CIPFA

CIPFA RESPONSE TO PROPOSED AMENDMENTS TO IAS 19 EMPLOYEE BENEFITS APRIL 2004

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AT THE HEART OF PUBLIC SERVICES

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THE CIPFA RESPONSE TO PROPOSED AMENDMENTS TO IAS 19 EMPLOYEE BENEFITS APRIL 2004

1 INTRODUCTION

CIPFA welcomes the opportunity to respond to the Accounting Standard Board's Discussion Paper. CIPFA's response has been produced by its Accounting and Auditing Standards Panel.

2 GENERAL COMMENTS

CIPFA considers that the IASB proposals represent a significant improvement on the accounting treatment currently required by IAS 19 for actuarial gains and losses arising on defined benefit pension schemes. If implemented, these proposals will bring IAS 19 closer to the UK standard FRS 17, which in our view and that of many other is a superior standard to IAS 19 in its original form. We still have some concerns about the proposals for multi-employer defined benefit schemes and additional disclosures; these we set out below in answer to the specific questions 5, 6, and 7 in the preface to the discussion paper.

3 ISSUES ON WHICH COMMENTS WERE INVITED

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 expenses.

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

Whilst in principle we have some reservations about creating further alternative accounting treatments, in this case CIPFA agrees with the proposal to create this option. It is in effect the required treatment for UK entities under FRS 17.

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

The Exposure Draft proposes that entities that choose to recognise actuarial gains and losses as they occur, outside profit or loss in a statement to recognise income and expense, should also recognise the effect of the asset ceiling outside profit or loss in the same way, ie in a statement of recognised income and expense.

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

We agree with the proposal. Whatever one's views on the asset ceiling itself, it makes sense to treat it in the same way as the recognition of actuarial gains and losses to which it relates.

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 (ie they should not be recycled).

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

We agree with the Board that there is no rational basis on which actuarial gains and losses could be recycled. Furthermore, we are strongly of the opinion that recycling is unsound in principle and we therefore support the proposal that actuarial gains and losses first recognised outside the profit or loss should not subsequently be recycled through profit or loss.

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 later periods.

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

We agree with this proposal for the reasons given in answer to the previous question.

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 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 needs to specify 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 the consolidated group are entitled to use those provisions.

Do you agree with these criteria? If not why not?

We note that there is a degree of confusion over the interpretation of the provisions in IAS 19 for multi-employer schemes. We therefore welcome the publication by IFRIC of a draft interpretation on this issue. (But please refer to our additional comments below.). We assume that the interpretation when finalised will be taken into account when amending IAS 19. CIPFA agrees that the provisions relating to multi-employer plans should be extended to the financial statements of entities within a consolidated group, in these cases requiring the use of defined contribution accounting where there is no consistent and reliable basis for allocating the assets and liabilities of the pension plan. We would like to see the basis for this exception expanded to include the common case where an individual subsidiary's exposure to pension liabilities in respect of staff employed on a group basis cannot have any real meaning, even though it would be perfectly possible to make an allocation on some pre-determined –and therefore arguably reliable- basis. We would also add that, if the arguments for the use of defined contribution treatment in a multi-employer scheme are sound, we cannot see the rationale for excluding entities which have debt or equity instruments traded on a public exchange. There is no reason to suppose that it is any easier for such entities to identify their share of these schemes' underlying assets and liabilities.

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 Post Retirement Benefits.

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

CIPFA agrees that the proposed reconciliation showing the movement of plan assets and the defined benefit obligation is an improvement upon the current reconciliation requirement which does not include amounts where recognition has been deferred. We also agree that more information about the classes of assets held by plans and the expected rate of return for each class should be given, as this information is important to enable users to assess risk sensibly. However we do not believe that the proposed information regarding the sensitivity of plans to changes in medical costs trends and the proposed disclosure of five year history of plan assets liabilities and surpluses and deficits are sufficiently useful to justify the additional burden on accounts preparers.

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.

We consider that the additional narrative disclosures currently required by SFAS 132, in particular the disclosure of additional asset categories if it affects understanding of the risks, would be useful but as part of an Operating and Financial Review (management discussion and analysis) rather than in notes to the financial statements. These disclosures would be more useful for larger more complex schemes and those with frequent changes in the mix of scheme assets and liabilities and it is our view that they should not be mandatory in respect of all schemes.

Additional Comments

We have read and considered carefully the draft Interpretation D6 Multi-employer plans published by IFRIC in May. Although the draft Interpretation is not mentioned in the proposed amendment to IAS 19 issued by IASB, it includes proposed amendments of its own relating to the definition and treatment of multi-employer plans and state plans which could have a major impact on public sector schemes if adopted as part of a revised IAS 19. We have specific concerns about three issues.

1. With schemes under common control there will frequently not be a reliable basis for allocating assets to each participating entity and disclosing them by class. For example, entities may have different demographic profiles and a different mix of active employees, pensioners and deferred pensioners. Disclosure of the asset classes for the total scheme and a statement that they are pooled is probably the most useful information that can be given. This is an issue which affects relatively few public sector schemes in the UK as most are unfunded, but some of the funded ones are very large.

2. IFRIC proposes to narrow the definition of state plans (IAS 19 existing paragraph 37) to exclude plans operated by independent agencies rather than by government itself. No reason for this change is given in the Basis for Conclusions section. We do not accept that the use of an independent agency to administer what would otherwise qualify as a state plan should alter the accounting treatment and would prefer to keep the existing text.
   A more serious problem with paragraph 37 is the reference to *additional voluntary benefits,* the existence of which removes the scheme from the state category and into the multi-employer category, thereby requiring defined benefit accounting unless sufficient information is not available. A strict interpretation is that this would apply to all Additional Voluntary Contributions (AVCs) (which are required by law to be offered by most public sector schemes in the UK). Such an approach seems hard to justify, particularly in the case of free-standing AVCs which are completely independent of the main scheme and adminstered by a separate financial institution. In our view, the nature and the scale of the additional benefits purchased and particularly the risks (if any) borne by the scheme in providing them need to be considered before deciding whether a scheme qualifies as a state plan. In brief, there needs to be far greater clarity in the definition of a state plan.

3. Finally, paragraph 19 of D6 states unequivocally that state plans are to be treated as defined contribution plans; this is amplified in proposed paragraph 38 (amended) of IAS 19 which explains that;
   a) most state plans are defined contribution and
   b) that any that are defined benefit are unlikely to obtain the necessary information for defined benefit accounting.

   From a UK perspective both statements are questionable . It may well be possible to obtain the information: the point is whether the resulting numbers have any meaning in the context of the plan's obligations and exposure to risk. If they do , then in our view a defined benefit state plan should use defined benefit accounting- and not merely make additional disclosures.