International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

commentletters@iasb.org
cc: info@efrag.org
cc: main@businesseurope.eu

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Exposure Draft ED/2010/3

Defined Benefit Plans

Proposed amendments to IAS 19

The Swedish Enterprise Accounting Group (SEAG) is a forum for Chief Accountants from the largest Swedish listed companies outside the financial sector. SEAG is administered by the Confederation of Swedish Enterprise, to which most participating companies of SEAG are joined.

Representing preparers' point of view, SEAG welcomes the opportunity to comment on the above-mentioned exposure draft.

We have reviewed the exposure draft and discussed the questions posted by the Board in a joint workshop where representatives of 20 of the largest Swedish entities participated. Although most entities are comfortable with the choices for presentation model given by the current IAS 19 we acknowledge the benefits of having a common presentation model. We support the initiatives to improve the accounting for employee benefits, but we strongly believe that the Board should have undertaken a fundamental review and addressed issues regarding measurement instead of limiting the project to a number of other questions. The proposals in the ED also have a connection to issues dealt with in the project on Financial Statement Presentation. If the ideas presented in this project are finalized, this will lead to a situation where some of the proposals in the ED on Defined Benefit Plans need to be amended. We therefore propose that the Board should coordinate those projects in order to avoid multiple changes in the presentation of Defined Benefit Plans. Given this, we believe it would better to concentrate on the measurement of Defined Benefit Plans now and await the development of the Financial Statement Presentation Project. We especially would like to draw the attention of the Board to the following issues that we feel are particularly important.

Measurement of the defined benefit obligation and the impact on asset return

The ED does not deal with the measurement of defined benefit assets and liabilities. Measurement is obviously just as critical as recognition and presentation. Measurement is the very fundamental for the creation of the entries later to be presented for the users of financial statements. We would like to stress the need to review the measurement principles with at least the objective to confirm that the current model is the best alternative.

In particular, we would like to stress the need to review the issue of the discount rate. As we discussed in a comment letter (dated 2009/09/29) regarding discount rates, Swedish entities are negatively affected by the rule that the yield on government bonds should be used (for discounting) in the absence of a deep corporate bond market. This has historically resulted in higher reported pension debt for Swedish companies with significant defined pension obligations in Sweden compared to competitors with their defined pension obligations mainly in other countries, even when the underlying obligations are very similar. We consider that the Board should re-examine the discount rate approach in the exposure draft from August 2009.

The effect of the proposed amendment in ED/2010/3 is a further decrease in comparability between those companies limited to use a government bond yield as discount rate and those allowed to use a corporate bond yield, as now also the financial income on the pension assets (netted in the financial expense) will be measured with the same discount rate. This will mean that the credit on the plan assets in the profit or loss before OCI will be relatively smaller for companies with defined pension obligations and plan assets in countries without a deep corporate bond market. The first issue is that the income will not reflect the actual composition of the plan assets (which affects all companies with plan assets regardless of discount rate). The second issue is that the proposed accounting model has a relatively worse impact on the income statement for companies with defined pension obligations and plan assets in countries lacking a deep corporate bond market. We would therefore prefer to retain the use of the expected return on the plan assets.

Lack of supporting principles for the presentation in OCI

We note that the presentation of effects of changes in actuarial assumptions and the difference between actual return on plan assets and the discount rate applied on those assets in OCI without further recycling/reclassification to profit or loss appear to lack support in principles. E.g. it is difficult to understand why no recycling of neither income nor expenses recognized and presented in OCI should take place. Regardless of whether the income/expenses are effects of remeasurements beyond the companies’ control or of settlements within the companies’ control there should be clear principles behind the suggested method of presentation.

Changes in definitions – Long-term employee benefits
The Board proposes to combine post-employment benefits (PEB) and other long-term employee benefits (LTEB) into a single category; long-term employee benefits. Any accounting differences between LTEB and PEB would be removed and the proposed disclosures in paragraphs 125A-125K would also apply to LTEB.

The Board has not made clear why this change is motivated considering the simplicity and the non-volatility in such benefits, i.e. LTEBs. We believe the costs exceed the benefits as the actuarial calculations that are currently made for LTEBs do not include the extensive disclosures as required for PEBs. Getting full disclosure reports from the actuaries will increase costs. We also believe that this ED and the Board's future ED on termination benefits should be issued and combined as the definition of termination benefits is necessary to evaluate some LTEBs having characteristics similar to termination benefits.

Summary
We partly agree that the proposed recognition, disaggregation and presentation of defined benefit obligations will increase the usefulness of financial statements. However, we disagree to the removal of expected return and what we see as a lack of supporting principles for the suggested use of other comprehensive income. We also regret that the Board has not dealt with the measurement issues which will cause further disadvantages to companies in countries without a deep corporate bond market. For Swedish companies this will mean relatively higher pension debt, reduced income (with the current proposal) and a perception of weaker financial position than competitors in other countries. Finally we believe that the combination of post-employment benefits (PEB) and other long-term employee benefits (LTEB) into a single category will lead to higher costs for preparers that exceed the benefits for users of the financial reports.

Our opinion is further explained in our answers to the Board's questions.

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?

By removing the corridor method, volatility increases. To illustrate this, we can take the example of a large listed Swedish entity that currently applies the corridor method. If this entity would have restated its financial reports from 2008Q1 to 2009Q2 by not applying the corridor method, the pension liability would have varied each quarter with at least 10 % and with an interval between + 20 % and – 22 %, which would be the equivalent of 4-8 billion SEK per quarter. Adding to this, interest rates have a natural variation, decreasing in a recession leading to a higher pension liability and increasing in a boom leading to a lower pension liability as a result. The removal of the corridor method increases the volatility in financial reports over the economic cycles. This volatility does not increase the usefulness of financial reporting for long-term obligations.

We therefore consider that the method of measurement should be reviewed and defined and/or confirmed before the method of recognition is prescribed. We understand that the current option of the corridor method, with deferred recognition of effects from remeasurement, was an answer to the fundamental difficulties of measuring the pension obligation. The proposed method of recognition and presentation appears to be a pragmatic solution to the problem, by reducing the number of options for presentation, without fundamental review of the measurement principles. We believe that the accounting rules should be developed in the following order: fundamental principles – measurement – recognition – presentation, and not the other way around.

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

No, we do not agree with this. It is not clear to us why immediate expensing of unvested past service cost is a better recognition requirement. We find it conflicting with other similar employee expenses where the cost is recognised over the period that the employee must fulfil certain criteria in order to get the benefit. We can make an analogy to termination benefits where there is a service requirement to receive the benefit. In these cases the expense is taken over the service period. Similar examples are found regarding contingent payments in business acquisitions and stock option programmes.

If the Board wants to continue with this objective, we propose, as an alternative, that the unvested past service cost could be recognised in OCI and subsequently recycled.

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?

Yes. We agree with the proposed disaggregation with the motivation that it will simplify the understanding of the effects of defined benefit plans by the users of financial statements.

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 7and BC19–BC23)
Why or why not?

Yes, we believe the service cost presented in profit or loss should exclude changes in the defined benefit obligation resulting from changes in demographic assumptions. The reason for this is that the profit or loss, in our view, should present the performance of the entity over a period undisturbed by one-time measurement effects on very long commitments like the pension debt. The usefulness of the profit and loss for performance measurement and prediction of future periods increases if one-time measurement effects are excluded.

However, we also consider that it could be questioned why the measurement effects on the liability should not be reclassified/recycled to the profit or loss over time. We therefore ask the Board to clarify the principles behind the amended proposal to present changes in pension liability from changed demographic assumptions in OCI without recycling.

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)

We disagree with the proposal to use the discount rate specified in paragraph 78 on the net benefit liability (asset). In general we consider that the measurement of pension liabilities and assets should be reviewed before the presentation model is decided. However, in commenting the specific proposal we believe that there are two flaws to the proposal.

Firstly, we still believe that the current rule of using government bond yield as discount rate in markets where no deep corporate bond markets exists is wrong. As commented in our letter to the Board (2009/09/29) this usually gives a disadvantage for those affected companies as the government bond yield usually is significantly lower than the high quality corporate bond yield. We encourage the Board to re-examine the discount rate approach in the Exposure draft from August 2009.

Secondly, by applying the discount rate on the net liability (assets) the new proposal in effect dictates that the discount rate shall be applied also on the plan assets. This is clearly not a good representation of the actual circumstances where the composition of the plan assets in many cases gives a return above the discount rate, albeit with volatility. Not using the expected return will lead to an understatement of income in profit and loss. The pension cost in the operating result will structurally be presented at a much higher level. The effect of the proposed amendment is also a further decrease in comparability between those companies limited to use a government bond yield as discount rate and those allowed to use a corporate bond yield, as now also the financial income on the pension assets (netted in the financial expense) will be measured with the same discount rate. This will mean that the credit on the plan assets in the profit or loss before OCI will be relatively smaller for companies with defined pension obligations and plan assets in countries without a deep corporate bond market.

Further, we disagree with the notion that the choice of expected return is too arbitrary. Our suggestion is to modify the proposals to remain with the use of an expected return on the pension assets. To address the Board's concerns regarding the subjectivity of the choice of expected return, additional guidance or limitation indicators could be added to the criteria for the selection of the expected returns, e.g. by requiring historical evidence (returns) to support the selected return on plan assets. The suggested disclosure requirements (125J) ask for the entity's asset-liability matching strategies. We believe that it would be beneficial for the users of the financial statements if the financial effects of those risk management strategies also are presented together with the expense items they (the strategies) are intended to mitigate. In other words our suggestion is to remain with the use of an expected return on plan assets in the profit or loss and to recognize and record the difference between expected return and actual return in other comprehensive income, possibly with subsequent recycling to profit or loss.

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?

We agree in principle that standardization of the presentation requirements for each of the components of cost will improve comparability across all companies. But it is not clear how the proposals in this ED relate to the ideas being developed in the Financial Statement Presentation project. As we said earlier in this letter, we believe it would be better to await the development of the Financial Statement Presentation project, since this project might have an impact on the presentation of defined benefit plans.

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?

Our answer to (a) is: No we do not agree that settlements are actuarial gains and losses. We believe settlements are usually effects of the own actions of an entity and should therefore be presented in profit or loss.
Our answer to (b) is: Yes.
Our answer to (c) is: Yes, but only if the effects are material.

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?

Yes, we mainly agree that the objectives are appropriate with the addition that (b) should also state that disclosing information about the entity's defined benefits plans should help understanding the performance of the entity and the effects of the entity's risk management strategies related to its defined benefit plans.

However, in general we think that the disclosure requirements are too onerous and that the aim should be to focus on the minimum number of requirements that are proven to be useful for the users of financial statements. Our experience from contacts with professional analysts is that very little focus is spent on the annual report in general and on the disclosures in particular.

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), 125I, BC60(a), BC62(a) and BC63–BC66);

(b) information about the process used to determine demographic actuarial assumptions (paragraphs 125G(b) and BC60(d) and (e));
(c) the present value of the defined benefit obligation, modified to exclude the effect of projected salary growth (paragraphs 125H and BC60(f));
(d) information about asset-liability matching strategies (paragraphs 125J and BC62(b)); and
(e) 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?

We disagree with the disclosure requirements stated under (c) and (e) above. We do not think that the present value of defined benefit obligations, modified to exclude the effect of projected salary growth parameters (paragraph 125H) is a necessary disclosure. We consider that the requirement for sensitivity analysis (paragraph 125I) makes the requirement for a separate valuation of the DBO excluding the effect of projected salary growth redundant. In addition, we strongly object to include additional disclosure requirements based on such weak grounds as the basis for conclusions state, i.e. the argument in BC 60(f) that “some users believe that this is relevant additional information”. In our mind there should only be one measurement model for the defined benefit obligation and additional methods disclosed only confuses the users and put unnecessary burden on the preparers. It is always easy to say that a single disclosure is not costly to provide but that should be put in the context of the full amount of disclosure requirements in IFRS.

Regarding factors that could cause contributions to differ from service cost we believe that this requirement would result in quite general statements as it in practice is very seldom that service cost and cash contribution are equal in size.

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?

We disagree with the proposal to add additional disclosures for multi-employer plans. In general, as mentioned under question 8, we believe that additional disclosure may overwhelmingly reduce understanding and usefulness. Information on exposure to risk is required in paragraph 125C(b), therefore we recommend that disclosures for multi-employer plans should be the same as for any other plan, leaving the entities the flexibility to decide on the appropriate level of disclosure even for multi-employer benefits as referred in paragraph 125B.

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?

No comment.

Other comments

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

We disagree with the requirement in 125I (ii) that ask for a simulation based on the opening balance of the period. We believe that this ex post simulation would not add any value for the users of financial statements.

Other issues

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. (Paragraphs 7, 73(b), BC82 and BC83)
Why or why not?

Yes, these are in line with the way we do it today.

(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)

We think that it is unclear what administration costs the proposal refers to.

(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)

No comment.

(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?

No comment.

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?

No comment.

Transition

Question 15
Should entities apply the proposed amendments retrospectively? (Paragraphs 162 and BC97–BC101) Why or why not?

The change should be implemented retrospectively with the exception of former LTEBs as information for those items for the comparative year are not already in the report received for that year. This would take extra cost to recreate. The financial statements would lack comparability if the changes would not be implemented retrospectively. However, the cost to do so in the case of LTEBs is not justified.

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?

We agree that the proposals would lead to a more understandable reporting of changes in defined pension liabilities and we partly agree that in general it would lead to better comparability. However, the removal of the expected rate of return would reduce comparability for those entities having substantial pension assets in jurisdictions without deep corporate bond markets. See our answer to question 5.

See also our answer to question 17 as we do not see the benefits of the proposed disclosures on the former LTEBs.

Other comments

Question 17

Do you have any other comments on the proposals?

Current IAS 19 has a distinction between LTEB and PEB. While the Projected Credit Unit Method is used for both LTEB and PEB, a significantly simplified approach for LTEB is required resulting in some significant differences in the accounting and disclosures. For LTEB all changes in the calculation, including past service cost and actuarial gains and losses, are recognised immediately in the income statement when they occur. The significant disclosures for PEB are not required for LTEB.

Paragraph 127 of IAS 19 supports the simplified approach. "The measurement of other long-term employee benefits is not usually subject to the same degree of uncertainty as the measurement of post-employment benefits. Furthermore, the introduction of, or changes to, other long-term employee benefits rarely causes a material amount of past service cost." Additionally the present BC90 to IAS 19 adds "The Board decided, for simplicity, not to permit or require a 'corridor' approach for other long-term employee benefits, as such benefits do not present measurement difficulties to the same extent as post-employment benefits […].”

Our experience with LTEBs, which are prevalent in Europe, confirms the Board’s views in paragraph 127 and BC90. These plans are rather straight forward and lack the volatility seen in PEBs.

The ED proposes to remove all differences between LTEB and PEB. There are several objections we have related to this:

- The Board has not made clear why this change is motivated considering the simplicity and the non-volatility in LTEBs. Has a study been performed?
- Information about this change has been quite sparse. It was not discussed in the discussion paper and we do not find any information from Board meetings. In the introduction to the ED it is first mentioned as the last point under Other issues. This gives a picture that either it was a last minute quick decision or that the Board does not understand the consequences of the change.
- If the OCI approach to actuarial gains and losses, without recycling, is the Board’s answer to address volatility in income statement for PEBs, how can this approach be justified for the LTEBs where no volatility exists?
- What is the cost benefit analysis with regards to the proposed disclosure requirements? The actuarial calculations that are currently made do not include the extensive disclosures as required for PEBs. Getting full disclosure reports from the actuaries will increase costs. What is the related benefit to users? Disclosure requirements, for example sensitivity analyses, will dissect these LTEBs and add volume to the annual reports, but why? These benefits are not complicated.
- We believe that this ED and the Board’s future ED on termination benefits should be issued and combined as the definition of termination benefits is necessary to evaluate some LTEBs having characteristics similar to termination benefits, for example the ATZ arrangements in Germany.

We are pleased to be at your service in case further clarification to our comments will be needed.

Yours sincerely,

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Dr Claes Norberg
Professor, Director Accountancy
Secretary of the Swedish Enterprise Accounting Group