The institute for the accountancy profession in Sweden

International Accounting Standards Board
30 Cannon Street
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Discussion Paper "*Preliminary Views on Amendments to IAS 19 Employee Benefits*"

FAR SRS, the Institute for the Accounting Profession in Sweden, is responding to your invitation to comment on the Discussion Paper "*Preliminary Views on Amendments to IAS 19 Employee Benefits*". Please refer to appendix 1 of this comment letter for detailed comments to your questions raised in the Discussion Paper. Please note that FAR SRS has decided to not respond to Questions 5 through 13, those relate to contribution-based promises, due to the fact that such plans that will be affected by this guidance are quite rare in Sweden. Accordingly, FAR SRS does not have any wide experience of whether the projected unit credit method works or not for the measurement of such promises. Consequently, FAR SRS believes that constituents that are significantly affected by the proposal for changes relating to contribution-based promises are best suited to answer those questions.

In summary, FAR SRS has the following views on the issues addressed in the Discussion Paper:

- FAR SRS welcomes the overall proposal in the Discussion Paper that entities should recognise all changes in the fair value of plan assets and in the present value of defined benefit obligations in the financial statements in the period in which they occur. There is no conceptual basis for deferral of actuarial gains and losses. This would mean that an entity will report an asset only when a plan is in surplus and a liability only when a plan has a deficit. However, FAR SRS believes that the IASB should, until the IASB reaches a conclusion in the "Financial Statement Presentation Project, keep the two current methods available under IAS 19 to present actuarial gains or losses, i.e. either in SoRIE or in the income statement. FAR SRS main arguments are summarised below:
  - FAR SRS believes it would be premature to require immediate recognition of actuarial gains and losses in the profit or loss, as Approach 1 suggests, before the IASB resolves substantial issues about performance reporting. Therefore, FAR SRS believes it is appropriate to retain the two remaining approaches currently available under IAS 19. It would also be premature to suggest any other approaches, such as Approaches 2 and 3, where some changes are recognized in other comprehensive income and some other changes are recognized in profit or loss, until IASB has developed guidance for which items are to be recognized in other comprehensive income. FAR SRS is also concerned that it would become too arbitrary to divide actuarial gains and losses into one portion that is to be recognized in other comprehensive income

and one portion that is to be recognized in profit or loss when there is no conceptual basis for such an allocation of actuarial gains and losses.

- The approaches proposed by the IASB lead to divergence from US GAAP, which requires all actuarial gains and losses to be immediately recognized in other comprehensive income.

- FAR SRS does not agree that entities should not divide the return on assets into an expected return on plan assets and an actuarial gain or loss (that represents the difference between expected and actual return). FAR SRS has understood that the IASB is concerned that the subjectivity inherent in determining the expected rate of return provides entities with an opportunity to choose a rate with a view to manipulating profit or loss. FAR SRS believes that such a statement is not consistent with an objective to develop principles-based standards. There is also a significant element of subjectivity involved in estimating other actuarial assumptions, and this fact does not prevent preparers from making such assumptions. Furthermore, FAR SRS' view is that it would be inconsistent to recognise the interest cost in the income statement if not the corresponding long-term return on the plan assets that exist to secure the benefit obligation also is recognised in the income statement.

- FAR SRS' general view is that items that are recognized through other comprehensive income subsequently should be recycled to the income statement. The Discussion Paper states that the decision not to propose recycling of actuarial gains and losses is made because of the pragmatic inability to identify a suitable basis for recycling. Since there is no general guidance in IFRSs on recycling of items, FAR SRS can accept that this matter is not dealt with in this project but later addressed in the Financial Statement Presentation Project.

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APPENDIX 1

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?

No.

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?

FAR SRS agrees that entities should recognise all changes in the fair value of plan assets and in the present value of defined benefit obligations in the financial statements in the period in which they occur. There is no conceptual basis for deferral of actuarial gains and losses. By removing the deferral mechanism the resulting asset or liability represents faithfully the entity's financial position. An entity will report an asset only when a plan is in surplus and a liability only when a plan has a deficit.

FAR SRS also agrees that entities should recognise unvested past service cost in the period of a plan amendment. This is consistent with paragraph 69 of IAS 19 which deals with service costs as opposed to past service costs. Paragraph 69 states that employee service gives rise to an obligation under a defined benefit plan even if the benefits are conditional on future employment (in other words they are not vested). The application of paragraph 69 gives rise to a current service cost in relation to obligations that only will vest if a certain future event will occur. Accordingly, not recognising past service costs when a plan amendment occurs is inconsistent with the treatment of vesting conditions in existing benefit plans.

However, FAR SRS does not agree that entities should not divide the return on assets into an expected return on plan assets and an actuarial gain or loss (that represents the difference between expected and actual return). The IASB states in paragraph 2.15 of the Discussion Paper that it is concerned that the subjectivity inherent in determining the expected rate of return provides entities with an opportunity to choose a rate with a view to manipulating profit or loss. Accordingly, the IASB states that its preliminary view is that entities should not divide the return on assets into an expected return and an actuarial gain or loss. FAR SRS believes that such a statement by the IASB is not consistent with an objective to develop principles-based standards. There is no more subjectivity involved in estimating the expected return on plan assets than it is in estimating other actuarial assumptions such as future salary increases, rates of employee turnover, and discount rates and so on. The IASB has also accepted a high degree of subjectivity in other recent amendments of standards, such as valuation of intangible assets in a business combination at the benefit of providing more decision-useful information to users of financial statements. We must assume that the entities are doing a proper job when developing their best estimate of the variables that will determine the ultimate cost of providing post-employment benefits. Furthermore, it would be inconsistent to recognise the interest cost in the income statement if we do not recognise some kind of long-term return on the plan assets that exist to secure the benefit obligation. In summary, FAR SRS believes that expected return on plan assets can be measured with sufficient reliability to justify its recognition. Recognition in a transparent manner of the current best estimate of the expected return on plan assets provides better information than non-recognition of such an amount even if the current best estimate involves some degree of subjectivity. FAR SRS also believes that the disclosure requirements of IAS 19 with regard to the expected return on plan assets make it easy for users of financial statements to evaluate the pension expense. In this regard, it would also make sense to introduce some kind of sensitivity analysis whereby the entity is required to disclose the impact of an increase of for example one percentage point and a decrease of one percentage point in the expected return on plan assets on the pension expense recognized in the income statement. Such a requirement would also be consistent with paragraph 120A(o) of IAS 19.

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?

FAR SRS has noted that the Discussion Paper ignores the present method of writing off actuarial gains and losses directly to the Statement of Recognised Income and Expense ("SoRIE"), and contains three different suggestions, one of which is currently available – immediate write-off to income statement – but that is hardly ever used, and two new options. FAR SRS believes that the two methods to present actuarial gains and losses immediately either in SoRIE or income statement, that is currently available under IAS 19, should not be changed until the "Financial Statement Presentation Project" has reached a conclusion.
FAR SRS believes that the concerns expressed by constituents and the IASB when developing and revising IAS 19 up until 2004 is still valid. When the IASB recently added an additional option for the recognition of actuarial gains and losses in 2004, the IASB expressed that "the IASB accepts that requiring actuarial gains and losses to be recognized in full in profit or loss in the period in which they occur is not appropriate at this time because the IASB has yet to develop fully the appropriate presentation of profit or loss and other items of recognized income and expense." (refer to BC 48E of IAS 19). In BC 48K of IAS 19, the IASB stated that "it would be premature to require their immediate recognition in profit or loss before a comprehensive review of both accounting for post-employment benefits and reporting comprehensive income." FAR SRS agrees with paragraphs BC 48E and BC 48K that it would be premature to require immediate recognition of actuarial gains and losses in the profit or loss before the IASB resolves substantial issues about performance reporting. It would offer substantial improvements to financial reporting if the IASB removes the corridor and spreading alternative, i.e., the deferred recognition approach, and just allows the immediate recognition of actuarial gains and losses, either in profit or loss or in other comprehensive income. It would reduce the options available for pension accounting and thus increase comparability.

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FAR SRS does not believe that any of the proposed approaches for presentation in the Discussion Paper provides more useful information to users of financial statements than an approach where all actuarial gains and losses are recognized in other comprehensive income, for the following reasons:

- It is not feasible to use the immediate recognition approach through P&L for actuarial gains and losses (Approach 1) until the IASB resolves substantial issues about financial statement presentation. These issues include:
  - Whether financial performance includes those items that are recognized directly in equity;
  - The conceptual basis for determining whether items are recognized in the income statement or directly in equity; and
  - Whether certain items reported initially in equity should subsequently be reported in the income statement (recycling)

  There is little point in fixing something in IAS 19 now that might be out of line with the final presentation standard. All approaches proposed by the IASB in the Discussion Paper prejudge issues relating to IAS 1 that should be resolved in the project on financial statement presentation.

- FAR SRS is concerned that a presentation approach where all changes in the fair value of plan assets as well as all changes in the present value of the defined benefit obligation are recognized in the income statement (Approach 1 in the Discussion Paper) would inappropriately combine information with different predictive implications. The fair value measurement of plan assets and the present value measurement of defined benefit obligations have information content in that it is a measurement of opportunity cost and is an estimation of a price that, in thin or non-existent markets, may not reflect the underlying cash flows expected to be received. However, movements in fair values or present values do not predict the future cash flow performance of the assets and liabilities related to pension plans, unless the entity intends to settle the defined benefit obligation and can find a willing counterparty. Where such plan assets and benefit obligations are not intended to be settled in the short term, which normally is the case, performance information should reflect what the business actually does and how it is managed. The information received from the present approach, where all actuarial gains and losses are recognized in other comprehensive income, provides users with more relevant information on potential cash-flow performance than under Approach 1. For example, a change in the discount rate will change the present value of the defined benefit significantly, although the future cash flows will not be affected since the estimated amount of pension payments may not have changed.

- Those capital providers/users that rely on earnings to understand the performance of businesses would also find it difficult to use financial statements prepared under Approach 1 to analyse how the business has or has not followed its strategy. If Approach 1 is not seen by management and its users as providing sufficient information for meaningful communication between the two groups (i.e., preparers and users), there is a danger that financial statements would be relegated to the status

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of a compliance document. Management and users might then feel compelled to develop alternative communication statements outside financial reporting that better meet their needs. FAR SRS feels that there is little point in adopting a model that might be incompatible with the outcome of the financial statement presentation project, when that project finally concludes.

- Far from removing complexity, recognizing all changes in the income statement is likely to result in users being given more complex information that would need supplementing with disclosures based on the information about transactional cash flows, which is of interest. Inclusion of information based on fair value would result in increased need for highly complex additional disclosures explaining the various estimations being used as well as factors causing the changes in fair value.

- In the meantime, before the IASB has reached conclusions in its financial statement presentation project, FAR SRS expects that the vast majority of preparers will argue that the resulting volatility of Approach 1 will not be a realistic portrayal of the long-term nature of post-employment benefit obligations. FAR SRS therefore expects that there will not be sufficient support from constituents for such a significant change in current practice at this time. An approach where actuarial gains and losses are recognized in other comprehensive income would be a pragmatic means of avoiding a level of volatility that FAR SRS expects many of the constituents consider being unrealistic.

- Approaches 2 and 3 suggest splitting actuarial gains and losses into one portion that should be part of service costs and therefore recognized immediately in the income statement and one portion that should be recognized immediately in other comprehensive income. Under Approach 2 and 3, actuarial gains and losses that are related to assumptions on future salary increases, mortality, rates of employee turnover, disability, early retirement, the proportion of plan members with dependants who will be eligible for benefits, claim rates for medical plans and future medical costs should be recognized immediately in the income statement as part of service cost and will create increased volatility in the income statement. Under Approach 2 and 3, actuarial gains and losses that are related to the discount rate and the rate of return on plan assets should be recognized immediately in other comprehensive income. As mentioned above, there is no conceptual basis for treating actuarial gains and losses in different ways as proposed under those approaches. FAR SRS therefore questions on what conceptual basis Approaches 2 and 3 operate in order for those approaches to bifurcate actuarial gains and losses into two different portions that are accounted for differently. FAR SRS objects to such an allocation of actuarial gains and losses for the following reasons:
    - It is an arbitrary method of dividing actuarial gains and losses into one portion that is recognized in the income statement and one portion in other comprehensive income. Accordingly, it generates income and expense items that are arbitrary and that have questionable information content.
    - Until a conceptual basis for determining whether items are recognized in the income statement or equity has been decided on, FAR SRS prefers to treat all

actuarial gains and losses in the same way, i.e., through other comprehensive income.
  - It will offer increased complexity for management to explain for users of financial statements the profitability of the business when they have to go into details why certain actuarial gains and losses are recognized as part of pension expense and why certain other actuarial gains and losses are not recognized as part of pension expense. FAR SRS is afraid that this will damage the credibility of financial reporting.
  - The current method to recognize all actuarial gains and losses in SoRIE is well established and easier to apply and understand.

- Approach 2, which requires interest cost to be presented in other comprehensive income, would be inconsistent with most other IFRSs, which require interest cost to be recognized in profit or loss.

- The approaches proposed by the IASB lead to divergence from US GAAP. The FASB recently published a new standard on pension accounting were all actuarial gains and losses are immediately recognized in other comprehensive income. Before a final conclusion is reached on the financial statement presentation project, FAR SRS believes that a step towards the solution that was achieved in the US would be a step in the right direction, i.e., to require immediate recognition of gains and losses in other comprehensive income.

FAR SRS acknowledges that there is no conceptual basis for the present approach to recognize gains and losses directly in other comprehensive income, but while the present situation is not conceptually pure nor would the Discussion Paper proposals (Approach 2 and 3) be pure either. There is no guidance anywhere how to distinguish between items that are to be reported in other comprehensive income and items that are to be reported in the income statement. There are a number of items that today are permitted to be recognized in other comprehensive income, e.g., changes in fair value of cash flow hedges and changes in fair value of available for sale financial assets (under IAS 39), exchange differences related to foreign operations (under IAS 21), and actuarial gains and losses (under IAS 19). FAR SRS believes that the same reasons for allowing value changes on cash flow hedges and AFS financial assets in other comprehensive income are equally valid for allowing certain value changes related to pension plans to be recognized in other comprehensive income.

(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?**

As discussed above under Question 3 (a) FAR SRS believes that before the IASB has reached a conclusion in its financial statement presentation project, we expect that the vast majority of preparers will argue that the resulting volatility of Approach 1 will not be a realistic portrayal

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of the long-term nature of post-employment benefit obligations. FAR SRS therefore expects that there will not be sufficient support from constituents for such a significant change in current practice at this time. An approach where actuarial gains and losses are recognized in other comprehensive income would be a pragmatic means of avoiding a significant level of volatility in the net income amount; a volatility that FAR SRS believes many of the constituents may consider to be unrealistic. FAR SRS believes that there will be much more focus on net profit for the period than comprehensive income for the period even after the most recent amendment of IAS 1, which will go into effect as of January 1, 2009. FAR SRS also believes that the concerns expressed by constituents and the IASB when developing and revising IAS 19 up until 2004 is still valid (see Question 3 (a) above). Accordingly, FAR SRS believes that the two methods to present actuarial gains and losses immediately either in SoRIE or income statement, that is currently available under IAS 19, should not be changed until the IASB reaches a conclusion in the "Financial Statement Presentation Project". It would offer substantial improvements to financial reporting if the IASB removes the corridor and spreading alternative, i.e., the deferred recognition approach, and just allows the immediate recognition of actuarial gains and losses, either in profit or loss or in other comprehensive income. It would reduce the options available for pension accounting and thus increase comparability.

FAR SRS does not agree that entities should not divide the return on assets into an expected return on plan assets and an actuarial gain or loss (that represents the difference between expected and actual return). See our response to Question 2 above.

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

Approach 1 does not entail any difficulties to apply, but FAR SRS questions the information content as discussed above.

It will be difficult to understand and apply an approach where actuarial gains and losses are split into two different categories as suggested in Approaches 2 and 3. FAR SRS objects to such an allocation of actuarial gains and losses for the reasons given under Question 3 (a) above.

Question 4

(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?

FAR SRS believes that the present approaches where actuarial gains and losses, as defined by IAS 19, are recognised in the income statement or other comprehensive income, as currently permitted, should not be changed (see our discussion under Question 3(a) above).

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Question 5 through 13

FAR SRS has chosen not to answer Questions 5 through 13, that relate to contribution-based promises, due to the fact that such plans that will be affected by this guidance are quite rare in Sweden. Accordingly, FAR SRS does not have any wide experience of whether the projected unit credit method does not work for the measurement of such promises. FAR SRS believes that territories that are significantly affected by the proposal for changes relating to contribution-based promises are best suited to answer those questions.

Question 14

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

It would make sense to introduce a sensitivity analysis whereby the entity is required to disclose the impact of an increase of one percentage point and a decrease of one percentage point in the following assumptions on the defined benefit obligation and pension expense:

- Expected return on plan assets
- Discount rate
- Mortality

Such a requirement would also be consistent with paragraph 120A(o) of IAS 19 that deals with medical plans. FAR SRS believes sensitivity analysis is even more relevant for pension plans as they are more predominant in most countries than what medical plans are.

If the IASB chooses to take the same path as the FASB on pension accounting and allows all actuarial gains and losses to be recognized in other comprehensive income, which FAR SRS support, it would be worthwhile to consider an increase in the disclosure requirements with regard to the actuarial gains and losses in a way that would enable readers of financial statements to understand the size of the actuarial gains and losses for the period that is related to each of the following assumptions, if material:

- Future salary increases;
- Mortality;
- Deviation from expected return on plan assets
- Discount rate
- Any other material actuarial assumptions used

Such a measure from the IASB would disaggregate the information about fair value changes and enable users of financial statements to better understand the actuarial calculations.

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