The South African Institute of Chartered Accountants

18 September 2008

Comment Letter
International Accounting Standards Board
30 Cannon Street
LONDON EC4M 6XH
United Kingdom

Dear Sir/Madam

SAICA SUBMISSION ON THE DISCUSSON PAPER ON PRELIMINARY VIEWS ON AMENDMENTS TO IAS 19 – *EMPLOYEE BENEFITS*

In response to your request for comments on the discussion paper on Preliminary Views on Amendments to IAS 19 – *Employee Benefits,* attached please find the comment letter prepared by The South African Institute of Chartered Accountants (SAICA). Please note that SAICA is not only a professional body, but also secretariat for the Accounting Practices Board (APB), the official standard-setting body in South Africa. The SAICA comment letter results from deliberations of the Accounting Practices Committee (APC), which is the technical advisory body to the APB, as well as representatives from the Actuarial Society of South Africa.

We would like to thank you for the opportunity to provide comments on this document.

Please do not hesitate to contact me should you wish to discuss any of our comments.

Yours sincerely

Sue Ludolph
Project Director – Accounting

cc: Moses Kgosana (Chairman of the Accounting Practices Board)
Prof Alex Watson (Chairman of the Accounting Practices Committee)

SAICA SUBMISSION ON DP PRELIMINARY VIEWS ON AMENDMENTS TO IAS 19 – *EMPLOYEE BENEFITS*

GENERAL COMMENTS

We welcome the Board's decision to improve the accounting for post-employment benefits. While we understand that a comprehensive post-employment benefit project is not possible in the short-term, we are of the view that the proposed scope of the short-term project is too broad. Our concerns stem from the fact that the short-term project proposes a fundamental change in the classification of post-employment benefits with a new measurement model (fair value) for only some of those benefits (i.e. contribution-based promises) without a reconsideration of the appropriateness of the measurement model for the other benefits (i.e. defined benefit promises). We believe that such an approach is not appropriate for a short-term project.

As a result, we believe that the Board should limit the scope of the short-term project to the issues relating to the recognition and presentation of defined benefit plans as defined in the current version of IAS 19.

Our responses to the specific questions asked in the discussion paper are set out below.

SPECIFIC 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?

On the basis of our overall comment with respect to the scope of the short-term project, there are no additional matters that we believe should be addressed. Rather, we believe that the scope of the project should be narrowed to deal only with the issues relating to the recognition and presentation of defined benefit plans as defined in the current version of IAS 19. We believe that the scope is inappropriate because the short-term project proposes a fundamental change in the classification of post-employment benefits which will result in a change in the way plans are classified currently, with a new measurement model (fair value) proposed for only some of those benefits (i.e. contribution-based promises) without a reconsideration of the appropriateness of the measurement model for the other benefits (i.e. defined benefit promises). It is not clear why defined benefit promises should not be measured on the same basis as contribution-based promises. Therefore, we believe it would be more appropriate if all these related issues are considered together rather than on a piecemeal basis.

Question 2 - Recognition of defined benefit promises

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?

No, we do not believe there are any other factors that the Board should have considered. However, we do note that the proposal of immediate recognition is likely to result in significant volatility in the financial statements, which may drive changes in behaviour. As a result, employers may seek to amend the terms of their post-employment benefit plans to protect their financial statements from the effects of this volatility. Also, employers may make amendments to the terms of post-employment plans as result of the proposals in the discussion paper which may change once the long-term project has been completed.

Question 3 - Presentation of defined benefit promises

(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?

We believe that until the Board finalises its financial statement presentation project and provides clear principles or guidance for the recognition of items outside of profit or loss, consideration of Approach 2 or 3 is premature. The principles underlying the presentation of employee benefit costs should be consistent with those for other items in the financial statements. For example, in many respects, post-employment benefit obligations are similar to asset retirement obligations, therefore we would expect a similar presentation approach. Our comments with respect to this question therefore are made subject to the progress on the financial statement presentation project and consistency with any overall principles defined under that project.

In respect of the three alternatives proposed for defined benefit promises presentation, we prefer Approach 1 which proposes the immediate recognition of all gains and losses relating to defined benefit promises in profit or loss because of its simplicity and consistency with IAS 37 − *Provisions, Contingent Liabilities and Contingent Assets*.

We also see merits in Approach 3, whereby remeasurements arising from changes in financial assumptions are recognised in other comprehensive income (OCI) and all other changes are recognised in profit or loss. However, we note that Approach 3 may result in practical difficulties for preparers of the financial statements, especially with regard to determining ‘interest income’ on plan assets.

We do not support Approach 2, whereby only service costs are recognised in profit or loss and all other changes are recognised in OCI.

As an alternative approach to those proposed by the Board, we propose that for a short-term project, the Board should not change the current accounting requirements of IAS 19, but should merely remove the corridor approach in respect of recognising actuarial gains or losses. In other words, the existing options of recognising actuarial gains and losses immediately in profit or loss or immediately in OCI should remain for the short-term until the financial statement presentation project has been concluded. Under this proposal, we would therefore continue to support, for the short-term, the current concept of 'expected return on plan assets', although this is not consistent with the discussion paper proposals.

Question 4 - 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?*

As noted in our response to Question 3 above, until the Board finalises its financial statement presentation project, any conclusion that the Board reaches in this area may be premature, on the basis that the principles underlying the presentation of employee benefit costs should be consistent with all other aspects of financial statement presentation for other accounting matters. As a result, we have not considered how the Board should improve the current approaches relating to presentation of defined benefit promises and we have not considered other alternative approaches.

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?

As noted in our answer to Question 1, we believe that the scope of the short-term project is not appropriate. This is as a result of the fact that some plans in certain jurisdictions would need to be reclassified as contribution-based promises under the proposals, and there is no consideration as to whether defined benefit promises should be measured on a different basis to contribution-based promises, we do not believe the Board should make changes to the current definitions of defined contribution and defined benefit plans as currently included in IAS 19. We believe that the proposed categorisation of benefit promises into defined benefit or contribution-based promises is a fundamental change to the principles of IAS 19 and therefore it is not appropriate for a short-term project without consideration of the measurement of defined benefit promises.

We would not be in favour of scoping out certain promises because we do not support rules-based standards.

We believe that the Board should clarify what is meant by the term "career average". Does the career begin when an employee commences employment or when an employee joins the benefit plan, which could be at a later date?

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?

Although most of the regulated pension plans in South Africa are final salary type plans, which would remain unaffected by the proposals, unregulated payments (such as a golden handshake on retirement) which are not linked to a salary would need to be reclassified as contribution-based promises under the proposals. We understand that in some jurisdictions in which cash balance plans are common, a significant number of plans currently classified as defined benefit plans would be reclassified to contribution-based promises.

Some possible practical application issues have been identified. For example, employees may be promised a benefit that pays a lump sum on retirement based on the average salary for the last 10 years of service. At face value, this should be treated as a defined benefit promise under the proposals. However, what if a particular employee only joins the plan 10 years prior to retirement? Is it envisaged that for that particular employee, the benefit should be classified as a contribution-based promise? If so, we foresee significant practical application issues because there is only one pool of assets for the plan as a whole. If however the intention is that the fund should be considered as a whole from the employer's perspective and not how it might be regarded were the circumstances of each individual to be considered, then we believe this should be made clear.

Another application issue relates to plans that pay different benefit promises depending on whether the employee dies before retirement, withdraws (resigns) from the plan prior to retirement or retires. In some cases, the benefit payable on death or withdrawal (resignation) may meet the definition of a contribution-based promise, while the benefit upon retirement may meet the definition of a defined benefit promise. It is not clear from the discussion paper how such elements would need to be treated.

Question 7 - Definition of contribution-based promises

Do the proposals achieve that goal of not making any changes to accounting to most promises that currently meet the definition of defined contribution plans in IAS 19? If not, why not?

Yes, we believe that the Board's proposals would not change the accounting for most traditional defined contribution plans.

However, as stated in our comments above, we do not believe the Board should make changes to the current definitions of defined contribution and defined benefit plans as currently included in IAS 19. We believe that the proposed categorisation of benefit promises into defined benefit or contribution-based promises is a fundamental change to the principles of IAS 19 and therefore it is not appropriate for a short-term project, without a reconsideration of the measurement model for defined benefit promises.

Question 8 - Recognition issues related to contribution-based promises

Do you have any comments on those preliminary views for recognition issues related to contribution-based promises summarised in PV9 and PV11? If so, what are they?

We support the following preliminary views on how to recognise contribution-based promises, noting that they broadly are consistent with the current IAS 19 and therefore would not result in a fundamental change to the accounting for most traditional defined contribution plans under current IAS 19:

- Both vested and unvested contribution-based promises should be recognised as a liability.
- Benefits earned under a contribution-based promise should be allocated to periods of service in accordance with the benefit formula.
- A liability should not be recognised for the additional amount determined by the benefit that an employer would pay when an employee leaves employment immediately after the reporting date.

However, with regard to the last bullet point above, we are concerned about the inconsistency between IAS 19 and IAS 39 − *Financial Instruments: Recognition and Measurement,* regarding the measurement of vested benefits. If employee benefits are vested, it implies that an employee may demand the payment of benefits anytime when they leave employment. IAS 19 currently measures this liability based on the expected period that the employee is expected to stay with the entity. However, IAS 39 requires a financial liability payable on demand to be measured at its face value. We encourage the Board to consider this inconsistency in its long-term project to revise IAS 19.

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?*

As noted above, the proposals appear to be a fundamental reconsideration of the principles of current IAS 19 and we believe that a fundamental reconsideration is not appropriate for a short-term project. In addition, we do not believe there should be changes to the current measurement approach in respect of defined contribution plans as currently included in IAS 19.

We are concerned with the Board's proposal to measure, at fair value, benefit promises that meet the definition of contribution-based promises. Due to the amount of promises that we believe would meet the definition of contribution-based promises in the discussion paper, because of the broad scope of the definition, we believe this as a major change for many jurisdictions. Furthermore, we believe that it would be premature to introduce fair value measurement for a certain category of promises that currently are being measured using the projected unit credit method, without a reconsideration of the appropriate measurement model for defined benefit promises.

If the Board proceeds with a fair value measurement approach for contribution-based promises, then the Board should include additional guidance on the application of such approach.

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?

Although we do not support a change in the categorisation of benefits, should the Board proceed with its proposals, we accept the Board's proposal 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. This approach will result in an obligation being measured consistently throughout its life.

We understand that such an approach would lead to similar obligations being measured in different ways in the post-accumulation phase, depending on the manner in which the benefits were accumulated. However, we believe the Board should deal with this inconsistency in a comprehensive long-term project to revise IAS 19.

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 acknowledge that, in principle, there should be no difference in respect of the level of information that should be disclosed for a contribution-based promise liability and a defined benefit promise liability. However, in light of the short-term nature of the post-employment employee benefits project, we do not support further disaggregation of information for contribution-based promises into components similar to those required for defined benefit promises. We believe this would be a significant change for a short-term project and preparers of financial statements may encounter difficulties as IAS 19 does not require such information currently.

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?

While we believe that, in principle, changes in the liability for contribution-based promises should mirror the presentation of changes in the liability for defined benefit promises, we support the proposal to present all changes in profit or loss for the sake of simplicity for a short-term project.

We believe that the Board should reconsider its proposal in its comprehensive long-term project to revise IAS 19.

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 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?

With respect to the discussion paper's proposal on the measurement of benefit promises with a 'higher of' option, our same comments as those made on the measurement for contribution-based promises in our response to Question 9 apply, as both propose the use of fair value measurement.

Question 14 – Other matters

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

On the basis that we suggest that the Board should not make any changes to the current definitions of defined contribution and defined benefit plan as currently included in IAS 19, we do not propose any additional disclosures.

Should the Board continue with the discussion paper's proposals, we do not have any specific additional disclosures to mention at this stage. However, because of the proposal to recognise all changes immediately and the resultant volatility, there should be appropriate disclosures for users to understand this volatility and the impact of the promise on the financial statements.

Question 15 - Other matters

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

We believe it would be useful if the Board clarified what is meant by a 'promise'.

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