Norsk RegnskapsStiftelse

International Accounting Standards Board
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London EC4M 6XH
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ED/2010/3: Defined Benefit Plans - Proposed amendments to IAS 19

IASB issued in April 2010 an exposure draft "Defined Benefit Plans. Proposed amendments to IAS 19". We appreciate the opportunity to comment on the paper. This letter expresses the views of Norsk RegnskapsStiftelse (the Norwegian Accounting Standards Board).

We do support the work and the initiative of IASB in proposing these changes in IAS 19, as we see the need for amendments of the current accounting for pension benefits within the current measurement framework.

In general we agree with most of the suggested changes in IAS 19. One major comment from Norway is that we disagree with the suggested solution of calculating the net finance cost. We also believe, in general and for most plans, that the benefit obligation and plan assets should be presented gross in the statement of financial position, and likewise that there should be a gross presentation of finance cost and return on plan assets.

Please find our comments to your questions in the appendix.

Yours faithfully
Norsk RegnskapsStiftelse

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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?

We support the conclusions made by the Board. Entities should recognise all changes in the present value of the defined benefit obligation and the fair value of the plan assets in the period in which they occur. This is in line with the IASB Framework and with other IFRS standards such as IAS 37 and IFRS 2.

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

Entities should recognise all prior service cost in the same period as a plan amendment is made regardless of whether the prior service cost is vested or unvested. We believe this is in line with the IASBFramework .

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?

We agree that the defined benefit cost should be disaggregated, based on the nature of the items. This will give the users of the financial statements a better understanding of the nature of the items in the statement of profit or loss. As commented on in question 5 below, we believe that the finance component should be presented gross, leading to a disaggregation into four components with finance income as the last component. We believe this is in line with the new principles in the financial statement presentation project.

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?

We agree that the service cost component should exclude changes in the defined benefit obligation resulting from changes in demographic assumptions. In our view those changes are remeasurements, and should be treated as such. (See however our comment on question 6.)

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 to the proposed measurement model. We believe that return on assets should be separately measured and presented as actual return on financial assets in accordance with IAS 39/IFRS 9, based on the best estimate of actual return. The return on assets will in this way be based on the composition of the pension assets in the pension plan. Accordingly we believe that return on pension assets should not be split into the two proposed components, but should in its entirety be recognised in the statement of profit or loss.

We specifically disagree with the proposal to use the prescribed interest rate on high quality corporate bonds to measure net finance cost. This proposal is intended to only reflect the time value of money. However, when using the interest rate on high quality corporate bonds, the discount rate does not only reflect the time value of money, but also a credit risk element inherent in high quality corporate bonds. We thus believe that the Board does not reach its goal of only reflecting the net effect of passage of time. The method suggested would be more understandable if the interest rate to be used for calculating the obligation was a risk-free rate only.

For entities in Norway, where we have to use government bonds (risk-free rate) as the basis for determining the discount rate, this will result in a lower value of the effect of passage of time than for entities that can determine the discount rate with reference to the market yield on high quality corporate bonds. The consequence is that the remeasurement component related to assets will be different than for entities using high corporate bonds as the basis, giving rise to additional comparability problems between entities operating in different jurisdictions.

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?

As a practical solution on this short term improvement project, we support the suggested solution, adjusted for a split of the finance element into return on plan assets and interest on the gross defined benefit liability. However, we see the need for a more conceptual clarification of which types of remeasurements should be presented as Other Comprehensive Income and which types of remeasurements should be part of the Income Statement.

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?

We agree. However, as settlement gains and losses should be included in the remeasurement component, there is a need for a clearer definition of the settlement amount related to retirement benefits. When introducing a different presentation for settlements than for other changes (plan amendments and curtailments), there is a need for a clearer definition of how to split the effect when a settlement occurs together with a curtailment.

(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)

We agree. Curtailments are related to future vesting of benefits such as salary increases and hence, in a situation with a curtailment, the effect is similar to plan amendments that should be presented in the statement of profit or loss.

(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?

We agree. Plan amendments, curtailments and non-routine settlements are changes that normally do not happen regularly, but might have great impact on the accounting numbers. It is therefore important that information is given in the disclosures to describe what has happened and the impact on the financial statements. It would also be important to improve the definition of non-routine settlements in order to be able to distinguish between routine and non-routine settlements.

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?

We agree with the objectives, but we would like to include in a) "to explain the risks and exposures the company is taking as part of its pension plans".

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 agree in general with the new disclosure requirements. However, we have the following comments.

Ref b). We believe that the phrase "information about the process used to determine actuarial assumptions" is vague, and might be interpreted in different ways. We believe it would be helpful to use the same wording as is used in IAS 36.134 d) I-II.

Ref d). We would like to see in the disclosures a more general description of the investment strategies for pension assets. For many companies the fair value of the pension plan assets is among the largest items in the statement of financial position (when presented gross), and the value of the company depends on how the assets are managed and invested. We suggest the following description to be included as implementation guidance, in order to exemplify a description of the investment strategy:

1) investment strategy including assets classes etc.
2) who is investing and managing the assets (the company itself, an asset management company with a discrete mandate, an asset management company as part of regular investment funds, the life insurance company etc),
3) information regarding the regulatory framework, if any, for the management of the pension assets (e.g. any restrictions regarding type or size of assets which could be invested in),
4) information on currency risk strategies (only domestic securities, currency hedging strategies etc) and
5) any asset-liability management strategies.

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 agree with the proposed additional disclosures.

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?

We agree with the proposed additional disclosures.

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

We agree in principle with the proposed additional disclosures, but we notice that the amount of disclosure requirements in IAS 19 will be enormous. There is a serious risk (as for IFRS in general), that the huge amount of detailed disclosures requirements are causing the preparers to be more focused on complying with all detailed regulations, rather than to focus on giving relevant disclosures in addition to the financial statements and to present the disclosures in a pedagogic manner in order to explain its financial results and position to the users. We believe the requirements could be more general, with examples of useful disclosures and leave it to the preparer to decide what is useful information.

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)

We agree.

(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)

We agree.

(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)

We agree, but the requirement should also be expanded to include any tax (other than income tax) or social security tax payable by the employer in direct relation to pension plans. In many countries social security tax is payable on all or parts of the funding contributed to the plan, or on all pension payments from the plan. IAS 19 should clarify that such direct taxes should be measured as part of the defined benefit obligation (which is current practice in most countries).

(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 agree.

(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)

We agree, and this is in accordance with current practice in Norway.

(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)

We agree. But we would like IAS 19 to specify that in certain "hybrid" plans (plans with certain elements of multi-employer features, for instance the plans offered by life insurance companies in Norway and other countries), parts of the mortality and disability risk might be shared between employers. Such plans have a risk result each year related to mortality and disability. Employers with low mortality or high disability get funds transferred from the risk result. In such plans the relevant estimates are the expected mortality and disability rates of the plan members of all employers participating in the risk sharing plan within the insurance company.

(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)

We agree.

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

See above.

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?

An example of a scheme can be described as this: The scheme is financed on a pay-as-you-go basis, with a yearly calculation of funding needed. This is translated into a flat percentage of salary for each participating employee, a percentage that can vary from year to year. A possible solution is that the obligation, plan assets and cost can be allocated to each employer based on the numbers of employees and their salary level. Based on this, this plan should be accounted for as a defined benefit plan. Although some of the demographic risks in the plan are shared between the participating employers, the companies still retain the demographic and economic risk of fulfilling the pension promise for the employees taken as a whole. The risk sharing in the plan must be reflected in the measurement of the obligation, but the obligation is still a present obligation. To account for such a plan as if it was a defined contribution plan would not be in line with the general principles of IAS 19.

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

We agree that the amendments should be applied retrospectively in order to have comparable figures. However, we believe that retrospective application of sensitivity analysis will be a costly burden for the companies as they will need to rerun all actuarial calculation for prior years, and it does not give the users of the financial statements any specific useful information. Sensitivity analyses should hence be limited to prospective application only.

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 with the Board that proposed changes in IAS 19 will cause the financial statements to be more understandable and useful. However, we believe that the increased disclosure requirements will increase the costs for the reporting entities and careful considerations should be made as to which requirements are truly necessary and not. Specifically, the actuarial calculations will for many companies be more costly due to the requirement to present sensitivity analyses.

Question 17
Do you have any other comments on the proposals?

"Hybrid plans"
As mentioned above we would like IAS 19 to specify that in certain "hybrid" plans (plans with certain elements of multi-employer features, for instance the plans life insurance companies are offering in Norway and other countries), parts of the mortality and disability risk might be shared between employers. Such plans have a risk result each year related to mortality and disability. Employers with low mortality or high disability get funds transferred from the risk result. These plans have elements of multi-employer plans, but the main features of standard single employer plan are retained. There is an employee-by-employee bookkeeping in the plans, and the premiums paid are related to each employee. The risk of turnover, salary increases and return on plan assets remain in full within each employer's plan.

We would like IAS 19 to address such plans within the section of multi-employer plans in order to avoid any confusion of whether or not such plans shall be accounted for. In our view, such plans shall not be considered as multi-employer plans for accounting purposes.

Discount rate.
In our view, IAS 19 should only give guidelines on how to set an appropriate discount rate and what factors to include (time value of money, risks etc), but the discount rate should not be linked to a specific market rate (corporate bond market). We acknowledge that a fundamental review of the basis for the discount rate is not realistic to address in this short term improvement project, but the issue should be included in phase II of the employee benefit project.

However, we believe that it is relevant to address the consequences of the current interpretation of paragraph 78 for companies in countries that are integrated into international financial markets, but do not have developed local, domestic markets for high quality corporate bonds. These companies today have to use the government rate as the discount rate for their pension obligations.

We believe that the lack of such a bond market should not influence the present value of the pension obligation or the time value of pension assets, cfr this ED. Furthermore, the use of the government rate as the discount rate in such countriesmeans that the financial statements for companies operating in these countries are not comparable with the financial statements for similar companies operating in countries with a deep bond market.

Our view is that for pension plans in such countries one should be allowed to estimate a proper risk adjustment to the discount rate rather than being forced to use the government bond rate. Moreover, IAS 19 does not give any alternatives if the government bond market is inefficient. In many countries the market dept for government bonds may vary with the general market conditions and economic cycles.

In our opinion, countries with well developed financial markets do have access to high quality corporate bonds. The companies in such countries are able to utilize various financial strategies to accomplish the ultimate objective of obtaining high quality corporate bonds denominated in the countries' currency. We believe the utilization of such financial strategies should be consistent with the intent of paragraph 78 and we thus recommend that this issue is addressed in this short term improvement project.

Gross presentation in the statement of financial position.
Gross presentation of any item in the statement of financial position is the main rule in the framework and other standards such as IAS 8, IAS 32 etc. Indeed, under IAS 32 there are strict rules regarding when an entity is allowed to net financial instruments. We do not see that any of the conditions in IAS 32.42-50 is met for a standard pension plan, if IAS 32 were to be used analogous.

By presenting pension liability and plan assets net in the statement of financial position, the relevant risk exposure of the items in the statement of financial position, is concealed for the users of the financial statements.

We acknowledge that this issue was briefly discussed in the introduction to the discussion paper (1.11), but we are not convinced that the conclusion was correct. Firstly, a vital issue for the users is the risk exposure, and thus not only whether or not the fund is controlled by the entity. Secondly, the assumption that the sponsor does not control the fund is weak and does certainly not apply to all pension plans/or countries. When the pension plan is organised in a separate pension fund, that fund is in many jurisdictions effectively controlled by the sponsor. When the pension plan is organised by a life insurance company, the management of the funds is outsourced to a life insurance company, which is managing the funds on the clients' behalf as any other fund administrator. If the client is not satisfied with the life insurance company, the client may move the funds to another provider.

In both these cases it is our view that the funds are controlled by the sponsor. Thus, we do believe that the funds and the pension liability should be presented gross in the statement of financial position. This will in our view give the best information to the users of the financial statements.

We acknowledge that this question can have different solutions for different pension plans. We hence ask the Board to consider a more general description of whether the obligation and plan assets should be presented net or gross, based on an assessment of facts and circumstances for each plan, by using the definitions of items in the statement of financial position given in the IASB Framework and in other IFRS standards.

The combination of post-employment benefits and other long-term benefits.
We also disagree with combining post-employment benefits and other long-term employee benefits into a single category. We do not believe that there is a substantive problem to be fixed for the current accounting treatment of other long-term employee benefits. As a result of the proposed changes, any differences between the original estimate and the actual result would be treated as an experience adjustment and recognised in other comprehensive income as opposed to the situation today where this difference is recognised in profit or loss.