



THE INSTITUTE
OF CHARTERED
ACCOUNTANTS
IN ENGLAND AND WALES

22 September 2008

Our ref: ICAEW Rep 103/08

Your ref:

Sir David Tweedie
International Accounting Standards Board
1st Floor
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By email: commentletters@iasb.org

Dear David

**PRELIMINARY VIEWS ON AMENDMENTS TO IAS 19 EMPLOYEE
BENEFITS**

The Institute of Chartered Accountants in England and Wales (the Institute) is pleased to respond to your request for comments on the Discussion Paper *Preliminary Views on Amendments to IAS 19 Employee Benefits*, published in March 2008.

Please contact me if you would like to discuss any of the points raised in the attached response.

Yours sincerely

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ACCOUNTANTS
IN ENGLAND AND WALES

ICAEW Representation

ICAEW REP 103/08

PRELIMINARY VIEWS ON AMENDMENTS TO IAS 19 EMPLOYEE BENEFITS

Memorandum of comment submitted in September 2008 by The Institute of Chartered Accountants in England and Wales, in response to International Accounting Standards Board Discussion Paper *Preliminary Views on Amendments to IAS 19 Employee Benefits*, published in March 2008.

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INTRODUCTION

1. The Institute of Chartered Accountants in England and Wales (the Institute) welcomes the opportunity to comment on the International Accounting Standards Board Discussion Paper *Preliminary Views on Amendments to IAS 19 Employee Benefits*, published in March 2008.

WHO WE ARE

2. The Institute operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, the Institute provides leadership and practical support to over 130,000 members in more than 140 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The Institute is a founding member of the Global Accounting Alliance with over 700,000 members worldwide.
3. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. The Institute ensures these skills are constantly developed, recognised and valued.
4. Our members occupy a wide range of roles throughout the economy. This response was developed by the Financial Reporting Committee of the Institute, which includes preparers, analysts, standard-setters and academics as well as senior members of accounting firms.

MAJOR POINTS

Welcome for the Discussion Paper

5. We are pleased that the IASB has taken the opportunity to review IAS 19 with a view to improving pension accounting pending the fundamental review of all aspects of post-employment benefit accounting. However, we suggest that this interim review has been more ambitious than was desirable, and we do not agree with many of the proposals.

Ending of the 'corridor'

6. We strongly support the removal of the deferral mechanism found in IAS 19, known as the 'corridor', under which the recognition of actuarial gains and losses may be deferred, within limits. We can see no conceptual grounds for deferring the recognition of part of an asset or liability, so in principle actuarial gains and losses should be recognised immediately.
7. We encourage the IASB to proceed now with removal of the corridor, whatever its decision on the other elements of its proposals.

Other comprehensive income

8. The project on financial statement presentation, and in particular the debate about other comprehensive income, is still ongoing. Until the IASB has established principles for determining which items should be included in profit

or loss and which in other comprehensive income, it is impossible to be definitive about how pension costs should be presented. In principle, pension costs should be dealt with on a basis consistent with other items in the accounts.

Contribution-based promises

9. We do not agree with the proposed definition of contribution-based promises. The existing distinction between defined contribution and defined benefit plans is conceptually sound and should be retained. It is counter-intuitive and misleading to postulate a defined-contribution promise that includes an element of risk.
10. We do, however, support the principle of measuring the liability for a contribution-based promise on the assumption that the benefit promise does not change, but we have reservations about some of the proposals for computing fair value (see paragraphs 30 et seq below, and particularly paragraph 35).

ANSWERS TO SPECIFIC QUESTIONS

Scope of the project

ITC4 The project targets specific issues. Chapter 1 describes how the scope of the project was determined and notes further issues that might be considered in a more comprehensive review. The European Financial Reporting Advisory Group has recently published a discussion paper *The Financial Reporting of Pensions that considers some of these further issues.**

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?

11. There are no additional issues that we believe the Board should have addressed as part of this limited project. In fact, we think that the scope of the project has been drawn too widely.

Recognition and presentation of defined benefit promises

ITC5 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.

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?

12. We agree that entities should recognise all changes in the value of plan assets and in the post-employment benefit obligation in the financial statements in the period in which they occur - ie, that the corridor approach should no longer be available.

13. We agree that entities should not divide the actual return on assets into an expected return and an actuarial gain or loss.
14. We agree that entities should recognise unvested past service cost in the period of a plan amendment.

ITC6 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.

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?

15. We believe that the principles determining the allocation of the elements of the pension cost should be same as those applying to all other items of income and expense in an entity's accounts. Therefore, this question is difficult to answer before the Board has established criteria for determining generally both which items should be included in profit or loss and which elsewhere in other comprehensive income; and, within profit or loss, how to distinguish between operating and financing costs.
16. However, our preliminary view is to support Approach 1, with further analysis within profit or loss as follows.
 - Service cost should be presented within operating activities (together with settlement and curtailment gains and losses).
 - The unwinding of the discount on the liabilities, and the effect of changes in the discount rate, should be presented within financing (if a financing section is presented).
 - The actual return on assets should be presented within financing (if presented), ensuring that the asset and liability sides of the financing element are presented consistently.
 - Other actuarial gains and losses arising on the liabilities should be presented within operating activities, since they represent the revision of the originally estimated cost of providing pensions. (See paragraph 44 regarding the consequential need for disclosure.)
17. This approach has the advantage of effectively putting the net cost of financing the net exposure in one place. It is conceptually rigorous in that the underlying operational elements of the cost are dealt with as for any other type of cost (in contrast to Approach 2, which seems to have no basis in

existing principles or standards). We accept that this approach will introduce additional volatility into the profit/loss of many entities but believe that extensive explanatory disclosure (including information about changes in fair values) would in any case be required, whatever approach were adopted.

18. Overall, we believe that the key principle guiding the Board's thinking should be to maintain consistency with other aspects of the financial statements, and that this is best achieved by Approach 1. Information about changes in fair values is important and should be provided, regardless of how it is disclosed.

(c) What would be the difficulties in applying each of the presentation approaches?

19. We do not believe that difficulties would arise in applying any of the presentation approaches. In particular, we expect that pension actuaries would have no difficulty in analysing the movements in pension liabilities between those arising from financial assumptions and from demographic (non-financial) assumptions.

Question 4

(a) How could the Board improve the approaches discussed in this paper to provide more useful information to users of financial statements?

20. A robust approach to presenting the components of defined-benefit cost can only be established in the context of an agreed framework for the presentation of financial statements. We do not believe that it is fruitful at this stage to spend time analysing different approaches that may or may not ultimately accord with the eventual views of the Board and the FASB on overall presentation.

(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?

21. We have no other suggestions at this stage.

Definition of contribution-based promises

ITC7 This discussion paper introduces a new category of post-employment benefit promises—'contribution-based' promises (Chapter 5). The Board's preliminary view is that contribution-based promises should be accounted for as described in Chapters 6–9.

ITC8 The Board's intention in defining contribution-based promises is to capture those promises for which the measurement requirements of IAS 19 are difficult to apply. However, in trying to find an appropriate and conceptual way to distinguish these promises, the Board has included in the scope of the project some promises for which the measurement requirements of IAS 19 are not particularly difficult to apply. In particular, the scope includes promises in which the benefit includes a fixed return on contributions.

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?

22. We are concerned that Board's proposed classification of promises will change the accounting fundamentally for a great many plans in response to a problem that affects relatively few plans. Moreover, it would result in mandating two fundamentally different approaches to accounting for pensions within a single standard. It is difficult to see how such a differential approach could ever be derived from sound principles, and it is clearly inappropriate for an interim project, described as being intended to introduce 'short-term improvements'. We do not anyway perceive the proposal as an improvement. Also, from a practical point of view it would cause significant boundary issues.
23. The scope of the current amendment, if the Board proceeds at all with introducing differential accounting for new categories of pension promise, should be limited much more narrowly to the problem of promises first identified in IFRIC D9 and should not necessarily follow the accounting proposed in the Discussion Paper; the possibility of alternative solutions leaving the core principles more consistent with those of existing IAS 19 should be explored.
24. We do not see how a contribution-based promise can encompass any demographic risk or salary risk. If it decides to pursue the changes proposed in this ED, the Board should therefore aim to establish that a promise with demographic risk cannot be a contribution-based promise.

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?

25. Our understanding from discussing the proposals with those involved in advising on corporates' pension liabilities is that very many plans would be reclassified, in many jurisdictions.
26. Clearly, practical difficulties will arise from the fact that no-one will have any experience of valuing any type of pension promise on the proposed basis. The mix of skills required - such as actuarial and business valuation (credit ratings etc) - has not in our experience been widely available previously.
27. With the proposed change from classifying *plans* as either defined contribution or defined benefit to classifying *promises* as either contribution-based or defined benefit, we foresee difficulties for plans that contain both types of promise yet have a single asset base in allocating those assets between the promises.

ITC9 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.

Question 7 Do the proposals achieve that goal? If not, why not?

28. We agree that there will be no significant changes for most defined contribution plans as currently defined.

Recognition issues related to contribution-based promises

ITC10 Chapter 6 discusses recognition issues related to contribution-based promises. The Board's preliminary views are summarised in paragraphs PV9–PV11.

Question 8 Do you have any comments on those preliminary views? If so, what are they?

29. We agree with the Board's preliminary views on the recognition issues related to contribution-based promises that are summarised in PV9 to PV11, although we note that attribution in line with the benefit formula will give a very different cost recognition pattern for some promises than at present when they are accounted for as defined benefit promises.

Measurement of contribution-based promises

ITC11 Chapter 7 describes the Board's deliberations on the measurement of contribution-based promises. The Board's preliminary view is that entities should measure the liability for a contribution-based promise at fair value assuming the terms of the benefit promise do not change. The Board reasons that fair value assuming the terms of the benefit promise do not change meets the measurement objectives described in this paper, ie it is based on:

- (a) explicit, unbiased, market-consistent, probability-weighted and current estimates of the cash flows;
- (b) current market discount rates that adjust the estimated future cash flows for the time value of money; and
- (c) the effect of risk, other than the risk that the terms of the benefit change

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.

30. We do not in any case believe that the *proposed* approach meets the measurement objective (as described in paragraph 7.7), in so far as it includes the effect of the entity's own credit risk in the measure of the liability for contribution-based promises. The Paper concludes in paragraph 7.29 that credit risk should be reflected, but we do not believe that this gives useful information about the amount and uncertainty of future cash flows, since the entity's obligation to pay the full amount of pensions does not reduce as its financial position worsens.
31. We suggest that contribution-based promises should be restricted to a narrower category than that proposed in the Paper - broadly, to promises dependent on the future value of assets or an index. In this case, the liability could be measured at the year-end value of the related assets or index, rather

than by discounting expected future returns at a high-quality corporate bond rate.

32. As part of its longer-term project there may be merit in the Board considering whether certain post-employment benefit promises are sufficiently similar in substance to insurance promises that the same principles should apply. This would require further analysis once the principles for insurance are established.

(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?

33. We believe that it would be premature to introduce the effect of risk at this stage, when the accounting for only some types of pension promise is under consideration. It would be wrong to introduce such a fundamental inconsistency into the standard.
34. We agree that contribution-based promises should be measured on the basis of the assumption that the terms of the benefit promise will not change (paragraph 30), although we are concerned that this should be described as a type of "fair value" measurement, since fair value would reflect the possibility of future changes to benefits. But we have significant difficulty with the remaining proposals, where the proposed measurement basis is very different from the required basis for defined benefit promises under existing IAS 19 (for example, in relation to probability-weighted cash flows and the effect of risk).
35. As noted above, we question whether any form of fair value is an appropriate measurement basis, since the actual obligation of the entity remains unchanged by changes in its own credit rating. Were credit risk to be reflected in the measurement, arguably for a funded promise it is only the liability in excess of the available funds that is exposed to this risk, and therefore only that element that should be adjusted for it. (We refer above to the difficulty that some plans might have in identifying the portion of their assets that is attributable to contribution-based promises, where a single plan contains both types of promise.)

ITC12 The definitions of contribution-based and defined benefit promises rely on the nature of the benefit promise during the accumulation phase. The Board's preliminary view is that the liability for benefits in the payment and deferment phases should be measured in the same way as they are in the accumulation phase, even though this could result in the same liability being measured in different ways depending on the way it was accumulated. The Board's reasons are set out in Chapter 8,

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?

36. We do not agree, because, as acknowledged by the Board, the liability can be valued in a different way depending on how it was accumulated. This will inevitably lead to an inconsistency:

- (a) either the contribution-based promise liability must be remeasured when it ceases to accumulate, so that it is measured consistently with defined benefit promises but with a significant discontinuity in its own measurement; or
- (b) two identical liabilities may be measured differently when the benefit has ceased to accumulate, merely because the type of promise is different.

Neither approach is satisfactory, but we prefer to accept the discontinuity rather than to measure identical liabilities differently as proposed in the Paper. We believe that the proposed approach would be particularly unhelpful to users.

(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?

- 37. We are not at present aware of any additional practical difficulties that would arise, beyond those set out above in relation to the accumulation period.

Disaggregation, presentation and disclosure of contribution-based promises

ITC13 The Board's preliminary view is that an entity should disaggregate changes in the value of the liability for a contribution-based promise into only a service cost and other value changes. The Board thinks that further disaggregation of changes in the fair value of the liability for a contribution-based promise would be difficult to achieve in an objective way.

ITC14 The Board's preliminary view is that all changes in the value of the liability for a contribution-based promise and all changes in any plan assets should be presented in profit or loss.

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?

- 38. Users need sufficient disaggregation to explain any volatility in profit or loss.
- 39. It is not at first sight clear why the assumptions set out in paragraph 9.7 should make it any more difficult to disaggregate the movements in a contribution-based promise than in a defined benefit promise, since they appear to be generally the same variables about which assumptions must be made in accounting for defined benefit promises. However, the inter-relationship between changes in the value of the liability and of the related assets, which often are not present for a defined benefit promise, might make

it more difficult to devise a disaggregation that conveyed useful information, such that ultimately only the simplistic split proposed in paragraph 9.8 was possible.

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

40. As in the case of defined benefit promises, we believe that changes in the liability for contribution-based promises should go to profit or loss.

(b) mirror the presentation of changes in the liability for defined benefit promises (see Chapter 3)?

Why?

41. We agree that the presentation changes in the liability for contribution-based promises should mirror that of defined benefit promises, since the principles are the same.

Benefit promises with a ‘higher of’ option

ITC15 The Board’s preliminary views on benefit promises in which the benefit is the higher of a defined benefit promise and a contribution-based promise are summarised in paragraphs PV16–PV18.

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?

42. We suggest valuing ‘higher of’ promises instead on the basis of which option, at the balance sheet date, is the more likely to crystallise. This approach is analogous to the approach taken by IFRS 2 – which addresses another form of employee benefits – in dealing with awards with multiple vesting conditions, as illustrated in IG Example 4 of that standard. Although in practice this might mean switching from year to year, based on our experience we believe that this would rarely be the case.

Other matters

ITC16 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 post-employment benefit liabilities could be introduced to allow users to understand the inherent uncertainties affecting the measurement of those liabilities.

Question 14 What disclosures should the Board consider as part of that review?

43. We suggest that the Board should consider requiring disclosure of details of the methodology used when assets have been valued on the 'Level 3' basis.
44. As set out in paragraph 16 above, we believe that certain actuarial gains and losses should be included within the entity's result from operating activities. Clear disclosure of the amount so included will be necessary to enable users to identify this potentially volatile number and assess its impact on the results.
45. The Board should also consider the information in the ASB's Reporting Statement *Retirement Benefits - Disclosures*.

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

46. No.

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