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30 July 2004

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

Dear Ms McGeachin

Exposure Draft of Proposed Amendments to IAS 19, Employee Benefits: Actuarial Gains and Losses, Group Plans and Disclosures

We welcome the opportunity to respond to the above exposure draft. Our overall comments on the exposure draft are set out in the main body of this letter, whilst our responses to the specific questions are set out in the attached appendix.

Unfortunately, we are not able to support the exposure draft in its current form. Our concerns can be grouped under the following three headings, each of which is discussed further below:

- Blurring of the distinction between standard setting and the work of IFRIC;
- Recognition of actuarial variances in equity; and
- Group plans.

Blurring of the distinction between standard setting and the work of IFRIC

As we noted in our response to IFRIC draft interpretation D6, we struggle to understand why the Board considers it acceptable to introduce changes to accounting for employee benefits by way of:

- a fully exposed amendment to IAS 19 (with a proposed implementation date for periods beginning on or after 1 January 2006);
- two IFRIC interpretations, one dealing with overlapping issues (each with a proposed implementation date earlier that January 2006) and which both, in our view, go further than just 'interpreting' the text of IAS 19; and
- an appendix to one IFRIC interpretation, which proposes direct amendments to the standard itself that are not subject to the full due process normally applied to amending a standard (with a proposed implementation date for periods beginning on or after 1 January 2005).

We are concerned that this approach could be detrimental to the Board's commitment to due process.

In our view, it would be much more logical and helpful for all of the proposals in IFRIC drafts D6 and D9 to be incorporated into a revised version of the Exposure Draft of Proposed Amendments to IAS 19 – Actuarial Gains and Losses, Group Plans and Disclosures so that all issues can be looked at as a package and be subject to a reasonable time frame for public comment. The profile given to the issues, the comment period and effective date should all reflect that, taken together, the above represents a major change to the requirements of the standard. Whilst we appreciate the fact that the Board is seeking to effect some changes prior to 2005, we believe that this may lead to more rather than less confusion.

Recognition of actuarial variances in equity

We understand, without necessarily agreeing with, the Board's desire (indeed, its tentative conclusion in open meeting) to abolish the deferred recognition of actuarial gains and losses. Also, whilst again not necessarily agreeing with them, we accept that the recent changes in other areas of IFRS (notably financial instruments and share based-payments) which require accounting based on sometimes highly subjective estimates of 'fair value' make the arguments for not recognising actuarial gains and losses much less convincing. The proposals in the exposure draft appear to us as an attempt to bring in full balance sheet recognition in a piecemeal fashion and by pre-empting a full debate on the subject.

We cannot support the introduction of a model for the full recognition of actuarial variances in equity which is optional and also allows gains and losses to bypass permanently the income statement. In our view, the Basis for Conclusions in the ED does not present a compelling case for the proposals. The discussion mainly presents a case for full balance sheet recognition and only obliquely discusses, in BC 10, the treatment actually being proposed, saying 'The Board does not believe that immediate recognition of actuarial gains and losses outside profit or loss is necessarily ideal. However, it provides more transparent information than deferred recognition.' We do not agree that including items already disclosed in the notes in great detail directly in the balance sheet whilst not reflecting changes to them in income is more transparent.

The impetus for the ED seems to be the UK experience with FRS 17, which finally comes into mandatory force in 2005. UK GAAP has long had a mandatory statement of comprehensive income (the statement of total recognised gains and losses or STRGL) one component of which is profit or loss. In this context, requiring some elements of pension cost to be reported in one part of the statement and others in another *without recycling between them* has some logic (even though the reasons for the split may be debatable). This is not the case for IFRS which requires all items to be reported ultimately in profit or loss. Aside of this, in our experience the STRGL is rarely (notwithstanding the UK Accounting Standards Board's initial hope) viewed as a meaningful primary statement by users of UK accounts. It is perhaps for this reason that voluntary early adoption of FRS 17 has not been particularly popular. For these reasons we do not consider that recent UK developments should form the basis for a change to IAS 19. Finally, comparability is only eroded, not enhanced, by allowing further choices in the standard.

In light of the above, in our view these proposals should be deferred and considered as part of a comprehensive review of accounting for employee benefits.

Group plans

We accept that the current IAS 19 is somewhat confused in the area of multi-employer group schemes and would welcome additional clarity. In particular, paragraphs 29 and 30 (bold paragraphs) acknowledge only two scenarios:

- sufficient information is available – in which case defined benefit accounting is required; and
- sufficient information is not available – in which case defined contribution accounting is required.

Paragraph 32 (a non-bold paragraph) then essentially overrides this by envisaging a scenario where even though all the information about the plan may be available it is still not possible to apply reliably defined benefit accounting. The current text of IAS 19 allows defined contribution accounting in this scenario, but only for some entities. Should the entity concerned be a subsidiary within a group plan, defined contribution accounting is *not* allowed. In other words, the impossible (or, more precisely, something the entity is not able to do reliably) becomes mandatory depending upon the ownership of the reporting entity and the other employers in the plan. The proposals in the ED go some way to removing this paradox, but do not remove it completely.

In our view, more clarity is required in the standard on when it is and is not possible to apply defined benefit accounting. In particular, the Board should make clear whether it believes that:

- (given full access to information) an acceptable allocation is always possible; or
- there are situations where an entity can have exposed itself to obligations which simply defy quantification with a level of precision acceptable for financial reporting purposes.

Whichever it is, we think the same should hold true irrespective of who happens to own the company concerned, whether all employers in the plan are under common control or whether the employer happens to have listed financial instruments. Our concerns over the proposals can be illustrated with a simple example. Consider a subsidiary which, meeting the criteria in paragraph 34, need not use defined benefit accounting because it determines that the result is not 'reliable'. Should that subsidiary have to issue a bond that is traded on a market it would fall under paragraph 34 and as a result be forced to use defined benefit accounting even though the amounts are only 'reasonable' but still not 'reliable'. This seems to us at best a recipe for confusion, and at worst an invitation to manipulation. In the absence of any specific transitional relief, the subsidiary would be required to apply this requirement retrospectively, which further complicates matters.

In our view, at the very least, the conditions in the proposed new paragraph 34 should be removed. That would mean that the same principles are applied to all entities. We would then suggest that the Board re-examines the question as to whether 'reasonable' but not 'reliable' accounting is acceptable to it and to the wider IFRS community.

Should you wish to discuss this letter with us, please contact David Lindsell on 020 7980 0106.

Yours faithfully

Ernst & Young

Ernst & Young Global comments on Exposure Draft of Proposed Amendments to IAS 19

Appendix: Responses to specific questions:

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?

No, for the reasons discussed in the body of the letter.

Should the proposal nonetheless proceed, we suggest that:

- the drafting is improved to make explicit whether the optional treatment, if selected, must be applied to all plans or only to all plans for which full recognition is applied (with other plans still using the corridor); and
- paragraphs 62, 93A and 93B are revisited. As drafted, the proposals could require a different approach to measuring some assets (like inventories or plant) depending on whether actuarial variances were recognised within or outside profit and loss. In our view, it should be made explicit whether the 'appropriate proportion' of amounts otherwise recognised in a statement of recognised income and expense should (like the appropriate proportion of items otherwise recognised in income) be included in amounts comprising the cost of an asset.

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 limit also includes unrecognised actuarial gains and losses and past service costs.] 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, ie in a statement of recognised income and expense.

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

No, for the reasons discussed in the main body of our letter.

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?

Not applicable, given our opinion on questions 1 and 2.

In terms of the Board's thought processes, though, we have an observation in response to paragraph BC 13. That paragraph includes the statement 'Furthermore, it is difficult to see a rational basis on which actuarial gains and losses could be recycled.' In our view, one such rational basis would be what is currently required by the standard (ie a minimum level of recognition in accordance with the corridor mechanism, with further recognition allowed within constraints of consistency). If the current spreading mechanisms are acceptable for determining *both* the charge to income and the balance sheet figure, it seems equally rational to us for them to be acceptable to determine just the former, with any differences only temporarily 'parked' in equity.

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?

Not applicable, in light of our response to the earlier questions.

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?

No, for the reasons set out in the body of our letter.

(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?

No, for the reasons set out in the body of our letter.

We note, though, that paragraph BC23 states that the board decided those provisions should be available to entities that meet criteria *similar* to those in IAS 27. Should the proposal proceed, we would suggest the criteria are *the same*. In particular regarding non-wholly owned subsidiaries.

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?

Yes.

As a drafting point, in our view the wording of paragraph 120(p) needs improving. As the governments of different jurisdictions have different arrangements for taxation, the term 'fiscal year' is inappropriate. We would suggest a reference to 'reporting period' as used in IAS 1, perhaps clarifying that this means full period not interim.

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.