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

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CANADIAN ACCOUNTING STANDARDS BOARD STAFF COMMENTS

The following comments represent the views of members of the staff of the Canadian Accounting Standards Board (AcSB) on the IASB Exposure Draft of Proposed Amendments to IAS 19, Employee Benefits — Actuarial Gains and Losses, Group Plans and Disclosures.

ANSWER TO QUESTIONS IN INVITATION TO COMMENT

Question 1 – Initial recognition of actuarial gains and losses

We do not support the introduction of the additional recognition option for actuarial gains and losses in post-employment defined benefit plans at this time.

We commend the IASB for trying to respond to a concern for improved transparency in accounting for employee benefits. From a process point of view, we believe that the IASB has been too quick to try to accommodate an approach used by the UK standard FRS 17, *Retirement Benefits*, without sufficient regard to due process. We view the proposed additional recognition option for actuarial gains and losses in post-employment defined benefit plans as a fundamental change. The additional recognition option does not increase the transparency of the balance sheet and clouds the transparency of the income statement by leaving out actuarial gains and losses (and the effect of the limit in paragraph 58(b)). The additional recognition option may be the right approach down the road, but more research and consultation needs to be undertaken before such a conclusion can be made.

The proposals impose a particular display, if an entity chooses to adopt the new alternative — the statement of recognised income and expense — that is a significant step with broader implications. We are concerned that this imposition has broader implications than for pension accounting. For example, the proposed amendment to IAS 1, *Presentation of Financial Statements*, which contains the sentence “A statement of changes in equity that comprises only these items shall be titled a statement of recognised income and expense”, applies to all circumstances, rather than only when actuarial gains and losses are involved.

We believe that standard-setting resources should be focused on a major project on employee benefits to critically re-think all measurement/recognition aspects, especially given that the IASB generally tries to remove alternatives rather than add more. The flexibility to choose a third option for the treatment of actuarial gains and losses reduces further the comparability of financial statements among entities. The two current recognition options already undermine such comparability, but we understand that most Canadian entities choose to defer the recognition of actuarial gains and losses by utilizing the corridor method. We believe that a third option will only add to the complexity and confusion already inherent in accounting for post-employment benefit plans.

We note that such a third option would create the potential for a voluntary IAS-Canadian GAAP difference in an area that is currently harmonized.

We also note that, during the AcSB's recently completed disclosures enhancement project, the AcSB initially considered whether the project should be expanded to include any changes to the measurement and/or recognition aspects of EMPLOYEE FUTURE BENEFITS, Section 3461 of the *CICA Handbook – Accounting*[1]. The AcSB decided not to address measurement and/or recognition aspects on a piecemeal basis as it was felt that there was insufficient benefit from ad hoc modifications to the existing model. Furthermore, such ad hoc modifications might hinder, rather than assist, a longer-term fundamental re-evaluation of the employee benefits model, which is required but must be done as a global convergence project. The AcSB's limited-scope disclosures project remained focused on improving the understanding of employee benefits through expanded disclosure. In so doing, the AcSB concluded that the users' understanding of the cost of post-employment benefits would be improved if the effects of smoothing were more clearly visible. Accordingly, the AcSB added disclosure of the components of cost recognized showing separately the effects of smoothing (see paragraph 3461.154(c)).

However, the AcSB also invited views from its constituents through its exposure draft process on whether they would favour a separate project to fundamentally re-evaluate the measurement and/or recognition aspects of accounting for post-employment benefits as a matter of high priority to be undertaken in conjunction with other standard-setting bodies.

The AcSB's Background Information and Basis for Conclusions document, *Employee Future Benefits — Additional Disclosures*, elaborates as follows:

> 69 Respondents expressed strong encouragement for international standard setters, including the AcSB (but not the AcSB by itself), to give high priority to a fundamental re-evaluation of the measurement and recognition aspects of accounting for employee future benefits. Some added that no decision should be taken without fully estimating its impact, citing the recent example of a full mark-to-market approach in a recent standard in the United Kingdom that led to expense volatility. Some observed that the financial and investment community has recently been extremely vocal in articulating its mistrust of pension cost calculations. Some reasoned that recent economic conditions have sent many "back to the drawing board". Some noted that certain smoothing aspects such as the delayed recognition of the actual return on plan assets are now outdated without a counterpart in other areas of generally accepted accounting principles.
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> 70 The AcSB agreed that a re-evaluation of the measurement and recognition basis used in accounting for employee future benefits is required to determine whether the current accounting model is appropriate or should be changed. However, the AcSB saw this re-evaluation as a significant issue that is best addressed through the international partnership with other standard setters, and it was beyond the scope of the current AcSB project.

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

As stated above, we disagree with the addition of a third option for the recognition of actuarial gains and losses. However, if the IASB, nonetheless, decides to proceed with this option, we have the following observations regarding Questions 2 to 4.

We suggest that the IASB consider further whether adjustments to the asset ceiling as a result of certain events should go through income, rather than outside profit or loss in a statement of recognised income and expense. For example, part of the effect of the asset ceiling may be the result of past service costs, which may be recognized on a straight-line basis over the

[1] See March 2004 Accounting Handbook Release No. 28 for the updated version of EMPLOYEE FUTURE BENEFITS, Section 3461.

average period until benefits become vested or if benefits vest immediately, recognized immediately, or the ceiling may be significantly reduced as a result of a change to pension legislation reducing the entity's ability to obtain benefit from the plan surplus. In these, and perhaps other, circumstances, we question whether the effect of the limit should also be recognized outside profit or loss in a statement of recognised income and expense.

We observe a parallel situation involving "available for sale" financial assets — the write-down to recognize impairment goes through income immediately, even though other re-measurements go through other comprehensive income.

Question 3 – Subsequent recognition of actuarial gains and losses

AcSB staff was divided on this issue.

Some staff members believe that an unreasonable onus has been placed on respondents to consider conceptual arguments for recycling in relation to post-employment benefits without fundamentally considering the issue of recycling in the Performance Reporting project. The Basis for Conclusions seems weak and insufficient to support a conclusion for or against recycling. Some add that other standards require recycling, and thus, why should IAS 19 not allow it? Some believe that if recycling is permitted, a continuity schedule of actuarial gains and losses should either be presented or disclosed.

Others agree that no conceptual argument exists for recycling. These staff members add that if a third recognition option is to be introduced it should be done so as simply as possible, i.e., without the added complexity of recycling. They express the view that there is no information value in the recycled amounts, as well as noting that there is no obvious basis on which to base the timing of recycling. Recycling of such amounts, in addition to lacking a conceptual basis, adds to the complexity of the financial statements, rather than enhances transparency.

Question 4 - Recognition within retained earnings

AcSB staff was divided on this issue.

AcSB staff members who believe in prohibiting recycling argue that the action of transferring actuarial gains and losses to retained earnings in a later period would add an arbitrary allocation. As acknowledged by the IASB, a conceptual argument does not exist for transferring actuarial gains and losses between equity and retained earnings, and thus, these gains and losses should be recognised immediately in retained earnings.

Other staff members who favour recycling support actuarial gains and losses ending up in retained earnings only when they have been recycled through income.

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 an extension of the provisions in IAS 19 to allow entities under common control, such as a parent and its subsidiaries, and others, to account for their multi-employer defined benefit plans as defined contribution plans. We welcome this change as it brings IFRSs closer to US and Canadian GAAP.

We do not agree with the criteria set out in the proposals to permit defined contribution plan accounting for entities within a consolidated group. Instead of the criteria set out in paragraphs 34(a) to (c) of the proposals, we favour a less restrictive approach that offers a solution to the practical difficulties in consolidating entities which use different methods of accounting for multiemployer defined benefit plans. Handbook Section 3461 allows defined contribution plan accounting for individual entities within a related group provided "individual entities within the related group are not able to identify their share of the underlying assets and liabilities" as stated in paragraph 3461.149 [underlining for emphasis]:

> The definition of a multiemployer plan refers to entities that are unrelated. Entities within a related group, such as a parent company and its subsidiaries, may share a benefit plan that satisfies the definition of a multiemployer benefit plan other than the requirement that the entities be unrelated. The costs of the benefit plan are not always allocated to, or funded separately by, the individual entities within the related group. As a result, individual entities within the related group are not able to identify their share of the underlying assets and liabilities. In such circumstances, a benefit plan is accounted for by the parent company and its subsidiaries in their individual financial statements following the standards on defined contribution plans in paragraphs 3461.014-.023. In its consolidated financial statements, the company accounts for the plan following the standards on defined benefit plans in paragraphs 3461.024-.134. Additional disclosures are required in the non-consolidated financial statements of the parent company and in the financial statements of its subsidiaries to indicate that defined contribution plan accounting has been used (see paragraph 3461.152(h)).

There would be a larger set of entities permitted to use defined contribution plan accounting in Canada than under the international proposal that requires meeting criteria similar to the criteria for exemption from preparation of consolidated financial statements found in IAS 27, *Consolidated and Separate Financial Statements*. We agree with the arguments presented in the Basis for Conclusions, BC18-BC 24, except for the restriction linked to IAS 27. The Basis for Conclusions discusses that costs would exceed the benefits for entities obtaining information for defined benefit plan accounting that also meet the criteria in IAS 27. However, the Basis for Conclusions does not elaborate on whether entities that did not meet the criteria in IAS 27 also incurred costs that exceeded the benefits of defined benefit plan accounting. We suggest that this issue be explored.

Question 6 - Disclosures

The AcSB recently completed a limited-scope project to improve and expand the disclosure requirements in EMPLOYEE FUTURE BENEFITS, Section 3461 of the *CICA Handbook – Accounting*. Revisions to Section 3461 reflect input received from Canadian constituents as a result of the October 2003 Exposure Draft, *Employee Future Benefits — Additional Disclosures*. We highlight in our response some of the AcSB's rationale in developing these amended disclosure requirements as documented in the April 2004 Background Information and Basis for Conclusions document, *Employee Future Benefits — Additional Disclosures*.

As part of this project, the AcSB considered the additional disclosures required by FASB in their revisions to SFAS 132. In many cases the AcSB agreed with these. However, the AcSB decided not to require certain of the new FASB required disclosures. The AcSB also decided to require certain disclosures that are not included in revised SFAS 132.

An overriding issue for the AcSB was to focus the disclosure requirements on providing significant benefits to users. Disclosure requirements for post-employment benefits are already extensive, resulting in a lengthy note in most financial statements. The accounting is also complex, which impacts the understandability of disclosures for the average financial statement user. The AcSB was concerned that the quantity and complexity of the information might reduce the value of the disclosures and therefore tried to limit additional disclosures to those that would provide significant benefit to users. It also noted that many companies have multiple plans and would provide the disclosures on a consolidated basis, which would limit the meaningfulness of some disclosures.

We provide comments below on new requirements only.

<u>120(c) Reconciliation of opening and closing balances of the present value of the defined benefit obligation AND 120(e) Reconciliation of opening and closing balances of the fair value of plan assets</u>

We agree with these reconciliation requirements. The recent amendments to Section 3461's disclosures retained the original reconciliation requirements as the AcSB concluded that such reconciliations, as confirmed by respondents during its exposure draft process, provide users with a better understanding of the components affecting these amounts in a user-friendly format.

<u>120(f) Reconciliation of off-balance sheet amounts to amounts recognized in the balance sheet</u>

We agree with this additional requirement. Section 3461 includes a similar reconciliation, although it begins with only the off-balance sheet accrued benefit obligation. The AcSB, as supported by respondents to its Exposure Draft, preferred a reconciliation format, rather than disclosure of the data in isolation.

<u>120(g) Added "effect of the limit" in paragraph 58(b) to total expense recognized</u>

We agree with this additional requirement to include the "the effect of the limit in paragraph 58(b)" in the total expense recognised. This approach is consistent with Canadian GAAP, which does not support a basis for deferring and amortizing the effect of adjusting an asset valuation account. Although pension accounting generally supports the deferral and amortization of certain gains and losses, Handbook Section 3461 requires that a change in the valuation allowance [effect of the limit in paragraph 58(b)] should flow through to the income statement immediately (Handbook paragraph 3461.102), and should be included in benefit cost in paragraph 3461.070(g).

<u>120(h) Total amount recognized in the statement of recognised income and expense for actuarial gains and losses, and the effect of the limit in paragraph 58(b)</u>

Although we disagree with the addition of a third recognition option for actuarial gains and losses, we agree with this disclosure requirement as it provides the effects of post-employment benefits on the statement of recognised income and expense.

<u>120(i) Plan assets, by category, including expected rate of return for each category</u>

We agree with the requirement for disclosure of plan assets, by category, but disagree with the requirement to disclose the expected rate of return for each category of plan assets. Section 3461's amended disclosure requirements include a similar requirement to disclose the major categories of plan assets, but not the requirement to disclose the expected rate of return for each category. However, the AcSB also has the following requirement in Handbook paragraph 3461.155(b)(ii) — "Additional asset categories when that information is expected to be useful in understanding the risks and expected long-term rate of return for plan assets" as it did not want preparers to limit the split of plan assets to three categories and an "other category" (with no further description) when disclosure of additional asset categories would be informative. The AcSB cited that there could be value, for example, in knowing that a plan invested a certain percentage of its plan assets in limited partnerships. The AcSB also noted that disclosure of additional asset categories is encouraged but not required by the FASB.

Section 3461 does not have a similar requirement to disclose the expected long-term rates of return for each major category of plan assets. Section 3461's proposed amendments did have such a requirement, but the AcSB eliminated this proposal.

The following excerpt from the Basis document (paragraph 39) explains the AcSB's rationale for this elimination:

> The AcSB eliminated a proposal to disclose the expected long-term rates of return for each major category of plan assets. Some respondents argued that such disclosure might be potentially misleading, as it could imply that entities derive the overall rate of return assumption from the sum of the individual asset categories (a "bottom up" approach) as opposed to an analysis of the portfolio as a whole. Some respondents also noted that disclosing the actual allocation of plan assets along with the overall long-term rate of return on plan assets should be sufficient to assess risk.

<u>120(k) Narrative description of the basis used to determine the overall expected rate of return on assets</u>

We disagree with this requirement. Section 3461 does not have a similar requirement as discussed in the Basis paragraphs 40-41,

> "… expressed concern that these types of disclosures are forward looking or provide explanatory information and commentary. The AcSB noted that generally accepted accounting principles do not require a description of the entity's business plan, of which pension investment strategies is only one component. The AcSB recognized the value in disclosing these items but considered them more appropriate for Management Discussion and Analysis (MD&A) than for financial statements. Members cited concerns that such descriptions would likely become boilerplate, and thus not add significant value. These requirements could backfire, as such narrative descriptions / objectives could be perceived as certainties when they could change in the future. There was also concern over the potential length of such disclosures.
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> Furthermore, in terms of a narrative description of the basis used to determine the overall expected long-term rate of return on plan assets assumption, AcSB members expressed concern about setting a precedent in providing information about the process management used to develop estimates, as there are many other management estimates in financial statements. The critical disclosure is the overall expected long-term rate of return assumption."

<u>120(m) Significant actuarial assumptions</u>

Even though this requirement is not new to IAS 19, we would like to note that Section 3461, consistent with SFAS 132 (revised 2003), not only requires significant actuarial assumptions at the balance sheet date, but also those used to determine the benefit cost, in order to clarify the assumptions for users, such as analysts.

120(n) Sensitivity analysis for medical cost trend rates

We agree with this requirement. Section 3461 has a similar requirement (without the reference to plans operating in a high inflation environment, which is not applicable in Canada) due to the significance of future health care costs and their degree of uncertainty.

Even though Section 3461 does not state that "all other assumptions shall be held constant," we support such a statement for greater certainty.

120(o) Current period and previous four periods of various amounts

(i) Present value of the defined benefit obligation; Fair value of plan assets; Surplus/Deficit in the plan

Even though Section 3461 only requires disclosure of these amounts for the current period, we support disclosure of the history of such amounts to enable users to understand the possibility of movements from a surplus position to a deficit position, which can occur from one year to the next. Also, such historical information would be readily available and not add too much information to the post-employment benefits note.

(ii) Effect of experience adjustments on plan liabilities and plan assets

We disagree with this requirement as it may lead to confusion amongst users given that paragraph 120(g) requires disclosure of the expense recognized for "actuarial gains and losses", but not "experience adjustments". Is there value in disclosing the fluctuations over time in the assets and obligations? If there is value, then we suggest modifying paragraph 120(c) to include the components of "actuarial gains and losses" showing "experience adjustments" as a separate component.

We also question the use of the terms "plan liabilities" and "plan assets" in paragraph 120(o)(ii) and Question 7(c), which we believe should refer to the "present value of the defined benefit obligation" and the "fair value of plan assets", respectively.

120(p) Expected contributions for next year

We disagree with this requirement. Section 3461 does not have this requirement, as explained in the Basis, paragraph 54:

> "Acknowledging respondents' concerns, the AcSB eliminated its Exposure Draft proposal to require expected contributions to be paid by the entity to defined benefit plans for the next fiscal year. Estimates of future cash inflows and outflows are not required to be disclosed in financial statements, and the AcSB accepted that there was no unique reason to require disclosure of estimates for these cash outflows. Such information would be forward looking, subject to potential management bias, and too uncertain to be included in the financial statements. The AcSB recognized that disclosure of expected contributions may be appropriate in MD&A. However, the AcSB did add information about the date of the most recent and next actuarial valuation, which alerts a reader that past contributions may be based on stale data."

121 Description of the plan

We agree with this requirement. Section 3461 has a similar requirement, although it does not explain that "the description of the plan shall include all the terms of the plan that are used in the determination of the defined benefit obligation". We believe that such an addition would require disclosure of an entity's cost-sharing policy for post-employment medical plans, amongst other matters. In developing its revised disclosures, the AcSB proposed a requirement to disclose the entity's cost-sharing policy for plans other than pension plans. The AcSB deleted this proposed disclosure as respondents "… noted that such a policy can change frequently (and thus, may not be useful when considering future cash flows) and that entities may have several health care plans, each having a different cost-sharing arrangement…." [Basis paragraph 25, in part]

Section 3461 requires identification of indexation features for pension plans as the AcSB acknowledged that such features can have a significant effect on the balance of the defined benefit obligation. Section 3461 also requires identification of the benefits included, such as health care and life insurance, for plans other than pension plans.

Question 7 – Further disclosures

(a) a narrative description of investment policies and strategies
We do not support such a requirement. The AcSB considered, but rejected requiring a narrative description of investment policies and strategies, for the reasons described above under Question 6, 120(k).

(b) Future benefit payments
We do not support such a requirement. As discussed in Section 3461's Basis paragraph 57:

> "Analysts suggested that disclosure of future benefit payments would assist users in evaluating possible funding requirements by the entity to meet plan cash outflows. The AcSB views the funded status of the plans (already required) as the most relevant information in this respect. It did not view benefits expected to be paid by the plan as being of significant additional value, and was concerned that disclosure of this additional information might be confusing to users of financial statements. Also, this is forward-looking information, as it includes the impact of expected future service and, hence, it is more appropriately dealt with in MD&A."

(c) Explanation of any significant change in plan liabilities or plan assets
We support such a requirement. There may be significant changes in the present value of the defined benefit obligation and the fair value of plan assets included in the reconciliations of their opening and closing balances that require explanations to aid in understanding the nature of the adjustments for trend analysis. Section 3461 has a similar requirement to disclose the nature and effect of each significant non-routine event occurring during the period.

Also see comment under 120(o)(ii) about terminology.

(d) Disclosure of additional asset categories
We support a requirement, rather than an encouragement of this disclosure. Please see comments above under 120(i).

OTHER COMMENTS ON DISCLOSURE

We would like to point out additional disclosures required by the AcSB that are not included in the US SFAS 132 (revised 2003), nor are they required by the proposed amendments to IAS 19. We did note these disclosures earlier in the memorandum, "Disclosures about Post-Employment Benefits", but include a discussion here for ease of reference. We begin the discussion below with a comment about structure.

<u>Structure</u>

In an effort to make the disclosure requirements of Section 3461 easier to follow, the AcSB formatted them as follows:

- a) Overall disclosure objective
- b) Accounting policy disclosures
- c) Defined contribution plan disclosures
- d) Defined benefit plan disclosures
  - (i) Information about the financial statements
  - (ii) Information about the defined benefit plans
  - (iii) Assumptions

The AcSB felt that this grouping, together with the use of appropriate headings, would be helpful to preparers in appreciating how the various disclosures fit together.

Overall disclosure objective

We were disappointed not to see the disclosure requirements set up with a disclosure objective/key principle as in ED2, *Share-Based Payments*, and ED3, *Business Combinations*.

Analysis of cost showing the effects of smoothing

In addition to the total cost recognized, an analysis of that cost showing separately:

a) each amount arising from events in the period (e.g. current service cost, actual return on plan assets, actuarial gains and losses arising in the period on the accrued benefit obligation), and

b) adjustments made to smooth costs over the periods in which employee services are rendered (e.g. deferral of current period amounts and amortization of deferred amounts),

(c) the difference between actual return on plan assets and expected return on plan assets, and

(d) the increase or decrease in a valuation allowance against the carrying amount of an accrued benefit asset.

A number of constituents have argued that the smoothing in the current accounting for post-employment benefits results in reporting that is not transparent and may be misleading. The AcSB agreed that a re-examination of the measurement basis used in accounting for post-employment benefits is required to determine whether it is appropriate or should be changed. However, they saw this as a significant issue that is best addressed through the international partnership, and it was beyond the scope of the current AcSB project. However, the AcSB did decide that, in the interim, disclosure of the elements of cost recognized could be formatted to provide separate information on "unsmoothed costs" and on the impact of smoothing. This would provide financial statement users with information on the impact of current period events and transactions on post-employment benefits costs as well as the impact of the accounting conventions that result in smoothing those costs.

Balance sheet classification

The amount(s) recognized in the balance sheet at the end of the period as an accrued benefit liability or accrued benefit asset, together with the balance sheet classification(s). The AcSB decided that disclosure of the balance sheet amounts would provide greater transparency if the balance sheet lines (and relevant amounts for each line) were also disclosed.

Total cash payments

Total cash payments for post-employment benefits. Several categories of payments may be made for post employment benefits, including contributions to funded defined benefit plans and to defined contribution plans; payments directly to plan beneficiaries; and payments to a third party service provider. The AcSB was concerned that financial statement users may not have information on some of these elements and underestimate the full cash cost of post-employment benefits. It therefore decided to require disclosure of the total cash payments for post employment benefits for the year.

<u>Effective date of actuarial valuations</u>

The effective date of the most recent actuarial valuation for funding purposes and the effective date of the next required actuarial valuation for funding purposes. As identified above under 120(p), the AcSB did not require disclosure of the expected cash contributions to the plan. However the AcSB did recognize the need of users to estimate future cash flows and, specifically, whether future cash outflows for post-retirement benefits would be significantly different from the current year. Contributions to funded plans are determined by actuarial valuations made for funding purposes. In Canada, these are generally required every three years (although in some circumstances they may be required more often). The date of the last actuarial valuation is important in understanding the current required funding while the date of the next actuarial valuation determines when the required annual funding amount will change. The AcSB therefore required disclosure of both these dates.

EXAMPLE

We assume that the IASB plans to update Appendix B— Illustrative Disclosures found in IAS 19 (revised 2000) to reflect the final amendments to the disclosure requirements. Handbook Section 3461's revisions include updates to the example illustrating the disclosures in the Section as preparers find such examples very helpful in visualizing the requirements.