Comments on the discussion paper 'the Financial Reporting of Pensions'

This comment consists of three parts:

1. The comment starts with the answer on question 16 because this is an important question also for the answers of the other questions.
2. Answers to the other questions;
3. Postscriptum.

1. Answer to Q16.

Q16.

In the detailed discussion paper I am not able to find special attention to a particular form of pension funds which exist in some countries. I mean the category of pension funds (with defined benefits) which are connected to a company but are at the same moment legally independent of the company. At this category of pension funds the representatives of the company has never more than 50% of the votes in the board. At the same moment all the members of the board of this category of pension funds have legally the obligation to take account of the interests of all participants (employer, employees, etc.). A second characteristic of this kind of pension funds is the phenomenon of sharing the risks of this pension fund. In accordance with the pension regulation of this kind of funds, the risk of pension benefits is usually only at the side of the employees and the retired and not at the side of the employer at all. The chance that the employer has to pay an additional amount besides the costs of service is extremely small. For example the risk to receive only nominal benefits instead of real benefits (including price or wage inflation) rests at the retired (and employees). A third characteristic of this category of pension funds is the phenomenon that employees are in many cases obliged to pay a large part of these costs of service by themselves. So the company pays only a part of these costs of service.

At the moment the listed companies with this category of pension funds have to apply the rules for defined benefits of IAS 19 according to the chartered auditors. As far as the reported amounts in the balance sheet relate to net assets or net pension liabilities for this category of pension funds, these companies report nonsense. If they report in this case net assets (which some do), the company will usually not receive any amount for these assets. The company, with this category of pension funds, would never be able to decide that the company should be paid by the pension fund. If in very extreme circumstances an amount could be paid by the pension fund on initiative of the pension fund, this amount has no relation with the reported amount according to IAS 19. If the companies report in this case net pension liabilities according to IAS 19, the company never has to pay. It is not the company which can decide about the amount to be paid. The pension fund decides which amount the premium or costs of service should be. The agreement between the company and the employee, usually the employers union and the trade union fix which part the employer and the employees have to pay. So the reported amounts in the annual account according to IAS 19 are without any economic reality. Even stronger, they are extremely misleading for all the stakeholders of this listed company.

This is the reason to make an additional proposal to the discussion paper. The solution for this problem should be to allow the companies with this category of pension funds to report only the costs of service in the profit and loss account. This means the same method as for companies with a pension fund with defined contribution. Additional information about this kind of pension fund (e.g solvability etc.) should be disclosed.

In your discussion paper you did not give any analysis for this category of pension funds (with defined benefits). We hope you will correct this omission. Or do you have the opinion that IAS 19 has not to be applied to this category of pension funds at all? Or do you think the solution for this reporting problem is that the company should make an appeal to IAS 1. 17?

2. Answers to the other questions.

Q1. The liability should be based on current salaries with the condition that the liability includes conditional indexation. See also the answer to Q2.

Q2. Two conceptual approaches can be distinguished. The reported liability (of the pension fund) is the sum of the individual accrued benefits of all employees/retired or the reported liability is the reflection of the risks of all related cash flows of the pension regulation. In the last case the liability represents the calculation of the present value of the accrued benefits plus the present value of the yet to accrue benefits in the future diminished by the present value of the yet to receive premiums. A long enough time horizon should be used, for example 15-40 years. The effort (which actuaries are able to) is to calculate the present value of all the cash flows of the pension regulation which has been fixed in the past. Difficult may be to calculate but this will deliver the principal prospective approach to the fair value of the pension liability (of the pension fund). The other approach (sum of the individual accrued benefits) can in general be classified as a retrospective approach at which the liability is restricted to only the cash flows of the sum of the individual accrued benefits up till now. The PUCM of IAS 19 can be classified as an retrospective method with some prospective elements. The liability as a sum of individual accrued benefits in general delivers systematically an underestimation of the risks of the regulation. This liability is also not a going concern value but a liquidation value. However, as a second best approach the liability as a sum of the individual accrued rights can be accepted under the condition that conditional indexation, by using a real interest rate for all cash flows instead of a nominal interest rate, and also a prospective mortality table is included.

Q3. Yes, see also the answer to Q2.

Q4. In principle yes, but see also the answer to Q16.

Q5. Yes.

Q6. Yes, but see also the answers to Q16 and Q2.

Q7. Including the probability.

Q8. Yes.

Q9. No, because of loss of information in the balance sheet.

Q10. Yes, in the annual account or otherwise in the disclosure.

Q11.Yes.

Q12. Yes, the disclosure should be more complete and divided to the different pension funds of the company.

Q13. No, the delivered information will always be too much arbitrary.

Q14. Yes, see also the answer to Q16 and to Q2. The employer's liability should reflect the plan's liabilities and not the other way around!

Q15. See the answers to Q16 and to Q2.

Q16. See above.

Q17. IAS 26 should be adapted first.

3. Postscriptum.

A remark on the use/abuse of the expression 'sponsor'. The term sponsor suggests that defined benefits or defined contributions are donations of the employer. Usually this payment of the premiums by the employer is part of a labour contract. This is the reason that it should be advised not to use this expression any more.