Accounting Standards Board
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Email: commentletter@efrag.org

25 June 2010

Dear Françoise

EFRAG's Draft Comment Letter on the IASB's Exposure Draft (ED) Defined Benefit Plans: 'Proposed amendments to IAS 19'

This letter sets out the Accounting Standards Board's (ASB's) views on the EFRAG draft comment letter (DCL) on the above IASB ED. The ASB has responded directly to the IASB and a copy of its letter is attached.

The ASB broadly agrees with the content, analysis and conclusions in the DCL. The ASB shares EFRAG's welcome for the proposals in the ED as an improvement to the current version of IAS 19. Like EFRAG, the ASB believes there is a need to undertake a comprehensive review of pension accounting.

You will note that the attached ASB letter refers to the PAAinE Discussion Paper, '*The Financial Reporting of Pensions*' and the follow-up '*Feedback and Redeliberations Report*' relating to it. The ASB considers that the work carried out in preparing those reports will provide the IASB with valuable material for consideration in its comprehensive review of pension accounting. EFRAG may wish to make a similar reference to this work in its final comment letter to the IASB.

More specific comments on EFRAG'S DCL are attached as an appendix to this letter. The comments relate in particular to the questions to constituents posed by EFRAG.

If you would like to discuss these comments outside of a TEG meeting, please contact Jennifer Guest, j.guest@frc-asb.org.uk, or me.

Yours sincerely

Ian Mackintosh

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Appendix 1 - ASB comments on EFRAG DCL to the IASB ED 'Defined Benefits' – Proposed amendments to IAS 19

Responses to the questions

Question 12 – Proposed Disclosure Requirements
(EFRAG's questions in paragraphs 58 and 95 of the Appendix to the DCL)

You will see from the attached letter that the ASB is suggesting a proposed disclosure which links the funding arrangements to the liability of the pension scheme, so that the user understands the pension liability. The ASB considers that to support the objective in paragraph 125A(c) of the ED a user needs a clear understanding of the pension liability including its duration. The ASB reporting statement 'Retirement Benefits – Disclosures' provides (in paragraph 24) in order to evaluate the economic resources available to the entity, users of financial statements are particularly interested in the period of time over which the liabilities of the defined benefit scheme mature. The ASB is also suggesting that this disclosure should replace that proposed in paragraph 125K of the ED.

Question 13 –Costs relating to the management of plan assets
(EFRAG's questions in paragraphs 75 & 76)

The IASB's proposal is that the return on plan assets shall be reduced by administration costs only if those cost relate to managing plans assets.

The ASB agrees with the conclusion in BC85 (a) of the ED that the ultimate cost of the benefit promise depends on the return of the plan assets less asset management costs and hence their present value should be included in the service cost and in the estimate of the defined benefit obligation.

You will see from the attached letter that the ASB is seeking greater clarity with regards to (d). The ASB concurs with the conclusion in BC85 (a) of the ED that the ultimate cost of the benefit promise depends on the return of the plan assets less asset management costs and hence their present value should be included in the service cost and in the estimate of the defined benefit obligation. However, we suggest the addition of the words 'the direct costs of' before 'managing the plan assets'. This is because there can arguably be in-direct costs of managing the assets which can be difficult to quantify. The direct costs are fund managers' fees and this should be clearly stated.

The ASB considers that it is straightforward and practical for preparers to separate the direct costs of managing the plan assets from other costs incurred.

Question 15 – Retrospective application
(EFRAG's question in paragraph 90).

Like EFRAG, the ASB agrees with IASB's proposal, but we have suggested that wording should be added from paragraph 13 of IFRIC 19:

'*An entity shall apply a change in accounting policy in accordance with IAS 8 from the beginning of the earliest comparative period presented.*'

In BC97 of the ED it explains that entities will not have to recalculate amounts from dates earlier than the beginning of the first period presented in the statements with the amounts depending solely on conditions at that date, not on assessments made on previous dates.

Question 16 – Costs and benefits
(EFRAG's question in paragraph 94)

The ASB considers that the benefits of the proposals outlined in (a) (i)–(iv) of question 16 in the ED outweigh the costs. We agree with the IASB that the cost of the proposal should be minimal since it is our understanding that entities are already required to obtain the information required to apply the proposed amendments.

Question 17 - other comments

The ASB considers that the deletion of paragraphs 126-131 of the current IAS 19 (other long-term employee benefits) should be accompanied by an explanation that these benefits are combined with post-employment benefits (BC77) and hence their treatment should be consistent with post-employment benefits.

The ASB is also concerned that the proposal to combine other long-term benefits with post employment benefits could result in misleading accounting. For example, a bonus plan that vests over a period of three years is (under the current rules) a long-term benefit and changes in estimates are taken in income. The ASB is concerned that under the proposals the changes in estimate would be recognised in OCI. The ASB questions whether a 40 year pension scheme and a 3 year bonus scheme should incur the same accounting treatment when the length of the schemes cover diverse time periods. The ASB suggests that the IASB should clarify if this is the intended outcome of the proposal and explain why it considers this to be the right answer.

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1 July 2010

Dear Andrea

Exposure Draft 'Defined Benefit Plans: Proposed amendments to IAS 19'

I am writing on behalf of the UK Accounting Standards Board (ASB) setting out its comments on the above Exposure Draft (ED).

The ASB welcomes the ED and considers that the proposals are an improvement on the current version of IAS 19. Its responses to the specific questions raised in the Invitation to Comment are set out in Appendix to this letter.

Whilst the ASB is in agreement with the proposals in the ED, it wishes to put forward a proposed amendment to the disclosures suggested by the IASB. Rather than the disclosure proposed in paragraph 125K, the ASB recommends that instead there should be a disclosure which links the reporting entity's funding arrangements with the liability of the pension scheme, so that the user understands how the pension liability is planned to be settled through employer contributions and investment returns. The ASB considers that users need a clear understanding of the funding obligations of the entity, in relation to liabilities to pay pension benefits.

While the ASB welcomes the proposals in the ED, we continue to believe that there still is a need to undertake a comprehensive review of pension accounting. We are aware that this view is shared by the European Financial Reporting Advisory Group (EFRAG) and a number of other members of the National Standard-Setters (NSS) group that I chair.

As you know, the ASB, in conjunction with EFRAG and a number of other European NSS, invested considerable resources in developing the January 2008 Pro-active Accounting Activities in Europe (PAAinE) Discussion Paper, '*The Financial Reporting of Pensions*'[1] and the November 2009 follow-up report '*The Financial Reporting of Pensions: Feedback and Redeliberations*'. The ASB welcomes the fact that some of the recommendations in those reports have been reflected in the proposals in the current ED. We believe that the work we have carried out also provides the IASB with

[1] The DP and Feedback and Redeliberations report can both be accessed on the FRC website at: http://www.frc.org.uk/asb/technical/projects/project0065.html.

valuable material for consideration in the comprehensive review of pension accounting.

Should you wish us to expand on any aspect of this response, please contact me or Jennifer Guest j.guest@frc-asb.org.uk

Yours sincerely

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Appendix

RESPONSE TO SPECIFIC QUESTIONS IN THE EXPOSURE DRAFT
Defined Benefit Plans: 'Proposed amendments to IAS 19'

This Appendix sets out the ASB's responses to the questions set out in the exposure draft's Invitation to Comment.

Recognition

Question 1 The exposure draft proposes that entities should recognise all changes in the present value of the defined benefit obligation and in the fair value of plan assets when they occur. (Paragraphs 54, 61 and BC9–BC12) Do you agree? Why or why not?

The ASB agrees with the proposal. We note that this will bring IAS 19 into line with the equivalent UK standard, Financial Reporting Standard (FRS) 17. The proposal also reflects the preliminary view expressed in the PAAinE DP (see Chapter 4 of that document), which was broadly supported by the respondents to that paper (see paragraphs 4.34 to 4.30 of the Feedback and Redeliberations report).

Question 2 Should entities recognise unvested past service cost when the related plan amendment occurs? (Paragraphs 54, 61 and BC13) Why or why not?

Yes. The ASB agrees that an unvested benefit meets the definition of a liability and hence agrees that entities should recognise unvested past service when the related plan amendment occurs.

Disaggregation

Question 3 Should entities disaggregate defined benefit cost into three components: service cost, finance cost and remeasurements? (Paragraphs 119A and BC14–BC18) Why or why not?

The ASB agrees with the proposal to disaggregate defined benefit costs into service, finance and remeasurements components, for the reasons set out in the Basis for Conclusions.

Defining the service cost component

Question 4 Should the service cost component exclude changes in the defined benefit obligation resulting from changes in demographic assumptions? (Paragraphs 7 and BC19–BC23) Why or why not?

The ASB agrees that the service cost component should exclude changes in demographic assumptions. The ASB has formed this view because it considers separating the remeasurement component provides users with better information in order to make their assessments about potential changes in the underlying assumptions and to predict future costs.

Defining the finance cost component

Question 5 The exposure draft proposes that the finance cost component should comprise net interest on the net defined benefit liability (asset) determined by applying the discount rate specified in paragraph 78 to the net defined benefit liability (asset). As a consequence, it eliminates from IAS 19 the requirement to present an expected return on plan assets in profit or loss.

Should net interest on the net defined benefit liability (asset) be determined by applying the discount rate specified in paragraph 78 to the net defined benefit liability (asset)? Why or why not? If not, how would you define the finance cost component and why? (Paragraphs 7, 119B, 119C and BC23–BC32)

The ASB agrees with the proposal, for the reasons set out in the Basis for Conclusions. The ASB acknowledges the limitation of the proposed approach, as outlined in paragraph BC32 of the ED, but we agree that using the same rate to calculate interest income on plan assets as the rate used to discount the liabilities is an acceptable practical expedient. Notwithstanding this, the ASB would like to see a clarification to paragraph 119B. In our view, it is not clear in this paragraph whether it is the net defined benefit liability at the start of the period, or the net defined benefit liability throughout the period which should be applied. The ASB encourages the IASB to undertake further research as part of a comprehensive review on pensions accounting on how to determine the discount rate to be used for employee benefit obligations.

Presentation

Question 6 Should entities present:

a) service cost in profit or loss?

b) net interest on the net defined benefit liability (asset) as part of finance costs in profit or loss?
c) remeasurements in other comprehensive income?

(Paragraphs 119A and BC35–BC45) Why or why not?

> The ASB agrees with the proposals, for the reasons set out in the Basis for Conclusions, and considers that the removal of the options currently in IAS 19 will improve comparability.

Settlements and curtailments

Question 7

a) Do you agree that gains and losses on routine and non-routine settlement are actuarial gains and losses and should therefore be included in the remeasurement component? (Paragraphs 119D and BC47) Why or why not?
b) Do you agree that curtailments should be treated in the same way as plan amendments, with gains and losses presented in profit or loss? (Paragraphs 98A, 119A(a) and BC48)
c) Should entities disclose (i) a narrative description of any plan amendments, curtailments and non-routine settlements, and (ii) their effect on the statement of comprehensive income? (Paragraphs 125C(c), 125E, BC49 and BC78) Why or why not?

> The ASB agrees with the proposals, for the reasons set out in the Basis for Conclusions.

Disclosures - Defined benefit plans

Question 8 The exposure draft states that the objectives of disclosing information about an entity's defined benefit plans are:

a) to explain the characteristics of the entity's defined benefit plans;
b) to identify and explain the amounts in the entity's financial statements arising from its defined benefit plans; and
c) to describe how defined benefit plans affect the amount, timing and variability of the entity's future cash flows. (Paragraphs 125A and BC52–BC59)

Are these objectives appropriate? Why or why not? If not, how would you amend the objectives and why?

The ASB considers that the objectives for disclosures are appropriate, for the reasons set out in the Basis for Conclusions.

Question 9 To achieve the disclosure objectives, the exposure draft proposes new disclosure requirements, including:

a) information about risk, including sensitivity analyses (paragraphs 125C(b),
b) 125I, BC60(a), BC62(a) and BC63–BC66);
c) information about the process used to determine demographic actuarial assumptions (paragraphs 125G(b) and BC60(d) and (e));
d) the present value of the defined benefit obligation, modified to exclude the effect of projected salary growth (paragraphs 125H and BC60(f));
e) information about asset-liability matching strategies (paragraphs 125J and BC62(b)); and
f) information about factors that could cause contributions to differ from service cost (paragraphs 125K and BC62(c)).

Are the proposed new disclosure requirements appropriate? Why or why not? If not, what disclosures do you propose to achieve the disclosure objectives?

The ASB considers that the IASB's proposals on disclosures are an improvement on the existing requirements in IAS 19 and agrees with (a)–(f) above, and the rationale for them set out in the Basis for Conclusions.

As set out in the answer to Question 12 below, the ASB believes that, instead of the disclosure proposed in paragraph 125K, there should be a disclosure which links the funding arrangements of the entity to the liability of the pension scheme, so that users understand how the liability will be settled from employer contributions and investment returns.

Multi-employer plans

Question 10 The exposure draft proposes additional disclosures about participation in multi-employer plans. Should the Board add to, amend or delete these requirements? (Paragraphs 33A and BC67–BC69) Why or why not?

The ASB supports the proposal to require additional disclosures about participation in multi-employer plans, for the reasons set out in the Basis for Conclusions.

State plans and defined benefit plans that share risks between various entities under common control

Question 11 The exposure draft updates, without further reconsideration, the disclosure requirements for entities that participate in state plans or defined benefit plans that share risks between various entities under common control to make them consistent with the disclosures in paragraphs 125A–125K. Should the Board add to, amend or delete these requirements? (Paragraphs 34B, 36, 38 and BC70) Why or why not?

The ASB supports the proposal, for the reasons set out in the Basis for Conclusions.

Other comments

Question 12 Do you have any other comments about the proposed disclosure requirements? (Paragraphs 125A–125K and BC50–BC70)

The ASB believes that there should be a disclosure which links the funding arrangements of the entity to the liability of the pension scheme, so that the users understand how it is planned that the pension scheme liability will be settled between investment returns employer funding contributions.

The ASB considers that to support the objective in paragraph 125A(c) of the ED a user needs a clear understanding of the pension liability including its duration. The ASB reporting statement 'Retirement Benefits – Disclosures' provides (in paragraph 24) that in order to evaluate the economic resources available to the entity, users of financial statements are particularly interested in the period of time over which the liabilities of the defined benefit scheme mature. In our view, this disclosure would be provide more useful information than that proposed in paragraph 125K

Question 13

The exposure draft also proposes to amend IAS 19 as summarised below:

a) The requirements in IFRIC 14 *IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*, as amended in November 2009, are incorporated without substantive change. (Paragraphs 115A–115K and BC73)

b) 'Minimum funding requirement' is defined as any enforceable requirement for the entity to make contributions to fund a post-employment or other long-term defined benefit plan. (Paragraphs 7 and BC80)

c) Tax payable by the plan shall be included in the return on plan assets or in the measurement of the defined benefit obligation, depending on the nature of the tax. (Paragraph 7, 73 (b), BC82 and BC83)

d) The return on plan assets shall be reduced by administration costs only if those costs relate to managing plan assets. (Paragraphs 7, 73(b), BC82 and BC84–BC86)

e) Expected future salary increases shall be considered in determining whether a benefit formula expressed in terms of current salary allocates a materially higher level of benefits in later years. (Paragraphs 71A and BC87–BC90)

f) The mortality assumptions used to determine the defined benefit obligation are current estimates of the expected mortality rates of plan members, both during and after employment. (Paragraphs 73(a)(i) and BC91)

g) Risk-sharing and conditional indexation features shall be considered in determining the best estimate of the defined benefit obligation. (Paragraphs 64A, 85(c) and BC92–BC96)

Do you agree with the proposed amendments? Why or why not? If not, what alternative(s) do you propose and why?

The ASB agrees with the proposals (a) to (g), for the reasons set out in the Basis for Conclusions, subject to seeking greater clarity with regards to (d). The ASB concurs with the conclusion in BC85 (a) of the ED that the ultimate cost of the benefit promise depends on the return of the plan assets less asset management costs and hence their present value should be included in the service cost and in the estimate of the defined benefit obligation. However, we suggest the addition of the words 'the direct costs of' before 'managing the plan assets'. This is because there can arguably be in-direct costs of managing the assets which can be difficult to quantify. The direct costs are fund managers' fees and this should be clearly stated.

Multi-employer plans

Question 14

IAS 19 requires entities to account for a defined benefit multi-employer plan as a defined contribution plan if it exposes the participating entities to actuarial risks associated with the current and former employees of other entities, with the result that there is no consistent and reliable basis for allocating the obligation, plan assets and cost to individual entities participating in the plan. In the Board's view, this would apply to many plans that meet the definition of a defined benefit multiemployer plan. (Paragraphs 32(a) and BC75(b))

Please describe any situations in which a defined benefit multi-employer plan has a consistent and reliable basis for allocating the obligation, plan assets and cost to the individual entities participating in the plan. Should participants in such multi-employer plans apply defined benefit accounting? Why or why not?

The ASB agrees that participants in defined benefit multi-employer plans should apply defined benefit accounting in those plans where it is possible to determine a consistent and reliable basis for allocating the obligation, plan assets and cost to the individual entities participating in the plan

Transition

Question 15

Should entities apply the proposed amendments retrospectively? (Paragraphs 162 and BC97-BC101) Why or why not?

The ASB agrees with IASB's explanation and reasoning in BC97 for retrospective application of the proposed amendments, but considers that it would be helpful to add the wording from IFRIC 19 (paragraph 13):

'*An entity shall apply a change in accounting policy in accordance with IAS 8 from the beginning of the earliest comparative period presented.*'

Benefits and costs

Question 16

In the Board's assessment:

(a) the main benefits of the proposals are:

i. reporting changes in the carrying amount of defined benefit obligations and changes in the fair value of plan assets in a more understandable way.

ii. eliminating some presentation options currently allowed by IAS 19, thus improving comparability.

iii. clarifying requirements that have resulted in diverse practices.

iv. improving information about the risks arising from an entity's involvement in defined benefit plans.

(b) the costs of the proposal should be minimal, because entities are already required to obtain much of the information required to apply the proposed amendments when they apply the existing version of IAS 19.

Do you agree with the Board's assessment? (Paragraphs BC103–BC107) Why or why not?

The ASB considers that the benefits of the proposals outlined in (i)–(iv) of the question in the ED outweigh the costs. We agree with the IASB's assessment that the cost of the proposals should be minimal since it is our understanding that entities are already required to obtain the information required to apply the proposed amendments.

Other comments

Question 17

Do you have any other comments on the proposals?

The ASB considers that the deletion of paragraphs 126-131 of the current IAS 19 (other long-term employee benefits) should be accompanied by an explanation that these benefits are combined with post-employment benefits (BC77) and hence their treatment should be consistent with post-employment benefits.

The ASB is also concerned that the proposal to combine other long-term benefits with post employment benefits could result in misleading accounting. For example, a bonus plan that vests over a period of three years is (under the current rules) a long-term benefit and changes in estimates are taken in income. The ASB is concerned that under the proposals the changes in estimate would be recognised in OCI. The ASB questions whether a 40 year pension scheme and a 3 year bonus scheme should incur the same accounting treatment when the length of the schemes covers diverse time periods. The ASB suggests that the IASB should clarify if this is the intended outcome of the proposal and explain why it considers this to be the right answer.