THE
INSTITUTE OF
CHARTERED
ACCOUNTANTS
OF SCOTLAND

AH/ASC-SUB/mb

International Accounting Standards Board
30 Cannon Street
LONDON
EC4M 6XH

26 September 2008

Dear Sir or Madam

IASB DISCUSSION PAPER – PRELIMINARY VIEWS ON AMENDMENTS TO IAS 19 EMPLOYEE BENEFITS

The Institute's Accounting Standards Committee and Pensions Working Party have considered the above Discussion Paper and I am pleased to set out their comments below.

The Institute is the first incorporated professional accountancy body in the world. The Institute's Charter requires its committees and working parties to act primarily in the public interest, and our responses to consultations are therefore intended to place the general public interest first. Our Charter also requires us to represent our members' views and protect their interests, but in the rare cases where these are at odds with the public interest, it is the public interest which must be paramount.

Our responses to the questions in the Discussion Paper are set out below.

Scope of the project

Q1: 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 do not believe there are any other issues that should be addressed as part of this project. If the project is intended to be completed in a short time frame before a more fundamental review of IAS 19 is conducted, then any amendments should be very limited, so that entities are not subject to two major changes in reporting in relatively quick succession. As explained below, we are not convinced that the presentation of the changes in pension assets and liabilities should be addressed in this short-term project before the IASB has more fully considered financial statement presentation, and do not believe that the new contribution-based promise definition should be introduced at this point.

CA HOUSE • 21 HAYMARKET YARDS • EDINBURGH • EH12 5BH
PHONE: 0131 347 0100 • FAX: 0131 347 0105
E-MAIL: enquiries@icas.org.uk • WEB: www.icas.org.uk

DIRECT LINE: 0131 347 0100 • EMAIL: enquiries@icas.org.uk

<u>Recognition and presentation of defined benefit promises</u>

Q2: 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?

In relation to the deferred recognition of changes in the liability for defined benefit promises, we believe that the Board has considered the relevant factors. The members of our Accounting Standards Committee and Pensions Working Party have differing views on the treatment of changes in plan assets and the defined benefit obligation. It is agreed that there is not a valid rationale under the conceptual framework for treating changes in pension assets and liabilities differently from changes in other similar assets and liabilities. Members of our Accounting Standards Committee are therefore comfortable with the IASB's preliminary view that entities should recognise all changes in the period in which they occur. However, many of our members working in the pensions industry are concerned that this approach will result in increased volatility in the financial statements which is not reflective of the underlying performance of the pension scheme. They support the arguments set out in paragraph 2.5 of the discussion paper, particularly that the period-to-period changes in the value of plan assets and liabilities are not relevant to the users of financial statements, due to the long-term nature of those assets and liabilities.

We agree with the Board's preliminary view that entities should not divide the return on assets into an expected return and an actuarial gain or loss. It is important that the actual returns should be reflected in the financial performance in order to assist those with a responsibility for stewardship. Nevertheless, it would also be useful if expected returns were disclosed, or that the most critical assumptions used were disclosed, in order to assist in evaluating the investment strategy and the management of the assets. We note, however, that this would make budgeting and reporting financial performance more unpredictable when the income statement is exposed to volatility in asset return relative to budgets.

We agree with the Board's decision not to change the treatment of plan amendments under IAS 19 as part of this project. This should be addressed as part of the fundamental review of accounting for retirement benefits.

Q3:

(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 values?

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

We believe that the issue of presentation of changes in defined benefit costs should be considered in the context of the Board's wider projects on the conceptual framework and financial statement presentation and should not be addressed in isolation. We do not support changes to presentation being made in this project in advance of the completion of the Board's financial statement presentation project. Regardless of the recognition and measurement criteria used in the balance sheet, the geography of the income statement is critical in assisting users to understand an entity's financial performance. This means that the income statement should readily show the items that are within management's control, and distinguish those that are influenced by external factors, thus meeting the objectives of financial reporting of decision-usefulness and reporting on stewardship.

CA HOUSE • 21 HAYMARKET YARDS • EDINBURGH • EH12 5BH
PHONE: 0131 347 0100 • FAX: 0131 347 0114
E-MAIL: enquiries@icas.org.uk • WEB: www.icas.org.uk

DIRECT LINE: 0131 347 0225 • EMAIL: ahutchinson@icas.org.uk

We have some brief comments on each of the approaches proposed in the discussion paper, although we do not support any of these being adopted at this stage. We believe that changes in defined benefit costs may be accounted for adequately in accordance with existing IAS 19 and IAS 1.

The main attraction of approach one is that it would reflect all pension costs in one place and would therefore be straightforward to understand. Any approach which separates out costs so that some are recognised in profit and loss and others in other comprehensive income is undoubtedly more complex. However presenting all pension costs as a single figure may be unhelpful as it does not allow the user to understand the nature of the different drivers of changes in assets and liabilities. Approach one is also consistent with the current conceptual framework. However, some of our members support approaches two and three, since they separate gains or losses arising from events that have different predictive implications. These are members who are concerned about the volatility potentially introduced by the removal of deferral mechanisms for the recognition of changes in pension assets and liabilities, and they believe that approaches 2 and 3 would help explain this volatility.

Q4:

(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?

As noted above in our response to question 3, we do not believe that any of the presentation approaches should be addressed at this time. Presentation of pension costs should be considered as part of the wider project on financial statement presentation.

<u>Recognition issues related to contribution-based promises</u>

Q5: 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 do not agree with the Board's preliminary views on defining a new category of contribution-based promises. This represents a major change from the existing standard and we do not believe that this should be undertaken as part of a short-term improvements project. The introduction of this definition could potentially change the accounting treatment for many pension schemes which would be accounted for as a defined benefit scheme under the existing IAS 19. We are not aware that there are sufficient problems with the accounting for these schemes to warrant this new treatment in a short-term project. This could result in very similar schemes being accounted for differently, a situation which would not be tenable in the longer-term. Therefore, a further change would be required at a later date. Ideally, all pension promises should be governed by a single set of principles which are equally applicable to all, to avoid drawing an artificial dividing line between different types of promises. We would therefore recommend that the Board does not pursue this option as part of a short-term project, and instead should focus resources on the fundamental review of pensions accounting.

Q6: 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?

We believe that many promises would be reclassified from defined benefit to contribution-based under these proposals, such as career-average promises.

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Q7: 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 meet that goal, if not, why not?

We agree that for promises that meet the IAS 19 definition of a defined contribution plan where contributions are paid soon after the period end, there will be little significant change in the accounting. There may be more significant changes for other defined contribution plans.

Q8: Chapter 6 discusses recognition issues related to contribution-based promises. The Board's preliminary views are summarised in paragraphs PV9-PV11. Do you have any comments on those preliminary views? If so, what are they?

We agree with the Board's decision not to address the treatment of unvested benefits as a liability as part of this project, although we believe that this area requires further consideration in the future.

We disagree with the proposal on the allocation of benefits to periods of service as this would not be consistent with the allocation method for defined benefit promises.

We agree with the Board's decision not to change the IAS 19 requirement that an additional amount is not recognised for a liability payable if an employee left employment immediately after the reporting date, even though there is an inconsistency with IAS 39.

Measurement of contribution-based promises

Q9:

(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?

We do not believe that a different measurement basis should be introduced for pension plans defined as contribution-based. There needs to be a much more in-depth debate on the appropriate measurement basis for all pension liabilities – this should not be pre-empted by this decision, which may not ultimately be in accordance with the conceptual framework and the measurement of other liabilities.

We have noted in previous responses to the IASB that we do not agree with the inclusion of own credit risk in the measurement of a financial liability as this results in counter-intuitive accounting information which merely confuses the readers of accounts.

Q10:

(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?

As noted above, we do not agree with the proposals for the measurement of contribution-based promises, but in principle, we agree that the measurement of the liability in the payout and deferment phases should be on the same basis as in the accumulation phase. We are not aware of any practical difficulties in this proposal.

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Disaggregation, presentation and disclosure of contribution-based promises

Q11:

(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?

In general, we believe that disaggregation of information about changes in the liability for pension promises is helpful, although as noted above, we do not support the introduction of the contribution-based promise category. We agree that it would be difficult to disaggregate changes in the contribution-based promise liability similar to those required for defined benefit promises – this demonstrates one of the problems with this proposal, in that there will be a lack of comparability between contribution-based promises and defined benefit promises.

Q12: 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?

Why?

Approach (b) – that the changes in the liability for contribution-based promises should mirror the presentation of changes in defined benefit promise liabilities, is preferable as it would create greater comparability and is more pragmatic in the context of a short-term project.

Benefit promises with a 'higher of' option

Q13:

(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 believe that the requirement to value the 'higher of' option may be burdensome if an entity does not have expertise in valuing options.

Other matters

Q14: The Board intends to review the disclosures required about post-employment benefit promises in a later stage of this project. As part of that review, the Board intends to consider best practice disclosures in various jurisdictions. For example, explicit requirements to disclosure information about the mortality rates used to measure post-employment benefit liabilities could be introduced to allow users to understand the inherent uncertainties affecting the measurement of those liabilities. What disclosures should the Board consider as part of that review?

A re-consideration of the disclosures required about post employment benefit promises is welcome, and we support the IASB undertaking this review in a later stage of this project. There are undoubtedly areas where clearer disclosures are required, it is important to ensure that disclosures are not simply expanded. Disclosures should be succinct and focused so that attention is drawn to the key information. A principles-based approach should be taken to avoid entities producing lengthy boiler-plate disclosures which do not aid comparability and can obscure the most important information.

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Q15: Do you have any other comments on this paper? If so, what are they?

We have no other comments on the paper.

I hope our comments are helpful to you in the development of this Discussion Paper. If you wish to discuss any of them further, please do not hesitate to contact me.

Yours faithfully

AMY HUTCHINSON
Assistant Director, Accounting and Auditing
Secretary to the Accounting Standards Committee

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