PRICEWATERHOUSECOOPERS

PricewaterhouseCoopers LLP
10-18 Union Street
London SE1 1SZ
Telephone +44 (0) 20 7583 5000
Facsimile +44 (0) 20 7822 4652
pwc.com/uk

Comment Letters
International Accounting Standards Board
30 Canon Street
London
EC4M 6XH

26 September 2008

Dear Sir

Discussion Paper - Preliminary views on amendments to IAS 19 (Employee benefits)

We are responding to your invitation to comment on the above discussion paper on behalf of PricewaterhouseCoopers. Following consultation with members of the PricewaterhouseCoopers network of firms, this response summarises the views of member firms who commented on this discussion paper. “PricewaterhouseCoopers” refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

Overall comments

We welcome the opportunity to comment on the discussion paper. We agree with the Board that it is appropriate to review the accounting treatment of post employment benefit obligations and we agree that there are a number of practical difficulties and inconsistencies that arise from the guidance in IAS 19 “Employee benefits” (IAS 19).

We understand that the Board’s objective is to address those aspects of IAS 19 that currently cause practical difficulties and to issue a revised standard in 2011. We believe that this could be accomplished effectively and within the Board’s timetable by making some limited clarifications and modifications to the existing guidance in IAS 19. This would then allow the Board to explore the alternative measurement and presentation models and the more fundamental changes proposed in the discussion paper as part of a longer term project that addresses all aspects of accounting for post employment benefits and their interaction with the related aspects of other projects.

Recognition and presentation of changes in post employment benefit liabilities

We agree with the Board that immediate recognition in the statement of financial position of changes in the measurement of plan assets and the defined benefit obligation provides a more faithful representation of the entity’s financial position. We therefore support the Board’s preliminary view that those changes should be reflected immediately in the statement of financial position in the period in which they occur and that the option to defer the recognition of both actuarial gains and losses and unvested past service costs should be removed.

We also agree with the Board that it is critical that users of financial statements understand the information provided about employee benefits. The change in the post employment benefit liability or asset is part of that information and users should be able to identify clearly the components of the change and where those components are presented in the income statement or in comprehensive income. For example, current service cost, curtailments, settlements, past service cost, interest cost and the expected and actual return on plan assets should be disclosed clearly in the primary financial statements or in the notes. The impact of changes in the assumptions used to calculate the post employment benefit liability should also be disclosed prominently in the notes.

Enhancing the information provided in connection with employee benefits would allow users to better understand the impact of post employment benefit liabilities on the financial statements and would enhance their ability to predict future cash flows. An assessment of the most informative way to present this information can best be carried out in conjunction with the Financial Statement Presentation project. The extent to which the presentation issues relevant to these projects overlap means the projects should be completed concurrently. We therefore believe that the existing options in IAS 19 for the immediate recognition of actuarial gains and losses (in the income statement or in comprehensive income) should be retained at this stage. The more significant changes in presentation proposed in the discussion paper should be deferred until both projects are complete.

Contribution-based promises

We agree with the Board that there are practical difficulties in applying the guidance in IAS 19 to a limited number of defined benefit promises. These difficulties relate to the attribution of the benefit to periods of service and to the measurement of any benefit that depends on the future return on reference assets. Both could be resolved effectively by:

Clarifying in IAS 19 whether expected future salary increases are an example of a situation where “service in later years will lead to a materially higher level of benefit than in earlier years” for cash balance type plans. We believe that generally this is the case and clarification that the benefit in these circumstances should be attributed on a straight line basis will eliminate existing diversity in practice.

Amending IAS 19 to require that the defined benefit obligation for benefits that depend on the return on reference assets is measured at an amount equal to the fair value of the reference assets (whether or not those assets are actually held by the plan) as proposed in IFRIC D9. The projected unit credit method should not be permitted for these plans.

We believe that a broader consideration of the issues associated with accounting for all post employment benefit obligations, such as the nature of a pension liability and the most appropriate measurement attribute, is required before a new accounting model for a particular type of employee benefit is proposed. We do not, therefore, support the introduction of a new accounting model for contribution-based promises.

Plans containing a ‘higher of’ option

We agree with the Board that IAS 19 does not deal with ‘higher of promises’ and that there is diversity in practice. We support the elimination of this diversity, but we believe a requirement to measure the additional obligation contained in a ‘higher of’ option at fair value introduces additional complexity and is inconsistent with the general principles in IAS 19.

The diversity in practice could be eliminated by amending IAS 19 to require that the additional obligation that might arise in connection with a 'higher of' promise be measured using an intrinsic value approach, as proposed in IFRIC D9, rather than trying to measure the fair value inherent in the optionality between the two benefits. IAS 19 should be amended to require that the two obligations inherent in a 'higher of' promise are measured in accordance with IAS 19. An obligation that depends on the future return on (actual or notional) plan assets should be measured as we have suggested above under the heading contribution-based promises. The higher of the two obligations should be recorded in the statement of financial position.

Our answers to the specific questions in the discussion paper are attached in the Appendix to this letter.

If you have any questions in relation to this letter please do not hesitate to contact Richard J Keys (020 7804 4555), or Tony de Bell (020 7213 5336).

Yours faithfully

PricewaterhouseCoopers LLP

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APPENDIX

Detailed responses to the questions in the discussion paper

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?

We agree that accounting for post employment benefits is a complex area that should be subject to a wide ranging review. We believe, however, that the principles applied to accounting for post employment benefits should be reconsidered as part of a broader project that takes into account the developments in the projects dealing with the recognition and measurement of insurance obligations and financial and other liabilities and with the measurement of fair value. Significant changes to those principles should be deferred until this work is complete. The changes proposed in the short term project should therefore be made in the context of the principles that already exist in IAS 19.

We also agree that there are some inconsistencies and practical difficulties with applying IAS 19 to a limited number of defined benefit plans and we support the Board's efforts to eliminate these. We suggest that this is accomplished as far as possible by clarifying the guidance in IAS 19 rather than by introducing new concepts and principles and that the more far reaching changes proposed in the discussion paper are deferred until a broader project considering employee benefit accounting is complete.

We suggest that, in a similar manner to the planned incorporation of IFRIC 11 into IFRS 2, the scope of the project is amended to incorporate the principles and conclusions of IFRIC14 into the revised standard.

Question 2- Recognition and presentation of defined benefit promises

Chapter 2 describes the Boards deliberations on the recognition of defined benefit promises. The Board's preliminary views are summarised in 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?

We support the removal of options in accounting standards and we support the Board's preliminary view that changes in the measurement of plan assets and the defined benefit obligation should be reflected in the period in which they occur.

We note that PV3 in the Discussion Paper is inconsistent with both presentation approach 3 suggested in paragraphs 3.15 and 3.16 in the Discussion Paper. It is also inconsistent with our suggestion that the existing options for the presentation of actuarial gains and losses either in the income statement or other comprehensive income are retained.

We agree with the Board that all past service costs should be recognised immediately in the income statement in the period in which a plan is amended. This is consistent with the principles in IAS 19. We recognise that there is an inconsistency between the treatment required by IAS 19 and that required by IFRS 2. However, this is one of a number of differences between IAS 19 and IFRS 2 and it is preferable, for the reasons described above to retain the principles in IAS 19 and ensure that the standard is internally consistent.

Question 3 – Recognition and presentation of defined benefit promises

Chapter 3 sets out the alternative approaches for the presentation of the components of the defined benefit cost and analyses the relative merits of each approach. These approaches are summarised in PV 5.

(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 agree that the presentation of employee benefit costs is critical to understanding the impact of employee benefits on an entity's performance and financial position. Users' ability to predict future expenses and cash flows is enhanced if they can separate regular benefit cost from the impact of changes in assumptions and irregular events such as curtailments and settlements and also from the impact of changes in funding cost and experience gains or losses on plan assets.

The issues associated with the presentation of the components of employee benefit cost are inextricably linked to the issues that will be addressed as part of the Board's project on reporting financial performance and should be considered simultaneously. We therefore suggest that the existing presentation options in IAS 19 for the immediate recognition of actuarial gains and losses in the income statement or in comprehensive income are retained in the short term project. We also suggest that the guidance in IAS 19 dealing with the presentation of employee cost in the income statement be retained. The broader aspects of presenting employee benefit expense should then be considered and resolved together with other presentation issues as part of the Financial Statement Presentation project.

We recognise that there are objections to the existing model in IAS 19. For example, where actuarial gains and losses are recognised in comprehensive income changes in assumptions that effect service cost are never reported in the income statement and because the estimation of the expected return on plan assets is subjective. However, these issues cannot be resolved without a broader consideration of the way changes in assumptions and re-measurement gains and losses are presented in the financial statements. We believe it is more effective that these issues are not dealt with in isolation, but considered in conjunction with the Financial Statement Presentation project.

There are complex issues associated with all of the approaches set out in the discussion paper. The immediate recognition in the income statement of all changes in the measurement of the defined benefit obligation and the value of plan assets (approach 1) is likely to create volatility and might lead to different entities using different methods to explain that volatility and the components of employee benefit cost. It is also not clear from the proposal how the different components of changes on the measurement of the post employment benefit liability would be separated. This disaggregation is vital to understanding the implications of post employment benefit obligations for financial performance.

There is no clear conceptual basis for presenting the different components of defined benefit expense in different performance statements (approaches 2 and 3) or for the way the components are separated. These approaches would add complexity to the financial statements and is not clear how they will enhance understanding of an entity's post employment benefit obligations. The basis for presenting the components of employee benefit cost should be explored, together with other related issues in the conjunction with the presentation of the financial statements as a whole.

We believe that requiring an entity to apply any of the three approaches explained in the discussion paper would eliminate an option, but would not be superior to the current options under IAS 19, which permit actuarial gains and losses to be recognised immediately either in other comprehensive income or in profit or loss.

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?

We have explained in our covering letter and in our answer to question 3 above that we believe amendments to the presentation of changes in the defined benefit obligation and changes in the measurement of plan assets should be made only in conjunction with the Financial Statement Presentation project, which should consider these issues in the context of the financial statements as a whole.

Whatever presentation is adopted, we believe it is essential that the different components of employee benefit cost are disaggregated on the face of the primary statements or in the notes so that users can understand each component of the change and how and where that component affects the financial statements.

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?

We agree with the Board that there are practical difficulties in applying the guidance in IAS 19 to a limited number of defined benefit promises. These difficulties relate to the attribution of the benefit to periods of service and the measurement of any benefit that depends on the future return on plan assets.

The practical difficulties in applying IAS 19 could be resolved by making the changes suggested in the attached covering letter. These changes will retain the existing principles in IAS 19, which are applied widely by many entities without significant practical difficulties. They will also result in a consistent and well understood model being applied to all defined benefit promises and will not change the accounting for defined contribution promises. These more limited changes will not add additional complexity to IAS 19.

The proposed definition of contribution-based promises is drawn widely and will cover many types of post employment benefit arrangements to which the existing guidance in IAS 19 can be applied without difficulty. The proposed guidance will also have a significant effect on the accounting for these promises and will result in a significant change in practice for many entities. We believe that these changes should not be implemented without a broader consideration of the issues associated with accounting for all post employment benefit obligations.

The proposed accounting for contribution-based promises will lead to a different measurement and attribution model being applied to plans with a similar economic effect, such as final salary and career average plans. It will also result in a different measurement method being applied to two identical pensions in payment depending on whether the obligation is classified as a contribution-based promise or a defined benefit promise. The proposed model also creates a new measurement attribute: “fair value assuming no change in the benefit promise”. We are not clear what this means and how an appropriate value could be obtained in practice.

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?

Yes, we believe that many benefit promises would be reclassified, for example, career average plans, flat dollar plans, cash balance plans and any plan with a guarantee or a ‘higher of’ provision would be affected. The proposals would affect many plans for which the principles in IAS 19 can be applied without any problems and would result in a significant change in practice for many entities. We also believe that for many of these plans the additional time and effort required to apply the proposals will be disproportionate to the possible benefits. We do not believe that such wide ranging changes are necessary at this time to deal with the issues the Board has identified.

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?

We agree that the proposal is unlikely to have a significant effect on the accounting for defined contribution promises where the contributions are paid shortly after the period end. However, the proposal achieves this by using an attribution model based on the plan benefit formula rather than the straight line approach most often required by IAS 19, but does not consider the impact on plans that are not defined contribution but are contribution-based.

Benefit promises 13 and 14 in Appendix A of the Discussion Paper illustrate the difficulties that attribution based solely on the plan benefit formula could cause. Promise 13 could equally be expressed as a contribution of CU100,000 on the last day that the employee works. An expense attribution model that follows the benefit formula for promise 13, would mean that the present value of the CU100,000 is recognised immediately and then accreted with interest to the CU 100,000. A benefit formula that expresses the contribution as being payable on the last day would suggest that no expense is recognised until the last day. Such a divergence in recognition for an economically identical benefit based purely on how it is expressed does not seem reasonable. How should benefit promise 14, which does not specify any link between the benefit and the service and is economically the same as promise 13, be recognised?

We believe, for the reasons described above, that these changes should be deferred until the broader implications of accounting for post employment benefit obligations have been considered.

Question 8- Recognition issues related to contribution-based promises

Chapter 6 discussed the recognition issues related to contribution-based promises. The Board's preliminary views are summarised in PV9-PV11. Do you have any comments on those preliminary views? If so, what are they?

We agree with the Board that a liability should be recognised for both vested and unvested defined benefit type promises. We recognise that there is a diversity of views on this subject and that IFRS 2 applies a different model. However, the principle in IAS 19 is well established and we believe it should be retained until the accounting for post employment benefits is comprehensively reconsidered.

We also agree with the Board that IAS 19 should not require recognition of any additional obligation that would be payable if an employee left immediately after the balance sheet date.

For the reasons described above, we believe that a comprehensive reconsideration of the accounting for all post employment benefits should be carried out before far reaching changes in the measurement and attribution models are made.

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?

The Discussion Papers suggests that the measurement attribute should provide useful information about the amount, timing and uncertainty of future cash flows and should therefore take into account estimated cash flows, the time value of money and risk. These factors are generally incorporated into the measurement of a defined benefit obligation under IAS 19 and we do not believe it is appropriate, at this time, to introduce a different measurement attribute for different types of benefit obligation.

We suggest that the measurement of all employee benefit obligations should be considered more broadly, in the context of other developments in the accounting models for financial and other liabilities and in the measurement of fair value. The issues that should be considered include whether an employee benefit obligation is a financial liability and the impact of credit risk.

We do not therefore support the measurement proposals in the Discussion Paper at this time. The changes to IAS19 that we have described above would address the issues with defined benefit accounting identified by the Board without the need for a new accounting model.

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?

We agree that an entity's employee benefit obligations should be measured in the same way during the accumulation, deferral and payout phases. The nature of the obligation and many of the measurement uncertainties are unchanged when the accumulation phase is over, so there is no reason to change the measurement basis.

There will be practical difficulties in measuring a contribution-based promise at fair value assuming no changes in the benefit promise. There is unlikely to be a market price for these obligations and we believe that many preparers and users of financial statements will not understand the notion of "fair value assuming no changes in the benefit promise". We do not therefore support the introduction of a new measurement model at this stage.

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 consider that significant disaggregation is necessary to properly explain the components of changes in an entity's employee benefit liabilities and is critical to understanding the financial statements.

We do not support the Board's proposal to introduce a new accounting model for contribution-based promises at this time, but we have suggested in our answer to question 14 below some ways in which the disclosures required by IAS 19 might be enhanced to provide a better understanding of the changes in the statement of financial position.

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?

We do not support the Board's proposal to introduce a new accounting model for contribution-based promises. We have suggested in our covering letter that the existing presentation options for the immediate recognition of actuarial gains and losses in IAS 19 are retained in this short term project.

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 agree with the Board that IAS 19 does not deal with 'higher of promises' and that there is diversity in practice. We support the elimination of this diversity and we believe this can be accomplished by making the less significant changes proposed in our covering letter.

The proposed requirement to measure the additional obligation in connection with plans that contain a ‘higher of’ option at fair value introduces additional complexity into IAS 19 and is inconsistent with the general principles in IAS 19, which does not require that post employment benefit obligations are measured at fair value.

We believe that the measurement of fair value in many cases will be difficult and will create an unnecessary burden for preparers of financial statements. The fair value measurement will seldom provide additional useful information above that provided by an intrinsic value measurement of the additional obligation.

Question 14

The Board intends to review the disclosures required about post-employment benefits in a later stage of this project. What disclosures should the Board consider as part of that review?

The disclosures required by IAS 19 are extensive and we recognise that some of these disclosures would no longer be applicable if all actuarial gains and losses are recognised immediately. We suggest that the Board takes this opportunity to reconsider all of the disclosures required by IAS 19 with the intention of eliminating excessive or unnecessary disclosures, simplifying the presentation and ensuring that they provide sufficient information to users of the financial statements to enable a clear understanding of the impact of post employment benefit obligations on an entity’s results and financial performance and the implications for future cash flows. This requires that the balances and movements are disclosed clearly, together with the underlying assumptions and the risks and uncertainties that affect the estimates. We suggest that the Board considers the disclosure requirements in this context. Sensible aggregation is preferable to extensive disclosures about many individual plans.

We suggest that the existing requirement to disclose the components of the post employment benefit liability (defined benefit obligation and plan assets) should be retained. The reconciliation of changes in the recognised benefit liability could be simplified in a way that more clearly explains the components of the changes in the liability. This may be accomplished by replacing the two reconciliations required by IAS 19 with a single reconciliation from the opening defined benefit liability to the closing defined benefit liability, which would tie to the disclosure on the face of the statement of financial position. Where relevant each item in the reconciliation should be cross referenced to where it is reported in the income statement or in comprehensive income.

The items in the reconciliation should include, where relevant, current service cost (showing the value of benefits earned during the year and employee contributions), interest cost, past service cost, the impact of curtailments and settlements, experience gains or losses on the defined benefit obligation, changes in the defined benefit obligation as a result of assumption changes other than the discount rate, changes in the defined benefit obligation as a result of changes in the discount rate, the actual and expected return on plan assets, the impact of business combinations and employer payments of benefits or contributions to funded plans. The underlying assumptions, both demographic and financial, for each of these items should be disclosed prominently together with the impact of changes in those assumptions.

Question 15

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

We have no further comments.