Institute of Actuaries of Australia

30 June 2004

Ms Anne McGeachin
Project Manager
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
UNITED KINGDOM

By email: CommentLetters@iasb.org.uk

Dear Ms McGeachin

IASB EXPOSURE DRAFT OF PROPOSED AMENDMENTS TO IAS 19 EMPLOYEE BENEFITS: ACTUARIAL GAINS AND LOSSES, GROUP PLANS AND DISCLOSURES

The Institute of Actuaries of Australia (Institute) is pleased to comment on the Exposure Draft of Proposed Amendments to IAS 19.

The actuarial profession in Australia and globally plays a major role in financial reporting. The members of the Institute have long held roles in the financial management and oversight of defined benefit superannuation funds in Australia, as well as roles in the financial management and reporting of many defined contribution funds and other employee benefits.

The Institute also plays an active role in international dialogue on reporting for superannuation arrangements and its members have experience with the current international standard as well as other countries' specific standards, including for example FAS 87 in the US and SSAP 24 or FRS 17 in the UK.

The Actuarial profession in Australia is already playing a significant role in the implementation of IAS 19 and will continue to work towards the smooth implementation of the new accounting requirements introduced with the adoption of IAS 19 in Australia.

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The Institute supports the general proposition of Australia adopting common, high quality, international accounting standards.

The Attachment to this letter sets out our responses to the specific questions raised by the IASB.

We would be pleased to discuss any of the matters raised in our submission or any other relevant issues. In the first instance, please contact Catherine Beall, Chief Executive via email (catherine.beall@actuaries.asn.au) or telephone (+ 61 2) 9239 6106.

Yours sincerely

Graham Rogers
President

ATTACHMENT - RESPONSES TO THE IASB QUESTIONS

Question 1 - Initial recognition of actuarial gains and losses

In general we believe that having fewer (or no) options in an accounting standard is preferable (to enable easier comparisons and less open to manipulation). This is especially so where there is no underlying need for options (for example options set up to cope with slightly differing circumstances may be reasonable).

The proposed amendments to IAS 19 will allow three very fundamentally different alternatives:

- Delayed recognition of gains and losses through the use of a corridor and amortisation;
- Immediate recognition of gains and losses outside of the income statement; and
- Immediate recognition of gains and losses in the income statement.

While disclosure will allow an experienced investor adequate information to assess the impact of providing the defined benefits on the sponsoring employer it cannot be desirable to have multiple fundamentally different approaches under the one standard.

We recognise that the proposed option will provide consistency between IAS 19 and the approach required under the UK standard FRS 17. However it has a number of shortcomings:

- The option of full recognition to retained earnings may allow profit manipulation (e.g. use aggressive or optimistic assumptions – in particular estimated return on assets - to reduce disclosed costs / improve profits). However, the other two alternatives, listed above, also provide opportunity for profit manipulation.
- The true cost of providing the benefits is never passed through the income statement of a company, most other items that go directly to equity eventually go though profit and loss.
- Question 3 mentions subsequent recognition of actuarial gains and losses. We would be in favour of subsequent recognition of gains and losses (as long as a consistent method is used – eg amortisation over a period of years – similar to FAS87 but without the 10% corridor). We discuss this further in our response to Question 3.

We encourage the IASB to continue with its project to develop a single approach to accounting for defined benefit arrangements as a matter of urgency.

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

We agree with the proposal.

Question 3 - Subsequent recognition of actuarial gains and losses

We disagree.

We believe that the costs should, at least eventually, go through the income statement, as long as a consistent method is used (eg amortisation over a period of years) similar to FAS87 but without the 10% corridor.

We do not believe that this is "recycling" since these actuarial gains and losses never went through the income statement. This means that the full market impact of actuarial gains and losses is immediately reflected in the balance sheet, but may be more slowly reflected in profit and loss (which may be reasonable since the gains and losses are not realised and reflect estimates of the future). This also means that all profits and losses are (eventually) reflected in the income statement of the company.

Question 4 - Recognition within retained earnings

It may be necessary to establish a separate component of equity for actuarial gains and losses if they are to be eventually recognised in the income statement.

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

We agree with this proposal.

Question 6 - Disclosures

We are generally supportive of the additional disclosures proposed, however we provide the following comments:

Paragraph 120(e) requires disclosure of the reconciliation of the value of fund assets from the beginning to the end of the year, including the expected return on assets and actuarial gains or losses. We suggest that it would be simpler, and of more benefit to users of the accounts, to disclose the actual return on assets instead, which is consistent with the disclosures required by the US accounting standard FAS 132.

Paragraph 120(o) requires disclosure of the defined benefit obligation, assets, the surplus or deficit in the plan and experience adjustments to the plan liabilities and assets for the current period and the four previous periods. We question whether this level of detail is necessary. Company accounts would normally only include comparative figures for one or two prior years in the income statement and balance sheet. If a user of the accounts wanted to obtain this information for additional prior years, they would be able to find it in previous years' financial statements.

If the requirement to show figures for four years is retained, we recommend that transitional provisions be implemented for companies that have been accounting under IAS 19 for less than four years. It would seem unreasonable to provide this information in respect of periods prior to the adoption of IAS 19.

Paragraph 120(p) requires an estimate of the expected contributions for the next fiscal year to be disclosed. We do not believe that the term "as soon as it can reasonably be determined" is necessary. If an estimate of the next year's contributions can only be "reasonably determined" after the company's accounts have been prepared, this is too late for inclusion in the accounts. The estimate needs to be made before the accounts are authorised for issue, regardless of whether it has been "reasonably determined" or not.

The amendment to paragraph 121 extends the requirement to disclose a description of the plan to include all terms used to determine the defined benefit obligation. A strict interpretation of this suggests that a company will need to disclose how each type of benefit is calculated. If this is the intention, this requirement will add a significant amount of detail to the notes, particularly for large funds with multiple categories of membership. We do not believe that additional details describing how each benefit is calculated will be of value to the users of the accounts.

Question 7 – Further disclosures

We suggest that companies be required to disclose details of funding arrangements. The liabilities reported under IAS 19 will not necessarily reflect the basis upon which the contribution rates have been set (i.e. the funding basis).

We believe that it is appropriate to provide certain information about the funding basis, for example, the current contribution recommendations and the economic assumptions, funding method used to make contribution recommendations and the extent of any legal as opposed to constructive obligation. This will allow users to consider the cash flow impact of pension funds.

We acknowledge the additional requirement proposed in paragraph 120(p). However the requirement of the new paragraph 120 (p) provides information for only 1 year at best.

This disclosure could also include details of the nature of any asset or liability recognised in the balance sheet, including any legal liability to make up a deficit or the ways in which the employer may benefit from any surplus.

In AASB 119, the Australian version of IAS 19, paragraphs Aus 121.1 and Aus 121.2 require Australian companies to disclose this information in their accounts.