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Mouvement

A F E P

Association Francaise des Entreprises Privées

IASB
30 Cannon Street
London EC4M 6XH
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Paris, September 5, 2008

Re : Preliminary views on amendments to IAS 19 Employee Benefits

ACTEO, AFEP & MEDEF welcome the opportunity to comment on the IASB discussion paper presenting preliminary views on amendments to IAS 19 Employee Benefits.

While we can understand and support the need to report employee benefit liabilities measured as of the balance sheet date, we disagree with all three approaches to the presentation of profit or loss as suggested in the paper. We believe the IASB should remain consistent with its prior judgements that no change to the presentation of actuarial gains and losses should be made prior to the completion of the project on presentation of financial statements. Indeed we strongly believe that building a sound reference to distinguish what is included in profit or loss from what is reported as other comprehensive income should be the first step before changing the presentation of gains and losses arising from employee benefit plans.

We also support that IAS 19 be amended in order to provide for relevant accounting for financial guarantees embedded in employee benefit promises. We however believe that only financial risks should trigger a measurement at fair value, while all demographic risks remain captured consistently under the projected unit credit method. We recommend that the existing categories be maintained, and embedded financial guarantees be separated and accounted for at fair value, with changes in value in P/L.

We provide the detailed analysis in the appendix to this letter.

Should you wish any supplementary comment or explanation, please do not hesitate to contact us.

ACTEO	AFEP	MEDEF
Patrice MARTEAU Chairman	**Alexandre TESSIER** Director General	**Agnès LEPINAY** Director of economic and financial affairs

Appendix to ACTEO & MEDEF's letter of comments on the discussion paper presenting IASB's preliminary views on amendments to IAS 19 Employee Benefits

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 ?

In our view, amending IAS 19 was not a priority, except for providing a more satisfactory accounting treatment for cash balance plans. We acknowledge that the reporting of pensions is complex ; however pension plans and related funding mechanisms are complex. In contrast with paragraph 1.6, and with the exception mentioned above, our members do not encounter any difficulty in applying IAS 19. We concur with the statement that comprehensive reviews of existing standards are preferable to successive partial amendments. Implementing changes is costly and tend to reduce the understandability of the information presented (lack of consistency, need for restatements...). As a result we have not identified any supplementary issue that should be scoped in.

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 ?

Although we believe that the IASB has considered relevant factors, we do not believe it has weighed them appropriately.

We understand the move by the IASB as resulting from feeling an urgency to have pension liabilities and related assets measured at the balance sheet date, using market inputs or other assumptions at the balance sheet date. In IASB's views, this change has immediate consequences on how actuarial gains and losses should be reported in the income statement. We believe that changes in the measurement of the liability can be implemented without altering at the same time the reporting of actuarial gains and losses in the income statement. We therefore disagree with the approach the IASB has followed.

As indicated in our answer to question 1, we believe changes in accounting practices should take place only after changes have been fully thought through. The IASB is in the very early stages of its project on the presentation of financial statements. No change in the presentation of gains and losses arising from pensions should be introduced before the presentation project is completed. We observe that one of the three options available today for the presentation of actuarial gains and losses has been introduced by the IASB quite recently. In IAS 19.BC48K, the IASB indicates "it would be premature to require [actuarial gains and losses] immediate recognition in profit or loss before a comprehensive review of both accounting for post-employment benefits and reporting comprehensive income."

While this conclusion is still valid, we further observe that the third option that has been introduced by the IASB is as of today widely used and stems from a recent change in practice.

We therefore strongly advocate in favour of retaining the three existing options in IAS 19, although we would be in favour in the longer run – after a comprehensive review of the appropriate pronouncements has been carried out - of retaining one presentation solution only. The IASB should not trigger frequent changes in accounting practice. Indeed, a study carried out by Mercer in France on the implementation of IAS 19 by CAC 40 listed groups shows that approximately 50% apply the corridor approach while the other half reports actuarial gains and losses as other comprehensive income[1]. Because of the change in measurement of the liability, the corridor approach would need to be adjusted, with all actuarial gains and losses reported first as OCI before being recycled in P/L following the existing recognition pattern.

While more and more entities have adopted in the recent past the most recently adopted option for the recognition of actuarial gains and losses (i.e. the SORIE option), we believe that the change of presentation in the statement of changes in equity recently introduced as part of IAS 1 amendments is likely to stop progress in that direction. We believe the IASB should identify P/L flows distinctly from other comprehensive income flows in the statement of changes in equity, in order to promote usefulness to users.

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 assenting the usefulness of information to users, what importance do you attach to each of the following factors, and why ;

a. Presentation of some components of defined benefit cost in other comprehensive income ; and

b. Disaggregation of information about fair value ?

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

We do not support any of the alternatives offered in the DP. Disaggregation between profit and loss and other comprehensive income items should be based on a robust definition of profit and loss, a definition the IASB has not yet started considering, although performance reporting project has been running for the last six years. Until the appropriate progress is made, no significant change should be decided.

We detail below our main comments on the various approaches proposed.

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[1] Mercer « Engagements de retraite : les sociétés du CAC 40 » Paris, 17 juin 2008. Only one group reports actuarial gains and losses in P/L.

- *Approach 1 :*

  We note that the IASB has not identified any benefit in terms of information usefulness to users to support approach 1. None of the arguments the IASB has put forward sounds particularly convincing :

  - *We disagree that approach 1 is necessary to bring the presentation of actuarial gains and losses in line with the framework* : whether actuarial gains and losses should be recognised in P/L or in other comprehensive income is a matter of disaggregation of gains and losses in the income statement and that the framework is silent on this issue. Furthermore, in view of the departures from the framework that the IASB has decided recently invoking that the framework is obsolete, we believe that this argument is no longer self-sufficient. We therefore consider this argument not workable.

  - *We disagree that consistency with IAS 8 and IAS 37 would call for approach 1* : an analysis is needed to establish whether IAS 19, or IAS 8 and IAS 37, have it right. In other words, we believe that, would the IASB decide, as a result of the present consultation, to adopt a specific, more relevant presentation of gains and losses arising from the re-measurement of long-term liabilities, IAS 37 and IAS 8 would deserve to be amended. There again, looking for the information most useful to users is necessary.

  - *We disagree that approach 1 should be adopted for practicality reasons :* the choice not to disaggregate the change in value of the liability on the face of the income statement does not simplify the implementation of the standard, as users need to understand, and preparers need to provide in the notes, the different components of the change in value. There is therefore no gain on the sake of simplicity. We agree with the Board that arbitrary allocation can be difficult to understand. Our view is that the Board needs to establish a rationale to define what to present in or out of net income, and when and on what basis, to recycle, in order to ensure that users are provided with a useful net income figure.

  - *The fact that approach 1 belongs to the existing IAS 19 is not relevant in the choice to be made :* the argument would equally serve selecting one of the two other options available in the existing IAS 19. Furthermore, retaining an existing option could be justified by the willingness to avoid changes in practice. We note that the option to recognise all gains and losses in P/L is not used in practice, as the IASB has observed when introducing a third option, back in 2004 (and as a study conducted by Mercer in France – see supra - has indicated).

  As a result of the above, we believe Approach 1 is not supported by any valid argument and does not serve the objective set by the Board, i.e. to provide information useful to users.

- *Approach 2:*

  Approach 2 takes the view that service costs should be separated from financing costs. Such separation is in our view valid to categorise gains and losses into categories such as operating and financing, as the IASB has tentatively decided in its financial statement presentation project. We however believe that such separation is not relevant to distinguish net income from other comprehensive income. Related arguments are not helpful deciding how to allocate between net income and other comprehensive income.

- *Approach 3 :*

  We fail to identify the rationale in Approach 3. We note however that the separation proposed is no more relevant than Approach 2 in distinguishing between net income and other comprehensive income.

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 ?

Lately the IASB has received presentations by user groups insisting on the important role that net income played in financial reporting. As the IASB well knows, ACTEO and other European preparers share the same view. To serve users best, the IASB should be actively working on an appropriate definition of net income, one that could be applied throughout the IFRS literature to distinguish between net income and other comprehensive income. Until an appropriate definition of net income is finalised, all arguments that have supported setting up the existing options are still valid. The judgement made by the IASB in 2005 is still valid, appropriate changes in the presentation of actuarial gains and losses should be made only after a comprehensive review of post-employment benefits and the presentation of financial statements. In the meanwhile consistency of presentation from period to period should be maintained.

Other comments on the issue of presentation :

1- Expected vs actual return on assets

The proposals include taking into account, in the determination of net income for the period, the actual return on assets instead of the expected return,. We disagree with this change and believe that differences between the actual and the expected returns on assets should continue to be dealt with as actuarial gains and losses. Expected returns are selected by entities in order to best reflect that pension plan assets are managed on a long-term basis. Expected returns reflect market long term return expectations on the various classes of financial assets which compose the portfolio. They are fully disclosed and could be easily challenged if they were not defined adequately.

Although actual returns may be assessed as more objective and more straightforward information, their use would generate short-term variations to be reflected in net income. As a result such a requirement would make net income lose part of its relevance and predictive value. Under our proposal, differences would be shown in the period as an other comprehensive income item fully displayed in the statement of comprehensive income, in quite a transparent and informative way.

2- Past service cost

We disagree that past service cost is recognised in full in P/L after a change in post-employment benefits has been made. Distinctions between past service cost and actuarial gains and losses are not easy to make and we do not think that there should be such a difference in accounting treatment. Past service cost should be recognised in OCI when first recognised, and remain presented in P/L as they are today, until a comprehensive review has taken place.

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 ?

We agree with the IASB that defined contribution plans with a return promise are not appropriately dealt with within the existing IAS 19.

Hence an amendment of IAS 19 requiring the financial guarantee obligations under those plans to be measured at fair value would be an improvement over the existing literature.

However we do not believe that the IASB has adequately identified the boundary that should be set between defined benefit promises and contribution based promises. In our view, the way in which the benefit is accumulated is not an economic feature of the resulting obligation. Hence, if retained, it would result in identical financial obligations to be reported differently in the absence of any economic difference. Such an outcome is contrary to the basic principles underlying IFRS standard setting.

We recommend the IASB to remain as consistent as possible with the existing IAS 19, i.e. to keep all promises in which the entity bears actuarial risks (demographic risk, turnover risk etc...) within the defined benefit category. Indeed applying the projected credit unit method to those plans is well implemented in practice and does not raise any issue in terms of divergence in practice or relevance.

We therefore recommend that the existing categories be maintained. Wherever the entity incurs a form of financial guarantee on top of a defined contribution benefit promise, the financial guarantee (the entity supplements the pension fund in ensuring employees the level of benefits to which they are entitled) ought to be measured separately in accordance with IAS 39 requirements on financial guarantees, i.e. de facto in accordance with IAS 37 with however two caveats : in order to remain consistent with the accounting for other employee benefits in IAS 19, we indeed recommend that :

- the discount rate be the same as for other employee benefits,
- the impact of the change in discount rate be recorded as other actuarial gains and losses.

As a result, the only change of category that the amendments to IAS 19 would trigger would be to exclude from the defined benefit category those plans which have all features of a defined contribution plan except for a financial guarantee that can be recognised and measured separately.

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 ?

Yes, many promises would be reclassified from defined benefit to contribution-based under the Board's proposals. All promises based on average career salary, for example, which are frequent in some geographical areas (in the Netherlands for example) would have to be measured at fair value.

Practical difficulties would arise in the measurement of fair value because of a lack of relevant market data to reflect demographic risks. In addition we believe that post-employment obligations should remain measured on the basis of their settlement value (i.e. the best estimate of future cash outflows for the entity).

Question 7

Do the proposals achieve that goal [i.e. that no significant accounting change is triggered for existing defined contribution plans] ? If not, why not ?

No significant accounting change is expected for existing defined contribution plans.

Questions 8 and 9

Do you have any comments on those preliminary views [related to recognition of contribution-based promises] ? If so, what are they ?

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 ?

To what extent should the effect of risk be included as a component of the measurement approach at this stage of the Board's post-employment benefit promises project ? How should this be done ?

As a summary of what we have detailed in our answers to the previous questions, we recommend the Board :

- to maintain the existing categories without making any change,
- to require the accounting for any return guarantee associated with a defined contribution or a defined benefit promise separately from the promise and at fair value.

We believe an amendment based on our proposals would better match the Board's objectives :

- the amendments would be adjusted and limited solely to circumstances where there is a need for change without creating any disruption in the accounting for the promises which are reported today in a satisfactory fashion ;
- the promises measured at fair value would be reduced to the promises which are similar to financial guarantees ; this would ensure greater consistency in accounting overall, financial guarantees arising within employee benefit plans being accounted for similarly to other financial guarantees, while promises involving demographic risks would remain accounted for consistently under the projected unit method ;
- no financial risk would remain not reported and potential divergences in practice would be eliminated.

Question 10

(a) Do you agree that the liability for the benefits in the payout and deferment phases should be measured in the same way as they are in the accumulation phase ? If not, why ?

No, we disagree. As explained above, the accounting for employee benefit promises should not be driven by a non economic feature and similar liabilities should be accounted for on a similar basis.

(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 ?

As explained above, fair value is relevant where financial risks only are involved while all promises generating demographic risks for the entity are better accounted for consistently, i.e. under the projected unit credit method in conformity with IAS 19 today.

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 ?

Our recommendations make solving this question unnecessary (see our answer to question 5).

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

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

Why ?

Our recommendations make solving this question unnecessary (please refer to our answer to question 5).

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 IASB proposals and note that they are consistent with our recommendations.

Question 14

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

No particular disclosure requirement is needed. Please refer to our response to question 11.

Question 15

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

We recommend the Board to limit those short term changes to the minimum.