, we wonder about the ease with which such options can be valued in practice. For entities which have no other involvement with options this may present a burden. Overall, in our view, the value of a CBP option embedded within a DB promise is likely to be immaterial in the majority of cases.

Question 14 – Other matters
The Board intends to review the disclosures required about post-employment benefit promises in a later stage of this project. As part of that review, the Board intends to consider best practice disclosures in various jurisdictions. For example, explicit requirements to disclose information about the mortality rates used to measure postemployment benefit liabilities could be introduced to allow users to understand the inherent uncertainties affecting the measurement of those liabilities. What disclosures should the Board consider as part of that review?

During our discussions with them, financial statement users have highlighted the following disclosure needs not met by existing IAS 19 requirements:

- Information on the timing of benefit payment cash flows;
- Average maturity of the benefit obligation;
- Sensitivity analysis.

These needs seem to us reasonable. Users also highlighted the need to retain a disaggregation of changes in plan asset values into expected return and actual return, provided that the expected return can be made more visible and not buried within operating profit as it is today. It seems reasonable that the main financial statements should identify both expected asset performance and the variance from that performance.

However, we must stress an important caveat, namely on information overload. In general the pensions note in most annual reports is already very extensive, and the more information that is added, the less understandable and digestible it will become. It will therefore be essential for choices and trade-offs to be made so that disclosures focus on just a few key items of information. These problems on disclosure become most acute where a large group has a substantial number of separate plans. Hence, for pragmatic reasons, we would urge that any disclosure requirements which do not already derive from the consolidated figures should be focused on material plans. Input from users should be sought to identify what information in addition to the financial statements themselves would be of most use to them.

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

We have no additional comments.