Submission by the Pensions Section of the German Actuarial Association (IVS)

on the Exposure Draft on IAS 19

Issued by the IASB – May 18, 2004

The Pensions Section of the German Actuarial Association (IVS) thanks the IASB for giving it the opportunity to respond as follows to the Exposure Draft of proposed amendments to IAS 19.

Before turning to each of the questions posed by the IASB, we would like to summarise our comments:

a) Broadly, we agree with the amendments to IAS 19 proposed by the IASB, even if the range of possible treatments is thereby widened significantly and comparability between financial statements thereby compromised.

b) If immediate balance sheet recognition is to be allowed outside of the Income Statement we question whether it is reasonable to introduce as an alternative treatment a methodology that is currently found neither under the current IAS 19 nor under FAS 87. The different methodologies in respect of the treatment of actuarial gains or losses can be summarised as follows:

   - Current IAS 19: immediate balance sheet recognition not permitted without immediate recognition in the Income Statement

   - Current FAS 87: under certain shortfall constraints, immediate balance sheet recognition required without recognition in the Income Statement. (Additional Minimum Liability/Other Comprehensive Income). However, when the liability is extinguished the actuarial gains or losses will have recognised in the Income Statement.

   - New IAS 19: immediate balance sheet recognition permitted without any immediate or deferred recognition in the Income Statement.

c) Concerning the recognition of actuarial gains or losses, we consider the upholding of deferred recognition important and correct both from a theoretical point of view as well as, pragmatically, within the context of convergence with US-GAAP. We do understand that the current methodology of deferring recognition of actuarial gains or losses can be significantly improved. However, we disagree with the "best in class" status given by the IASB to the UK standard, FRS 17, on this issue.

d) We recommend a slight improvement in the disclosure requirements.

<u>Question 1: Initial recognition of actuarial gains or losses</u>

We **agree** with the addition of this option.

It is, however, interesting to provide an answer to a further, more important aspect that the question implicitly raises, namely whether we agree that immediate recognition of actuarial gains or losses is an appropriate methodology for recognising actuarial gains or losses.

We consider deferred recognition more appropriate than immediate recognition, for the following reasons:

- Is **immediate recognition** really better than **deferred recognition**?
  Immediate recognition suggests **a level of accuracy, which is seldom reflected in reality**. One example concerns the level of liabilities: by prescribing a single valuation method (the Projected Unit Credit Method), a level of comparability between arrangements is implied that does not necessarily exist in reality. [For example, the Defined Benefit Obligation in accordance with IAS 19 will not necessarily reflect the appropriate level of accrued liability in all instances: for an arrangement that is closed to entrants vs. one that is open to new entrants, because costs are intentionally deferred into the future by way of a rising service cost under the former and not under the latter]. Another example concerns the use of the market value of assets: by requiring immediate recognition of unexpected movements in the balance sheet, a prosperity or bankruptcy may be implied (with corresponding immediate accretions and reductions to equity) that may be just as misleading as the balance sheet recognition if actuarial gains or losses are deferred.

  In contrast, deferred recognition takes account of the fact that the measurements used for both liabilities and assets are approximate in nature. We understand that the criticism levelled against the current 10% corridor approach are, to some extent, legitimate. In particular, that the choice of the number of 10% may be considered to be arbitrary. One could, for example, abolish the corridor altogether and amortise the actuarial gains or losses over the liability-weighted, remaining duration of the underlying liabilities.

  If the IASB is sympathetic towards this approach we are convinced that the International Actuarial Association (IAA) will be happy to work together with the IASB to agree on a suitable way forward.

- Is the **indefinite deferral** of actuarial gains or losses acceptable to the IASB?
  If actuarial gains or losses are never recognised in the Income Statement, this effectively results in an indefinite deferral of such gains or losses. This seems to be inconsistent with the IASB's criticism of the current practice of deferring recognition in the Income Statement under IAS 19 and FAS 87. We ask whether it is reasonable <u>to introduce</u> a methodology for immediate recognition that is not permissible under US-GAAP (where recycling is required). The different methodologies in respect of the treatment of actuarial gains or losses can be summarised as follows:

- Current IAS 19: immediate balance sheet recognition not permitted without immediate recognition in the Income Statement

- Current FAS 87: under certain shortfall constraints, immediate balance sheet recognition required without recognition in the Income Statement. (Additional Minimum Liability/Other Comprehensive Income). However, when the liability is extinguished the actuarial gains or losses will have recognised in the Income Statement.

- New IAS 19: immediate balance sheet recognition permitted without any immediate or deferred recognition in the Income Statement.

  Apart from the intentions to accommodate preparers in the UK, where FRS 17 will apply from 2005 we cannot see a rational justification for doing so. Also, we see some similarities to IFRS 2 and the treatment of cash-settled share-based payments, where we understand calculation gains or losses are ultimately passed through the Income Statement.

- Treatment of **long and short-term** effects seem incongruent:
  IAS 19 requires actuarial assumptions, with the exception of the discount rate, to be consistent with the best estimate of the long-term. We believe that it is unreasonable that short term deviations from the long-term assumptions be recognised immediately in the balance sheet, while the long-term deviations from the long-term assumptions are never recognised in the Income Statement.

  An Example may clarify the point:

  A plan has salary-related benefits. The long term expected return on assets may be 7%, but short-term expectations for the current year are 0%. Using the 7% assumption will reduce operating expense even though the expectations would require a higher operating expense. In future, the difference may simply be recognised outside of operating expense.

Question 2 – Amount of surplus that can be recognised as an asset

We **agree** with the proposal.

However, as outlined in our response to Question 1, this issue is entirely dependent on what line is taken towards endorsing the balance sheet approach.

Question 3 – Subsequent recognition of actuarial gains or losses

We **agree** with the proposal.

However, as outlined in our response to Question 1, this issue is entirely dependent on what line is taken towards endorsing the balance sheet approach.

Question 4 – Recognition Within Retained Earnings

From an actuarial point of view, we have **no comments** to make here.

Question 5 – Treatment of defined benefit plans for a group in the separate financial statement of the entities in the group

We **agree** with the proposal.

Question 6 – Additional Disclosures

We **broadly agree** with the proposal and welcome the intended convergence towards FAS 132. We do suggest some improvements, though:

a) In paragraph 120, item (e) asks for a reconciliation of plan assets including expected return, item (l) asks separately for actual return. We suggest eliminating item (l), because this can be determined simply from the information provided under item (e).

b) In paragraph 120, item (o) asks for experience development over the current and the preceding four years.

   We suggest that clarification be made for first time preparers, to the effect that the first year for which this experience development is to be shown is the transition year at a minimum. Disclosing numbers for earlier periods is encouraged. This is because the numbers for the three years prior to the transition year may be expensive to obtain in practice.

c) Paragraph 121 has been amended with the addition of the following sentence: ”The description of the plan *(provided in paragraph 120(b))* shall include all the terms of the plan that are used in the determination of the defined benefit obligation.” This can be an onerous and difficult rule to implement for some (large) entities.

   May we suggest a more practical approach of outlining the principle plan provisions only?

Question 7 – Further Disclosures

We **do not believe** that additional disclosures should be required.

Yours faithfully,

The Committee for Employee Benefits of German Actuarial Association (DAV)