29 September 2008

International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH

Dear Sir/Madam,

The CBI welcomes this opportunity to respond to the International Accounting Standards Board (IASB) on their consultation paper covering their preliminary views on amendments to IAS19, Employee Benefits. The CBI speaks for some 240,000 businesses in the UK, many of whom report under IFRS, and who also sponsor retirement benefit plans for their staff.

Along with this letter, we also submit for IASB's consideration a copy of the CBI's response to the UK Accounting Standards Board and PAAinE paper on accounting for pensions. We regard the general tone of our comments on the IASB's paper as consistent with this response, and would particularly like to draw attention to the major thrust of that response – that piecemeal reform of the balance sheet's approach to pensions is both unhelpful and counterproductive. It is essential that work on the conceptual framework is completed before further pensions-specific reform is undertaken.

Any significant changes proposed at this stage – such as a change to the measurement of certain plans indicated by the contribution-based approach – should provide consistency within the pensions section and be made with consistency to the measurement of liabilities elsewhere in the balance sheet. We would not wish to see significant change put into practice until this consistency can be achieved.

In this response we set out that:

- While CBI members accept the current corridor method requires some reform, this must not take place before a more fundamental review is completed
- The use of actual return on assets would cause significant volatility and should be avoided until the presentation of the volatility has been fully considered
- The contribution based promise approach would introduce unacceptable inconsistencies into the balance sheet. The CBI cannot support it.

While CBI members accept the current corridor method requires some reform, this must not take place before a more fundamental review is completed

The removal of the corridor method would entail immediate recognition of all actuarial gains and losses so that the balance sheet reflects the current funded status. Proponents of this move argue that this would increase the transparency of the pension liability within the balance sheet and would improve comparability between companies as all would use the same method. The corridor is not a permitted method for companies reporting under UK GAAP, for instance.

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Whilst there are few strong feelings of loyalty amongst CBI members for the current corridor approach, the potential volatility that removal of this method would bring about requires that its replacement with an alternative method is placed alongside more fundamental reform than the incremental process IASB is currently considering. Presentational issues for pensions accounting need to be considered more thoroughly before any change, and this is a process that must be undertaken after the completion of work on the conceptual framework, not before.

The use of actual return on assets would cause significant volatility and should be avoided until the presentation of the volatility has been fully considered

The use of actual as opposed to expected returns would cause significant fluctuations in the P&L charge from year to year. The increase in volatility resulting from using actual rather than expected returns would cause significant problems, especially for those firms with legacy pensions liabilities close to or greater than the capitalisation of the company.

For users of the accounts, this would create an unhelpful lack of clarity, whereby the trading performance of the company is masked behind the investment performance of the pension scheme. Firms may react to this by choosing to reconsider their investment strategy to reduce volatility of plan assets, particularly in equities, which could affect the long term cost of providing pensions and is not in the interest of sponsors or members.

We also understand that many users of accounts find expected returns on assets a useful measure as these provide an indication of the long term cash flows arising from the assets as opposed to the short term volatile actual returns which can give very misleading information from year to year. The cash flows into the pension fund are also based on a long term expected asset return and so it would seem appropriate and consistent to include this item within the accounts. Furthermore at present the actual return can be found within the disclosures so the information on actual returns is already available.

Until the full review of the presentation of accounts has been completed we believe the current approach is sufficient. While it is true that investment return can be negative, whereas expected returns very rarely are, it is equally the case that actual returns can significantly outperform prudently–set expectations. One possibility for reform within the current framework might be to standardise the framework of expected returns to ensure a prudent approach is taken to deal with any abuse rather than change the structure for all. CBI members could support such a step.

The contribution-based promise approach would introduce unacceptable inconsistencies into the balance sheet. The CBI cannot support it

Our members appreciate that there are some types of benefits, such as cash balance plans or defined contribution plans with return guarantees, where it is not clear how accounting should classify and allow for them within IAS 19. We do not believe, however, that this justifies the proposed contributions-based promise approach brought forward in IASB's paper. Creating a new definition of arrangements that would class together benefits such as defined contribution and career average revalued earnings plans muddies the water around pensions accounting and risks making things more confusing for users of accounts, not less.

We believe that the immediate issue of how to deal with cash balance plans or defined contribution plans with a guarantee can be solved on a short-term basis by providing more clarity over how these benefits should be valued based on the approach that employers already use to deal with these plans, rather than creating a whole new benefit type.

Introducing a contribution based promise approach that would value career average benefits on a different measure to that used for defined benefit schemes does not make sense as a short term fix. The situation could arise, for instance, where exactly the same benefit would be attributed a different value depending on whether it had arisen from a defined benefit plan or a contribution based plan introducing inconsistency within the pension section of the balance sheet.

Implementing such an approach could begin to drive employer behaviour and encourage employers to redefine their plans to enable them to use the most favourable outcome, for example defining a career average revalued earnings plan as a final salary plan with a 30 year averaging period, so that it is included within the defined benefit category. We do not believe that any change that would drive such behaviour should be implemented without a full review of the issues.

Therefore we believe that this is too significant a change, with potentially unwelcome outcomes, for this short term initiative and we believe that this should be reconsidered as part of the fuller review. It is also difficult to assess the impact of valuing contribution based promises using a fair value approach while the project for determining how to calculate the fair value liability is ongoing.

We also do not believe that there should be any change for current defined contribution plans where the contributions are paid shortly after they are due and any changes to definitions should not make the accounting any more burdensome for these types of plans.

We hope you found our comments helpful and we look forward to hearing your full response to the consultation.

Yours Faithfully,

Neil Carberry
Head of Employment and Pensions policy

Enc: CBI response to ASB/PAAinE paper