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UNITED KINGDOM

CL 25

Basel, 23 July 2004
PROPOSED AMENDMENTS TO IAS 19, EMPLOYEE BENEFITS

Dear Ms. McGeachin

We welcome the opportunity to offer our comments on the above draft.

Our main conclusions after carefully considering the proposals are as follows:

- The proposal for a third option for the treatment of actuarial gains and losses has considerable disadvantages in our opinion. It would also pre-empt proper debate of comprehensive income and recycling. On balance it is therefore inappropriate.
- The proposal on multi-employer plans in individual affiliates appears sensible and acceptable subject to certain refinements detailed below.
- The proposal for additional disclosures is only partly acceptable. Although driven by convergence, it substantially exceeds what is necessary to achieve this. The Board should critically re-examine the list of additions and require rigorous practical justification for items which go beyond current US GAAP requirements.

These conclusions are explained in more detail in the answers below.

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 recognised income and expense.

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

We strongly disagree.

Many will see an advantage in bringing into the balance sheet values which are at present included only „statistically“ in the notes. We have doubts on whether these values are appropriate to bring into the balance sheet. For instance, on the defined benefit obligation element, we need to make a best estimate of the economic resources which will probably flow

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out of the entity. Short-term fluctuations in expected rates of return on assets or in interest rates may here be misleading because of the extremely long-term nature of the assets and liabilities. The corridor approach, even if approximative, tries to solve this valuation issue, avoiding less relevant erratic variations from period to period whilst retaining current measurements as reference points for valuation. A balance-sheet amount calculated on a single-point-in-time basis does not adequately reflect the long-term aspect. The valuation question is, however, one which needs thorough debate before any material changes are made, and this debate – involving also the FASB – should not be pre-empted by a hasty and unnecessary amendment.

However, our objections go substantially further than this valuation doubt.

- In all other areas the IASB has rightly pushed for the elimination of alternative accounting treatments, except where they are needed to reflect real differences in economic circumstances. Creating a third option would clearly be inconsistent with this approach and substantially reduce comparability between entities.
- The IASB admits that the option is not ideal. To insist on adopting such an option would harm the claims of IFRS to be „high-quality" standards.
- With IFRS 2 the IASB's main argument was to ensure that the costs of services received were properly reflected in the income and other financial statements. An approach which, by prohibiting recycling, ensures that certain costs and revenues are never reflected in income clearly contradicts this concept. While some may argue that the balance sheet would become more „relevant" (which we disputed above), it is clear that the statement of performance would become less so.
- The debates with the IASB's active constituents on comprehensive income, performance and recycling have not yet properly begun. The treatment of defined-benefit employee benefit plans will be central to those debates. It would be more appropriate to devote attention to moving forward on those broader conceptual matters rather than apparently pre-empting them with such an ill-judged amendment for which there is no urgent or clearly justified need. Similarly, any amendment of IAS 1 should also await the outcome of these debates.
- Many constituents stress the importance of convergence of IFRS with US GAAP. The proposal would move in the opposite direction, at least in respect of current rules.

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

Paragraph 58(b) of IAS 19 limits the amount of a surplus that can be recognised 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?

We do not agree since we are not in favour of the third option. Even if the third option were adopted, we have some doubts about whether the suggestion might leave amounts recognised as assets in the balance sheet which exceed the values recognisable as assets according to the „Framework" (in excess of the probable flow of economic benefits to the entity). We favour leaving paragraph 58(b) unchanged.

Question 3 - Subsequent recognition of actuarial gains and losses

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?

We strongly disagree. Apart from our fundamental objections to the third option, which is the basis for this suggestion, we believe that recycling in general is vital to having a meaningful picture of an entity's profit generation over time, with all costs and revenues considered.

Question 4 - Recognition within retained earnings

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?

We disagree. See our answers to questions 1-3.

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?

a) We understand the proposed amendments to mean that a subsidiary which is a participant in a multi-employer plan where the other participants are members of the same group may still treat the plan as a multi-employer plan if certain other criteria are met. If this understanding is correct, we agree with the proposal.

b) The proposed treatment should not be restricted to wholly-owned subsidiaries. The IAS 27 (revised) approach should be applied to ensure that treatment is consistent between subsidiaries: the criterion could be "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?

While we can support the additional disclosures needed for convergence, we believe that the IASB should rigorously and critically re-examine those proposals that go beyond that for proper justification of need, so that the substantial extra data collection costs imposed especially on large multinational groups are kept to a minimum.

The following specific points are submitted for the Board's consideration in this respect:

- *Para 120 (i), percentage and the expected return of each asset category:* This requirement would cause undue cost and effort for groups having several dozens of pension plans. We consider that the asset allocation provides better information for the users.
- *Para 120 (k), narrative description of the basis used to determine the overall expected return rate:* We disagree with this requirement, which is the consequence of the introduction of the proposed option, which we reject. If the option to take actuarial gains and losses to equity without recycling were permitted, we would agree with the disclosure if limited only to the enterprises having chosen to apply the option.
- *Para 120 (n), simulation of medical benefit plans:* Reference should 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.
- *Para 120 (o), five years' data:* Users can obtain the history from the financial statements of the previous years, so this is not necessary.
- *Para 120 (p), estimate of contributions to be paid during the next year:* We disagree with this requirement as reliable information is often not available at the balance sheet date.

Finally, we would ask the Board to consider whether they want to give guidance in principle on how to present disclosures in situations where an entity has dozens of plans. We assume that aggregation is permitted for values, for instance, but what is intended for (e.g.) expected rates of return and descriptions in such circumstances is unclear. We believe that this should be left to the entity's judgment based on its circumstances.

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.

No, we do not believe that these disclosures should be required, though we have would no objection to a FAS 132-type recommendation.

Further comment

Another aspect of current pension accounting which is sometimes questioned is that employers with funded defined benefit plans can record a pension “income” in times of significant funded surplus. The ED does not address this point. The amounts of such income reported may be significant where actuarial gains and losses are immediately recognised as they occur. This would be mitigated, but not removed, by recognising gains and losses outside the P&L because the effects on the amounts in the balance sheet would remain. In our view, this point deserves some consideration, and the IASB should address under what circumstances the release of a previously recorded pension provision is appropriate, as part of a comprehensive review of pension accounting.

Yours sincerely,

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Erwin Schneider

Alan Dangerfield