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Dear Sirs

Discussion Paper : Preliminary views on amendments to IAS19 Employee Benefits

Thank you for the opportunity to comment on the above paper.

This letter sets out Punter Southall's comments on the above discussion paper. Punter Southall provides a full range of actuarial advice, pensions consultancy and pensions administration services. Our clients are primarily large and medium sized occupational pension schemes and their employers and as such we feel well placed to comment on the paper.

Introductory Comments
We welcome the decision of the Board to concentrate on a few urgent issues at this stage in advance of its fundamental project on pension accounting in conjunction with the FASB.

We have not answered the questions on the sections of the paper concerning contribution-based promises (questions 5 to 12) as we believe that this area should be abandoned for this review. The difficulties in measurement that gave rise to the new definition are largely non-existent in the UK pension arrangements that we advise and the current split between defined benefit and defined contribution is clear. However, it is increasingly common in the UK for schemes to switch to a career average salary definition for future service. These have always been accounted for in the same way as defined benefit arrangements and we do not see any theoretical justification for doing otherwise. We think that the proposals, as they are currently written, will affect too many schemes for whom the current treatment is fair and adequate.

Any change to the accounting treatment of such schemes could have significant cost implications. We also believe that the proposals on benefits with a "higher of" option would have significant cost implications for limited benefit.

Responses to Questions

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 or priority?

We agree with the principle of addressing any urgent issues at this stage in advance of the fundamental review of accounting for pensions. However, we believe that pensions should not be considered in isolation and that treatment must be consistent with other parts of the accounting framework.

One issue that we would like further clarity on is the treatment of the expenses of running the scheme. At present the only mention of these is in paragraph 107 where they are deducted from the expected and actual return on assets. With the current methodology, reconciliations of assets and liabilities can theoretically be incorrect.

An increasingly common practice is to include a reserve in the liabilities for all future expenses. We welcome the recent amendment set out in the Improvements to IFRSs paper to allow this treatment.

Given the short timescale, we do not believe that there are any more urgent issues that could have been discussed.

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?

We agree with the removal of deferral mechanisms and support the Board's reasoning in arriving at the conclusion. This will not be a significant issue for the majority of UK companies who use the SORIE option at present.

We agree that the expected return on assets is a very subjective figure and potentially subject to manipulation. However, we do not believe that the actual return on assets should be recognised in the income statement, see our answer to question 3 for further information.

The proposal to recognise unvested past service costs immediately will not have a significant effect in the UK where benefit improvements generally vest immediately. We can see the merits of arguments in either direction. here.

Question 3(a)
Which approach to the presentation of changes in defined benefit costs provides the most information to users of financial statements? Why?

If change to the current position is to be adopted, we believe that approach 3 is the most appropriate of the three choices.

Approach 1 would produce extremely volatile profit and loss accounts for long-term pension commitments. We agree that presenting all the relevant information in profit and loss combines items with different predictive implications inappropriately.

We believe that an amount representing the net interest cost should be presented in profit and loss and hence reject approach 2. This item reflects the expected change in assets and liabilities over time and its level reflects the funding position in the Scheme.

Under approach 3, the remeasurement gain or loss to be presented in OCI should be that relating to changes in discount rate and expectations of inflation (i.e. the net discount rate) rather than just the discount rate. Expectations of inflation are derived from market data in the same way as for the discount rate, hence separating their effects would be anomalous.

The remaining item that flows through profit and loss will be made up of changes in demographic assumptions such as mortality and experience gains or losses due to items such as salary experience, membership changes etc. These are long lasting changes in the costs of providing the benefits and recognition through profit and loss seems appropriate. However, demographic assumptions are often altered in step changes and there are likely to be some large one-off entries in profit and loss created by changing this assumption and therefore potentially significant volatility in the profit and loss account.

In terms of the choices for interest income in approach 3, we favour the use of the discount rate as this is objective and less open to manipulation. Furthermore, the net interest cost would then represent the interest on the surplus/deficit in the scheme.

Question 3(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*

We do not believe that presenting some of the items in OCI will cause any problems to users of accounts as all the information needed to draw their conclusions will still be available.

(ii) *disaggregation of information about fair value?*

We believe that dis-aggregation of changes in the fair value of assets provides information that enables users to project future performance if they so wish.

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

See answer to 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?*

See question 3 above and our introductory comments.

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?

We do not foresee any practical difficulties in identifying benefits with a 'higher of' option. It is fairly common for UK defined benefit plans to have a defined contribution underpin, though it is often unlikely to bite. Equally defined contribution schemes exist with defined benefit underpins.

At present such promises are valued as the larger of the defined contribution pot and the actuarial value of the defined benefit liability. When these two figures are close, there is clearly theoretical option value in the guarantee. However, applying option value calculations would significantly increase complexity and therefore cost to the entity.

Given that the present value of the defined benefit and defined contribution promises are often significantly different and the option therefore has little value, we do not believe that the additional benefit obtained from determining the option value warrants the expenditure that this would entail. We would therefore prefer to maintain the current calculation.

Question 13(b)
Do you have any other comments on the proposals for benefit promises with a 'higher of' option? If so, what are they?

We have no additional comments.

Question 14
What disclosures should the Board consider as part of that review?

We believe that the current disclosures are adequate for the vast majority of UK pension schemes. We certainly support the disclosure of mortality assumptions, but believe that it is almost impossible to justify not doing so under the materiality requirements of paragraph 120 vi.

For larger schemes that have material impact on the entity, parts of the ASB's Reporting Statement are often adopted and we do not believe there is any need to improve on this. Making some of these suggested disclosures mandatory could create significant costs for some schemes for potentially little benefit.

Disclosures are more informative when entities show the individual return on asset assumptions as opposed to one overall expected rate of return. We would welcome the removal of the option to disclose a single overall expected rate of return.

Question 15
Do you have any other comments on this paper? If so, what are they?

We have no further comments.

Yours faithfully

P. Black

Peter Black FIA
Principal