EFRAG
European Financial Reporting Advisory Group

23 July, 2004

CL 26

Sir David Tweedie
Chairman IASB
30 Cannon Street
London EC4M 6XH
UK

Dear David,

Re: Exposure Draft of proposed Amendments to IAS 19 *Employee Benefits:* Actuarial Gains and Losses, Group Plans and Disclosures.

On behalf of the European Financial Reporting Advisory Group (EFRAG) I am writing to comment on the Exposure Draft of *proposed Amendments to IAS 19 Employee Benefits: Actuarial Gains and Losses, Group Plans and Disclosures.* This letter is submitted in EFRAG's capacity of contributing to IASB's due process and does not necessarily indicate the conclusions that would be reached in its capacity of advising the European Commission on endorsement of the definitive amendments on the issues.

The Exposure Draft proposes the inclusion of an additional option in IAS 19 allowing entities to recognise actuarial gains and losses as they occur in the balance sheet and in the Statement Of Recognised Income and Expense (hereafter referred to as SORIE), being a statement outside the income statement. After considering all arguments put forward by its constituents, EFRAG supports the objective of the Exposure Draft to allow the recognition of actuarial gains and losses in the balance sheet and in the SORIE.

The improved IAS 1 *Presentation of Financial Statements* introduced the requirement to show on the face of the statement of changes in equity "total income and expense for the period" being the sum of a) profit or loss for the period and b) each item of income and expense for the period that, as required by other standards or by interpretations, is recognised directly in equity. According to the proposed amendments to IAS 19 an entity applying the proposed third option would be required to present, as part of its primary statements, a statement of changes in equity that would be limited to the changes in equity arising from transactions other than with its shareholders. Such a statement has now to be titled a SORIE.

In addition, the Exposure Draft proposes the following amendment to IAS 1: when an entity chooses to present changes in equity arising from transactions with shareholders separately from other transactions (i.e. only applies paragraph 96 and not paragraph 97 of IAS 1) the statement of changes in equity shall be titled SORIE. It should be noted that even if the third IAS 19 option is not used this means that whenever a statement of changes in equity includes only those items specified in paragraph 96 of IAS 1 the statement must be titled SORIE. We strongly believe that the full debate of the larger issue of comprehensive income, which will require its own full due process, should not be pre-empted. The majority of our members believe that this issue is pre-empted by the proposed amendment to split the statement of changes in equity in two parts, one of which deals with transactions other than with shareholders. EFRAG, therefore, does not support this part of the proposal.

As regards the subsequent recognition of actuarial gains and losses, the exposure draft proposes that when such gains and losses are recognised outside profit or loss, they should not be recognised in profit or loss in a later period (i.e. they should not be recycled). EFRAG believes that the issue of recycling should be studied in a comprehensive way and therefore the proposed amendments to IAS 19 should by no means pre-empt the outcome of the IASB's project on comprehensive income in this respect.

The Appendix sets out our answers to the questions raised in the exposure draft.

If you would like further clarification of the points raised in this letter Paul Rutteman or myself would be happy to discuss these further with you.

Yours sincerely,

Stig Enevoldsen
EFRAG, Chairman

Question 1 - Initial recognition of actuarial gains and losses

IAS 19 requires actuarial gains and losses to be recognised in profit or loss, either in the period in which they occur or on a deferred basis. The Exposure Draft proposes that entities should also be allowed to recognise actuarial gains and losses as they occur, outside profit or loss, in a statement of recognized income and expense.

Do you agree with the addition of this option? If not, why not?

Response

The Exposure Draft proposes to include an additional option in IAS 19 allowing entities to recognise actuarial gains and losses as they occur in the balance sheet and in the Statement Of Recognised Income and Expense (hereafter referred to as the SORIE), being a statement outside the income statement.

The improved IAS 1 *Presentation of Financial Statements* introduced the requirement to show on the face of the statement of changes in equity "total income and expense for the period" being the sum of a) profit or loss for the period and b) each item of income and expense for the period that, as required by other standards or by interpretations, is recognised directly in equity. EFRAG does not support that the SORIE is mandatory whenever an entity chooses to apply the proposed option (see paragraph 93B, Appendix F: Amendment to IAS 1 and BC 12). While some EFRAG members favour this requirement, EFRAG as a whole does not support it, nor the consequential amendment to of IAS 1 because it could be seen as pre-empting the outcome of IASB's project on comprehensive income for which we believe a proper due process needs to be adhered to.

We note that the IASB is proposing an additional option in spite of its expressed intention in the Preface not to permit choices in accounting treatment. In this respect, we wish to highlight that the IASB does not necessarily regard the proposed option as an ideal solution, but notes that it would produce transparent information about defined benefit plans.

After considering all arguments put forward by its constituents, EFRAG supports the introduction of the option. In applying the proposed option an entity will recognise in the balance sheet in full the actuarial gains and losses as they occur, with immediate posting to equity. Under the current IAS 19 requirements companies can choose to either recognise actuarial gains and losses immediately in profit or loss or to defer the recognition of part of their actuarial gains and losses. The deferral mechanism is the option most widely used in practice. EFRAG believes that a number of entities would prefer to recognise actuarial gains and losses in the balance sheet rather than immediately recognising them in profit or loss and by that transparency of financial statements would be improved.

A minority of the TEG members, however, remain strongly opposed to the introduction of the proposed option. In their view the introduction of a third option would impair comparability. Moreover, permitting expense to be charged directly to equity and not at any item recognising those costs through profit or loss is in breach with the framework. The framework envisages that costs be recognised in profit or loss and the introduction of this additional option gives entities the choice of recognising actuarial gains and losses outside profit or loss or through profit or loss.

<u>Question 2 - Initial recognition of the effect of the limit on the amount of a surplus that can be recognised as an asset</u>

Paragraph 58(b) of IAS 19 limits the amount of a surplus that can be recognized as an asset to the present value of any economic benefits available to an entity in the form of refunds from the plan or reductions in future contributions to the plan (the asset ceiling). The Exposure Draft proposes that entities that choose to recognise actuarial gains and losses as they occur, outside profit or loss in a statement of recognised income and expense, should also recognise the effect of the asset ceiling outside profit or loss in the same way, i.e. in a statement of recognised income and expense.*

Do you agree with the proposal? If not, why not?

<u>Response</u>

EFRAG believes that these proposals are a logical consequence of the proposal to recognise actuarial gains and losses as they occur in the SORIE.

<u>Question 3 - Subsequent recognition of actuarial gains and losses</u>

The Exposure Draft proposes that, when actuarial gains and losses are recognised outside profit or loss in a statement of recognised income and expense, they should not be recognised in profit or loss in a later period (i.e. they should not be recycled).

Do you agree with this proposal? If not, why not?

<u>Response</u>

EFRAG believes that the issue of recycling should be studied in a comprehensive way. The proposed amendments to IAS 19 could be seen as pre-empting the outcome of the IASB's project on comprehensive income in this respect.

<u>Question 4 - Recognition within retained earnings</u>

The Exposure Draft also proposes that, when actuarial gains and losses are recognised outside profit or loss in a statement of recognised income and expense, they should be recognised immediately in retained earnings, rather than recognised in a separate component of equity and transferred to retained earnings in a later period.

Do you agree with this proposal? If not, why not?

<u>Response</u>

EFRAG believes that these proposals are a logical consequence of the proposal to recognise actuarial gains and losses as they occur in the SORIE without any subsequent recycling in the profit or loss.

Question 5 - Treatment of defined benefit plans for a group in the separate or individual financial statements of the entities in the group

(a) The Exposure Draft proposes an extension of the provisions in IAS 19 relating to multi-employer plans for use in the separate or individual financial statements of entities within a consolidated group that meet specified criteria.

Do you agree with this proposal? If not, why not?

(b) The Exposure Draft sets out the criteria to be used to determine which entities within a consolidated group are entitled to use those provisions.

Do you agree with the criteria? If not, why not?

Response

(a) We found it very difficult to understand from the proposed amendments to paragraph 34 and the new paragraph 34A what the intended change is in the IAS 19 requirements for separate or individual financial statements of entities in a group. Therefore, we recommend the Board to redraft this portion of the amendments.

(b) As regards the criteria to be used to determine which entities within a consolidated group are entitled to use the proposed extension, we challenge the need for the entity to be a wholly-owned subsidiary and believe that the IASB should consider applying a similar approach as in the improved IAS 27 *Consolidated and Separate Financial Statements* (e.g. "the subsidiary is a partially-owned subsidiary of another entity and its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the subsidiary treating the defined benefit plan as a multi-employer plan).

Question 6 - Disclosures

The Exposure Draft proposes additional disclosures that

(a) provide information about trends in the assets and liabilities in the defined benefit plan and the assumptions underlying the components of the defined benefit cost and

(b) bring the disclosures in IAS 19 closer to those required by the US standard SFAS 132 Employers' Disclosures about Pensions and Other Postretirement Benefits.

Do you agree with the additional disclosures? If not, why not?

Response

EFRAG debated the proposed sensitivity analysis about medical cost trend rates. Although EFRAG acknowledges that medical cost trends do vary greatly for the time being and make such a sensitivity analysis relevant, EFRAG believes in more principles based requirements.

EFRAG therefore recommends that reference be made in IAS 19 to paragraph 116 of IAS 1 *Key Sources of Estimation Uncertainty*, with medical cost trend rates given as an example, instead of the specific requirement on medical cost trend rates as currently proposed in paragraph 120 (n).

Question 7 – Further Disclosures

Do you believe that any other disclosures should be required, for example the following disclosures required by SFAS 132? If so, why?

(a) a narrative description of investment policies and strategies;

(b) the benefits expected to be paid in each of the next five fiscal years and in aggregate for the following five fiscal years; and

(c) an explanation of any significant change in plan liabilities or plan assets not otherwise apparent from other disclosures.

SFAS 132 also encourages disclosure of additional asset categories if that information is expected to be useful in understanding the risks associated with each asset category.

Response

No, we do not believe that these disclosures should be required, nor any others beyond those proposed in the exposure draft and discussed above.

Other comments

Based on the proposed editorial amendments, it is our understanding that in the revised IAS 19 “should” and “enterprise” will not be consistently replaced by respectively “shall” and “entity”. Since any inconsistent use of these words can impair the quality of translations of the amended IAS 19 we recommend the Board to make these editorial amendments throughout IAS 19 and to follow a consistent practice in all amended IASs.