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Anne McGeachin
Project Manager
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Ms McGeachin,

Re: Request for Comment on IASB ED Proposed Amendments to IAS 19 Employee Benefits: Actuarial Gains and Losses, Group Plans and Disclosures

I have prepared the following comments (see attached) in response to the International Accounting Standards Board's request for comments on specific matters detailed in the above exposure draft.

Please note that these comments are made within the context of my PhD research on accounting for defined benefit funds (DBF) by sponsoring employers in Australia.

Should you require further clarification concerning my comments please do not hesitate to contact me.

Yours faithfully,

Isabel Gordon

Amendments to IAS 19, Employee Benefits: Actuarial Gains and Losses, Group Plans and Disclosures

Question 1 – Initial recognition of actuarial gains and losses

IAS 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?

The treatment of actuarial gains / losses influences the size of the pension cost and the net pension position in the sponsoring employer's books. Australian standard-setters have, so far, resisted the recognition of actuarial gains and losses (AGL) other than immediately in the profit and loss to safeguard the comparability of the sponsors' financial statements. IAS 19 Employee Benefits permits either immediate or deferred recognition of AGL in the income statement. IASB ED Proposed Amendments to IAS 19 Employee Benefits: Actuarial Gains and Losses, Group Plans and Disclosures is proposing a third option in the statement of recognized income and expense (SRIE). This is similar to FRS 17 in the UK that permits AGL to be recognized in the statement of total recognized gains and losses.[1]

The central issues become:

1. what is the nature of AGL? Are AGL items of revenue and expense (and included in the income performance statement in the normal way) or are AGL the result of remeasurement of events?

2. what are the principles to follow to inform practice when an item should be recognized in the profit and loss or retained earnings?

3. Given that preparers of financial statements are sensitive to practical considerations and that preparer input is sought in the standard-setting process, what are the guiding rules to balance competing interests?

<u>1. Nature of AGL</u>

AGL represent that part of the pension expense attributable to the actuary's estimates. Actuaries use assumptions for the discount rate to calculate the present value of accrued benefits, the expected rate of return on plan assets and mortality tables to value DBF. The

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[1] FRS 17 uses two performance statements - the profit and loss account that shows the reasonably stable service and interest cost reduced by the expected return on assets; and the second performance statement, the statement of total recognised gains and losses (STRGL), that absorbs changes in market values immediately and offsets retained earnings.

quantum of AGL is linked to the difference between the actuary's assumptions and estimates and the actual market movements, and any changes in actuarial assumptions. If the actuary is well calibrated, AGL will be minimal, but in practice this is not always the case.

The Australian Accounting Standards Board considers that AGL meet the definition of income and expense according to the IASB Framework for the Preparation and Presentation of Financial Statements and should accordingly be recognized in the income statement (see AASB preface to IASB ED Proposed Amendments to IAS 19 Employee Benefits: Actuarial Gains and Losses, Group Plans and Disclosures, p.v). The alternative view is that AGL do not constitute enhancements or losses of future economic benefits (FEB) but arise from the changes in the value of assets and liabilities from external market sources. Under this view, AGL do not represent performance measures for management but result from the remeasurement of fund assets and liabilities. However, applications of this approach depend upon the measurement method used and link the accounting treatment in the income statement to the valuation model used. For example, under an exit price model, enhancements / losses of FEB are recognized as the market price changes and not when the asset is sold (as under an historical cost measurement model).

2. Recognition in the profit and loss or retained earnings

When sponsor companies recognize the net pension position on the balance sheet, the implicit assumption is that the fund is connected in substance to the employer. The pension expense reflects the change in the net pension position recognized in the balance sheet for that accounting period. Any changes to the way the components of the pension expense (that is, service cost, interest cost, AGL and return on plan assets) are recognized interrupts the articulation of the balance sheet and the profit and loss. These "interruptions" can comprise delayed recognition in the profit and loss and / or recognition outside the profit and loss (for example, in SRIE). If AGL are regarded as expense and revenue items under the valuation system used, the internally consistent approach is the immediate recognition of AGL in the profit and loss for that period. Deferring AGL to later periods or offering options to recognize AGL in retained earnings does not address the problem. It is inconsistent to recognize the net pension position on the balance sheet (assuming that the definitions of an asset and liability are met) but at the same time claim that AGL result from events outside the control of management.

3. Guiding rules to balance competing interests

Practical considerations of recognizing AGL in the income statement centre on the unnecessary volatility introduced into the profit and loss as a result of external and transitory movements in market prices. This impact increases as the proportion of DBF assets invested in equities increases. The preparer's perspective is twofold: first, effective communication to the market about the nature of AGL and the potential impact of this on the share price; and second, the overall impact of accounting for DBF, especially the volatility from AGL, on dividend policy. If the mainstream business operations are unchanged, the preparer's focus shifts from measurement considerations to allocation considerations and possible compromises. An informed market will realize that the volatility is sourced to an accounting adjustment.

Recommendation

On balance, it seems logical to recognize AGL immediately in the income statement under the exit price model (and most DBF use the exit price model). The justification of direct-to-equity adjustments in this case begs the question of why DBF mark to market in the first place. I do not support the addition of another option (to recognize AGL in SRIE) to deal with AGL.

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 recognize 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?

I do not agree with this proposal for the reasons outlined above.

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 recognized in profit or loss in a later period (ie they should not be recycled).

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

I agree that AGL should not be recycled for the reasons outlined above.

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 recognized immediately in retained earnings, rather than in a separate component of equity and transferred to retained earnings in a later period.

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

Not applicable for the reasons outlined above.

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 provision in IAS 19 relating to multiemployer 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 use 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 comment.

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?

No comment.

Question 7 – Further disclosures
Do you believe any other disclosures should be required, for example the following disclosures re quired 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

No comment.