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Mme Françoise Flores
Chair
European Financial Reporting Advisory Group
13-14 Avenue des Arts
B-1210 Brussels

By email: commentletter@efrag.org

Chère Mme Flores

IASB ED *DEFINED BENEFIT PLANS: PROPOSED AMENDMENTS TO IAS 19*

1. The ICAEW welcomes the opportunity to comment on EFRAG's draft comment letter, published in April 2010, on the International Accounting Standards Board Exposure Draft ED/2010/3 *Defined Benefit Plans: Proposed Amendments to IAS 19*. Our responses to the main issues highlighted by EFRAG are set out below. A draft of our response to the IASB, which has not yet been finalised, is attached to this letter. This provides further explanation of our views and also considers some additional points not brought-up in the EFRAG response.

2. We second EFRAG's support for the removal of the 'corridor' option. We do not see any conceptual grounds for deferring the recognition of part of an asset or liability in existence at the balance sheet date, and therefore we support the immediate recognition of actuarial gains or losses in the statement of comprehensive income.

3. We also support the immediate recognition of unvested plan costs in the year of amendment. This treatment is consistent with the broader methodology for attributing benefit to periods of service in paragraphs 67 – 71. Paragraph 68 explains that the Projected Unit Credit Method 'attributes benefits to periods in which the obligation to provide post-employment benefits arises', while paragraph 69 then goes on to clarify that such obligations are still recognised regardless of whether the benefits are vested or not. This immediate recognition is justified on the basis that a constructive obligation has been created. We believe the same reasoning should apply to the treatment of unvested past service costs; past service has resulted in a constructive obligation which should therefore be recognised as incurred, ie; in the period of plan amendment.

4. We agree with EFRAG that performance statement presentation should be mandated in the three categories set out in the ED. Disaggregation in this way improves clarity and consistency. Our understanding from those users we have consulted is that they would welcome this change as removing diversity in practice which hitherto has impaired comparability between entities.

The Institute of Chartered Accountants in England and Wales
Chartered Accountants' Hall
Moorgate Place London EC2R 6EA UK
icaew.com

T +44 (0)20 7920 8100
F +44 (0)20 7920 0547
DX 877 London/City

5. We also agree with EFRAG's answer to question 5 supporting the ED proposal to calculate finance costs as a single measure by applying the discount rate to the net defined benefit liability (or asset). Presenting a single figure in finance costs simplifies the current treatment, improving understandability, although we note the Board's comment that applying the liability discount rate as an approximation of the effect of the passage of time on plan assets is a practical expedient rather than an approach with strong technical support.

6. We plan to suggest in our answer to question 7 that non-routine settlements are most appropriately presented in profit or loss. EFRAG notes that clarification of the expression 'non-routine settlements' is needed, but does not indicate where it believes the effects of such settlements should be presented. We believe that there is a fundamental difference in substance between routine and non-routine settlements and that the presentation should reflect this.

7. We also believe that EFRAG's answer to question 11 could be expanded. As currently worded the ED would require the full disclosures to be made in the financial statements of every subsidiary participating in a group scheme. Where this information is already publicly available, ie through disclosure in publicly available group accounts, we believe that this would lead to excessive disclosure and significant additional cost with little added benefit to users. We accept that such an exemption would be appropriate only where the specific plan was disclosed and identified separately in the group accounts and that in practice this would often result in the disclosures having to be given at subsidiary level. This issue is not currently reflected in the EFRAG letter.

8. One additional point not covered in EFRAG's letter are the proposed changes to the definitions of short and long-term employee benefits. The exposure draft proposes amendments to the paragraph 7 definitions of short-term and long-term employee benefits, in part by inserting the words 'expects to become' before 'due to be settled'. It appears that the change aims to focus the distinction on the point at which the entity estimates the benefit will be utilised rather than the contractual entitlement date. However, we do not believe that the proposed definitional changes succeed in bringing clarity to the distinction between the two categories. In particular, insufficient clarification has been provided regarding application and we believe that entities might well interpret the definitions and requirements of the revised standard inconsistently. Clarity is particularly important as application may be complex in some situations and may result in significant change in accounting treatment.

9. For example, we believe that greater guidance is necessary on how to classify a benefit with multiple potential utilisation points. Our understanding is that the Board does not intend such benefits to be split, but rather to be treated as either wholly short- or wholly long-term. However, this approach is not clearly articulated and application guidance, which would be welcomed if the standard itself remains unclear, is not provided.

10. As a related point we note that reclassification of the defined benefit liability has the potential to add to volatility. We would suggest that the liability be classified once at inception as either short- or long-term and that reclassification not be permitted. As a result of these concerns we suggest that this aspect of the proposals requires further consideration.

11. Further, we do not believe that the effects of remeasurement of long-term bonuses or other deferred compensation of this type should be presented in Other Comprehensive Income. The ED applies the new presentation requirements equally to post-employment benefits and to other long-term employee benefits, including long-term bonuses and other deferred compensation. As a result the effect of remeasurement of these obligations would be presented in OCI rather than through profit or loss. While we agree that this combination might appear to be a simplification, and that it might be appropriate for many classes of benefit, we do not believe at this stage that it is appropriate for changes in the value of bonuses to be presented outside profit or loss. We believe that this change should be deferred to the Board's fundamental review of employee benefit accounting.

EFRAG Q1: Do you have any other comments about the proposed disclosure requirements?

12. Paragraphs 35-43 of our draft letter address this point. These are reproduced below:

We have reviewed each of the disclosures contained in proposed new paragraphs 125C – 125K. Set out below are our specific responses to aspects of these paragraphs we believe should be given further attention. While we have few specific comments, we are concerned that – taken as a whole – the disclosures would be considerable. While we agree that this would be appropriate for a plan that is material to the entity, we are concerned that preparers might lose sight of the overriding concept of materiality in compiling their financial statements, particularly given the extensive use of the phrase “an entity shall” at the start of the various disclosure paragraphs. With the welcome introduction of the disclosure principles, we might have expected instead introductory text that suggests consideration of the matters in the various paragraphs as a means of achieving the objectives.

125C: We believe that 125C(a)(iii) may be problematic in practice. For entities with multiple plans, detailing all of the responsibilities of trustees could result in voluminous disclosure of little interest to users. We prefer the approach taken by the UK ASB in its non-mandatory Reporting Statement Retirement Benefits – Disclosures; here only ‘significant and unusual powers’ of the trustees are recommended for disclosure.

We believe that 125C(a)(iv) should be expanded. This currently requires disclosure of any recognition ceiling for a defined benefit asset. Where the entity has recognised an additional liability as the result of the interaction of an asset ceiling and a minimum funding requirement, we believe that this too should be disclosed.

125F: Currently IAS 19 (120A(k)(ii)) refers to ‘property occupied by, or other assets used by, the entity’. This category is absent from 125F. We note that such arrangements would in any case be disclosable under the related party provisions of IAS 24, the pension plan being a related party of the entity. However, we feel that the added prominence previously contained in IAS 19 aids consistency of disclosure, and that at least some cross-reference to the requirements of IAS 24 should be included in 125F.

125G: Paragraph 125G(b) requires disclosure of the process used to determine ‘demographic actuarial assumptions’. While we note the Board’s rationale in BC60(d) for not requiring disclosure specifically of mortality assumptions, in our view they often will be key assumptions and we would support their mention, as an example, in 125G(b).

125H: This paragraph requires disclosure of the accumulated defined benefit obligation. We note the comment in BC60(f) that “in some circumstances, this amount is similar to the amount of the entity’s obligation if the plan were to be terminated” but are unconvinced about the usefulness of a disclosure that may in other circumstances be misleading. We believe that, in place of this requirement, it may be more useful to provide an analysis of the plan obligation between amounts relating to active members, deferred members (those no longer accruing benefits in the plan but not yet drawing a pension) and pensioners. This information would facilitate an assessment of the likely impact of the projected growth in salaries on the obligation as well as enabling other useful analysis to be performed, such as comparing the likely payment profile and the liquidity of assets.

125I: Paragraph 125I requires disclosure of the effect of changes to significant actuarial assumptions on the plan liability and current service cost. We wonder whether this requirement should be extended to also demonstrating the effect on longevity swaps held as plan assets, whose value is also affected by changes to these same assumptions.

125J: We support the proposed disclosure of asset-liability matching strategies such as those mentioned in paragraph 125J but believe that it would be useful for disclosure to made also of the use of derivative financial instruments more generally; the impact of these on the risk and liquidity characteristics of the entity’s exposure to net defined benefit obligations can be significant in some cases.

125K: 125K concerns factors that may cause a variance in future contributions. By specifying contributions this limits the requirement to funded plans. As noted above, we believe that the paragraph should be amended such that it applies not only to contributions but also to benefit payments to be made under unfunded plans.

EFRAG Q2: Do you believe that the costs of managing plan assets should be deducted from the return on those assets? Which approach do you prefer?

13. We agree that the administrative costs of managing plan assets should be recognised as part of the return on plan assets, other than in plans where the ultimate cost of the benefit promise depends on the net return on plan assets, when the directly attributable costs of managing the assets should be taken into account in estimating that net return and, hence, the defined benefit obligation. (We note that this exception is not reflected in the proposed definition of the return on plan assets.)

EFRAG Q3: In your experience, do you believe it is possible in practice to separate the costs of managing plan assets from other costs incurred?

14. Paragraphs 50-55 of our draft letter address this point. These are reproduced below:

We agree that the administrative costs of managing plan assets should be recognised as part of the return on plan assets, other than in plans where the ultimate cost of the benefit promise depends on the net return on plan assets, when the directly attributable costs of managing the assets should be taken into account in estimating that net return and, hence, the defined benefit obligation. (We note that this exception is not reflected in the proposed definition of the return on plan assets.) The practicability issues noted below would apply for any such costs that were not directly attributable.

However, we do not believe it is clear that the present value of the future cost of administering benefit payments attributable to current or past service should be included in the measurement of the defined benefit obligation. While conceptually we can see some logic for this proposal, we also believe that such costs are not always clearly distinguishable from future operating costs, particularly when a plan still has active members, and that in any case there may be practical difficulties in making a reliable estimate of such costs.

We can most clearly see the conceptual support for future administration costs to be recognised as part of the defined benefit obligation where a plan is closed to all future service accrual. In such a case the entirety of these costs, insofar as they could be accurately attributed to the plan, would constitute a present obligation arising from past events. Even here, though, there might be practical difficulties because these costs can be borne in a number of ways (for example directly by the sponsoring entity (within a separate cost centre or as part of a wider HR function), by the plan but reimbursed by specific additional contributions by the entity or by the plan but with no specific reimbursement) and in some cases arriving at a reliable estimate may be impracticable.

Where a plan still has active members, it may be still more difficult to find an appropriate boundary between costs that relate to past service and to ongoing service.

A solution some might put forward would be to require recognition of future administration costs on, and only on, plan closure to all future service accrual. However, it is not clear that such a black and white dividing line between two quite different treatments would be appropriate.

Were future administrative costs of benefit payments not to be included in measuring the defined benefit obligation, we believe that they should not be included as part of the return on plan assets but instead charged as administrative costs in arriving at profit or loss.

EFRAG Q4: Concerns have been raised about the availability of the information needed by entities for a full retrospective application. Do you believe that the information needed for a full retrospective application is available to entities? If not, what information would not be available?

15. We agree with the proposal in the ED that full retrospective application be required. In most cases the information necessary to apply the new requirements should be accessible relatively easily; therefore we see no reason why the normal IAS 8 approach of retrospective application should not be required.

EFRAG Q5: In your assessment, do the benefits of these proposals outweigh the costs? Please support your response with evidence of the benefits and costs you believe grow from these proposals.

16. In our assessment benefits outweigh costs so far as the 'core' proposals of the ED are concerned: in general the proposals should bring about benefits through improving the accounting for employee benefits that outweigh the incremental costs. However, we note that some of the less highlighted points, in particular the recognition of future administrative costs and the separation of actuarial gains and losses on other long-term employee benefits, do have significant cost implications. In our letter to the IASB we plan to urge the Board to ensure that these are fully considered in finalising the proposals.

Please contact me should you wish to discuss any of the points raised in this letter or the attached draft response.

Yours sincerely

John Boulton ACA
Technical Manager, Financial Reporting Faculty
T +44 (0)20 7920 8642
E john.boulton@icaew.com