

The Association of Corporate Treasurers

Comments in response to ***Discussion Paper – Preliminary views on amendments to IAS 19 Employee benefits*** Issued by the IASB, March 2008

October 2008

The Association of Corporate Treasurers (ACT)

The ACT is a professional body for those working in corporate treasury, risk and corporate finance. Further information is provided at the back of these comments and on our website www.treasurers.org.

Contact details are also at the back of these comments.

We canvas the opinion of our members through , our monthly e-newsletter to members and others, *The Treasurer* magazine, topic-specific working groups and our Policy and Technical Committee.

General

The ACT welcomes the opportunity to comment on this matter.

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We have not commented on every element of your paper but rather have concentrated on the areas we regard as most important.

The discussions in your paper as to certain aspects of pension accounting make it clear that measurement and presentation issues are complex and for that reason might be better dealt with in the context of a comprehensive presentation project. Taking the issues one at a time may result in a whole that is inappropriate and confusing. Furthermore introducing a selection of miscellaneous changes now, followed by further changes after a more extensive review will only serve to confuse. If the result of this current consultation shows a very divided set of views we recommend that the Board refrains from making any changes save those getting overwhelming support. While all would acknowledge that the current standard contains some flaws it is far from obvious that the alternatives would be any better.

Familiarity with the standard, for preparers and users alike, is a strong advantage to maintaining it unchanged. Current standards do require very extensive disclosures in

the notes to the accounts so that those who believe that the standard is bringing the wrong numbers to account are able to make adjustments for their own analyses.

Specific Questions

Chapter 2 describes the Board's deliberations on the recognition of defined benefit promises. The Board's preliminary views are summarised in preliminary views PV2–PV4, namely:

- **PV2** 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.
- **PV3** Entities should not divide the return on assets into an expected return and an actuarial gain or loss.
- **PV4** Entities should recognise unvested past service cost in the period of a plan Amendment

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?

Deferral / spreading of gains and losses

The question as to timing of recognition of defined benefit promises is closely bound in with the measurement methodology being applied to the assets and liabilities and to the presentation in the accounts either in the profit and loss or in other comprehensive income. Pension assets and liabilities tend to be held for the longer term so that the use of point in time valuations and the reliance on a significant number of assumptions in reaching those valuations mean that immediate recognition of all actuarial gains and losses could present a misleading picture.

We have previously held that the ability to defer recognition was a convenient method of applying a smoothing to the potential misrepresentation derived from point in time values. However taking a purist point of view if the accounts are supposed to show what has happened during the year there can be little argument for deferring recognition of valuation changes that have genuinely happened.

We therefore support your preliminary view PV 2, but subject to the measurement and presentation outcomes discussed below.

Expected vs actual returns

IAS 19 permits entities to recognise in profit or loss an expected return on assets. The difference between the actual and expected return on assets forms part of the actuarial gains and losses that an entity currently deals with through the deferral methodology or taken immediately through P&L or through OCI. Your preliminary view PV 3 seeks to end the use of an expected rate of return in calculations.

The use of expected returns can introduce some subjectivity and an element of smoothing. Some would argue that this provides the user with a fairer picture of the long term outlook for the fund and the sponsors funding obligations. The trustees and sponsors inevitably will be making use of forecasts of expected return over an even longer period than one year.

However if IAS 19 is to be based on fair values and taking any changes in value to P&L in the period in which they occur, then your PV3 is consistent with that and is one that we support, again subject to the further discussions below.

The downside with this approach is that the P&L could show significant volatility year on year due to the vagaries of market valuations rather than through any intrinsic action by management. For this reason alternative presentations do need consideration.

Company reports and accounts, in the UK at least, are supposed to be management's accountability report to the company's owners on its stewardship for the past year. The purpose of accounts within UK company law does not include providing the basis for a predictive valuation for potential investors. Recording what has actually happened during the year is the relevant focus, so it follows that any form of smoothing of P&L is inappropriate.

Plan amendments

Your paragraph 2.16 explains that:

"Past service costs arise when an entity introduces a defined benefit plan that attributes benefits to past service or changes benefits attributed to past service under an existing defined benefit plan. IAS 19 requires entities to recognise past service costs from vested benefits immediately, and recognise past service costs from unvested benefits on a straight-line basis over the average period until the benefits vest."

On the basis that the IAS 19 principle should be immediate recognition of gains and losses in the period in which they arise, we agree with the IASB's preliminary view PV 4 that unvested past service costs should be recognised in their entirety in the period in which a plan amendment is made.

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 namely:

- **PV 5** *The Board does not express a preliminary view on the presentation of the components of post-employment benefit cost in comprehensive income. Instead, the Board outlines three approaches to presentation that illustrate ways in which information about post-employment benefit costs could be presented. The approaches are:*

Approach 1: An entity presents all changes in the defined benefit obligation and in the value of plan assets in profit or loss in the period in which they occur.

Approach 2: An entity presents the costs of service in profit or loss. Entities present all other costs in other comprehensive income.

Approach 3: An entity presents remeasurements that arise from changes in financial assumptions in other comprehensive income. Remeasurements arising from changes in financial assumptions are prompted by changes in the discount rate and in the value of plan assets. An entity presents changes in the amount of post-employment benefit cost other than those arising from changes in financial assumptions (eg the costs of service, interest cost and interest income) in profit or loss.

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?

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

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?

The ACT notes that the IASB does have a current project to look at Financial Statement Presentation and therefore making changes in the area of pensions may be premature, until the wider principles are agreed.

Approach 1 is reflective of your PV3 and would mean that the full economic consequences of decisions on and management of the pension assets and liabilities flow through year by year to P&L. This has the advantage of simplicity but in reducing all the effect on pensions into one figure the result becomes less decision useful to users. Time and again users explain that they are using the accounts to understand 'sustainable long term earnings'. In the context of accounts and the management's accountability to shareholders, the question is "What has happened to sustainable earnings during the period being reported on. Approach 1 fails in this end and in our view introduces a degree of volatility in P&L that is damaging to a proper understanding of the financial results.

Approach 2 attempts to bring out in the P&L the service costs related to pensions and keeps the financing costs and revaluations gains separate in OCI. Many users in their analysis of accounts do find it helpful to be able to keep the financing separate from operating and other business activities. However under this approach all income and gains and losses from plan assets are removed from P&L, resulting in the loss of what many see as an appropriate offset in P&L between the costs of providing post-employment benefits and the benefit of setting aside funding for these.

Approach 3 appears similar to Approach 2 in that the effects of changes in financial assumptions and in asset valuations all go to OCI but in this approach an element referred to as interest income on plan assets goes to P&L. Your paragraph 3.29 explains that interest income could be taken to mean:

- The expected return on plan assets as currently required in IAS19
- Taking actual dividends and interest received, or
- Imputing interest from market bond yields

Under this approach changes in assumptions on the service cost go to P&L rather than to OCI and this is different to what happens now under IAS 19 if the option to take actuarial gains and losses to OCI is adopted. We believe that this is a sensible refinement of the existing standard.

The contentious element in adopting Approach 3 is defining what is meant by interest income. Each of the 3 methods suggested has its weaknesses. An expected return could be arbitrary and over time vary significantly from the actual returns. Actual dividend and interest ignores the return in the form of capital growth. Imputing interest from bond yields would create a form of standardisation and would have the advantage that the interest on assets and the interest on the liabilities would both be based on the same measure, but a bond yield could be substantially different from the actuals. The difficulties of finding the appropriate basis for the 'Interest income' are well illustrated by the existing anomaly that very often companies can have a pension deficit but yet be showing an interest income element in P&L. (Their expected return on assets exceeds the discount rate on liabilities.)

Our preference would be to remain with the existing treatment as between P&L and OCI since the ideal longer term solution may be to introduce a far more detailed and itemised analysis for users. However if the Board is determined to start the process of change then Approach 2, is our preference. Because of the vagaries of the assumptions around the interest income and cost it might be better to remove both sides from the P&L and confine the pensions cost to the service costs related to pensions and keep the financing costs and revaluations gains separate in OCI. Distortions to earning per share are avoided.

The Association of Corporate Treasurers

The ACT is the international body for finance professionals working in treasury, risk and corporate finance. Through the ACT we come together as practitioners, technical experts and educators in a range of disciplines that underpin the financial security and prosperity of an organisation.

The ACT defines and promotes best practice in treasury and makes representations to government, regulators and standard setters.

We are also the world's leading examining body for treasury, providing benchmark qualifications and continuing development through training, conferences, publications, including *The Treasurer* magazine and the annual *Treasurer's Handbook*, and online.

Our 3,600 members work widely in companies of all sizes through industry, commerce professional service firms.

Further information is available on our website (below).

Our policy with regards to policy and technical matters is available at <http://www.treasurers.org/technical/resources/manifestoMay2007.pdf>.

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