TREASURY, RISK
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PROFESSIONALS
ACT

The Association of Corporate Treasurers

Comments in response to
Exposure draft ED/2010/3
Defined benefit plans (proposed amendments to IAS 19 Employee benefits
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The Association of Corporate Treasurers (ACT)

The ACT is a professional body for those working in corporate treasury, risk and corporate finance. Further information is provided at the back of these comments and on our website www.treasurers.org.

Contact details are also at the back of these comments.

We canvas the opinion of our members through our monthly e-newsletter to members and others, *The Treasurer magazine* and our Policy and Technical Committee.

General

The ACT welcomes the opportunity to comment on this matter.

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For companies with defined benefit pension plans the financial impact and the accounting impact of those plans can often be material to the financial position of that company. Any change to pension accounting has the potential to cause a substantial change to the numbers being reported. The IASB is right, however, that in the final analysis their responsibility is "to set standards intended to result in clear and consistent information that faithfully represents an entity's financial position, financial performance and cash flows so that users of that information can make well-informed decisions."

It will therefore be important that the IASB, professional accountants, preparers, analysts and others strive to help users of accounts to understand the change.

Responses to specific questions

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 immediately when they occur. Do you agree? Why or why not?

The IASB proposes to remove from IAS 19 options that allow a company not to recognise some gains and losses that arise when the company changes its estimate of a defined benefit obligation, or when there are changes in the fair value of its plan assets (often referred to as removal of the 'corridor' method). Instead, the ED proposes that companies should recognise these items immediately. This will inevitably increase volatility and some may argue that the long term nature of pension assets and liabilities means that some form of smoothing is appropriate. Even so we are of the opinion that both eliminating options that hinder comparability between entities and, that faithfully representing financial position and performance must, in the long run, be the right objectives. There is little real justification for spreading gains and losses. The gains and losses being spread are already disclosed, so there is no reason to expect them to cause a problem if disclosed in a different way through immediate recognition[1]. We therefore support the Board's proposal.

Treasurers have a particular interest in looking at their company's activities and performance from a cashflow point of view. Even if "smoothing" of accounting is eliminated Treasurers will take some comfort from the approach of the Regulator and the actuaries to recovery plans to make good any deficits which do allow for any additional cash payments to be phased.

Question 3
Should entities disaggregate defined benefit cost into three components: service cost, finance cost and remeasurements? Why or why not?

We note that the IASB is proposing that:
"An entity shall present:
(a) service cost and gains and losses arising from curtailments in profit or loss." (*Service cost directly represents the cost of the services received. This includes current and past service cost, but not changes in the estimate of service cost.*
"(b) net interest on the net defined benefit liability (asset) as part of finance costs in profit or loss.
(c) remeasurements of the net defined benefit liability (asset) in other comprehensive income."

These proposals would replace the current arrangements whereby there is a huge degree of discretion for companies to include the service costs, interest costs and expected return on plan assets mixed between operating expense and finance costs. We therefore agree with the proposed disaggregation into these three components.

[1] Except where a company has, for example, financial covenants or an equivalent provision in its constitutional documents expressed in terms of "current GAAP" rather than a fixed "GAAP" as at the time of agreement.

Question 4
Should the service cost component exclude changes in the defined benefit obligation resulting from changes in demographic assumptions? Why or why not?

We note that the Board has concluded that the service cost component would be more relevant for assessing an entity's ongoing operational costs if it did not also contain current period changes in past estimates of service cost. We question whether the treatment of costs should depend on whether they are recurring or not and whether this introduces a new principle into accounting? However since a category for remeasurements is proposed we accept that this is the most appropriate line for changes arising from demographic assumptions and that they should be excluded from the service 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?

The ACT supports this proposal in the ED.

The IASB has explained that there is a widespread view that an important economic effect of a funded plan is that there is offset between the change in plan assets that arises from the time value of money and the interest cost that arises from the defined benefit obligation. The Board concluded that part of the return on plan assets should appear in the finance cost component but not to require that the total return on plan assets be classified as interest income, because that would be inconsistent with its decision to disaggregate the defined benefit cost into service cost, finance cost and remeasurements.

Finding an objective way of splitting the overall long term return on the plan assets is difficult and many different methodologies can be suggested. The existing use in IAS 19 of an estimate of expected return is subject to a variety of interpretations and different assumptions are used by different companies. By taking the same interest rate as is applied to the liabilities a more objective and consistent number will be produced.

Applying this to the net asset or liability is consistent with the actual investment approach of many defined benefit plans where there has been a trend towards matching assets to liabilities more and more closely. The methodology in the Exposure Draft will also remove the anomaly that some companies with a pension deficit were still showing a net finance income from the plan.

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?
Why or why not?

We agree with the above presentation of the pension components.

The exact use of other comprehensive income is part of a larger debate on the presentation of accounts and performance statements and recycling so it may be that the above categorisation will need to be reconsidered at some future date.

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 affects the amount, timing and variability of the entity's future cash flows.

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

We welcome the Board´s proposal to adopt a principle-based approach and agree with the broad objectives stated.

Question 9
To achieve the disclosure objectives, the exposure draft proposes new disclosure requirements, including:
a. information about risk, including sensitivity analyses;
b. information about the process used to determine demographic actuarial assumptions;
c. the present value of the defined benefit obligation, modified to exclude the effect of projected salary growth;
d. information about asset-liability matching strategies; and
e. information about factors that could cause contributions to differ from service cost.
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 range of disclosures proposed by the Board. However given the proposed principle-based approach, we wonder whether the range of disclosures should be presented as examples or guidance rather than a mandatory list. Before mandating specifics we would hope that the IASB performs an assessment of the costs and benefits of any proposals.

The Association of Corporate Treasurers

The ACT is the international body for finance professionals working in treasury, risk and corporate finance. Through the ACT we come together as practitioners, technical experts and educators in a range of disciplines that underpin the financial security and prosperity of an organisation.

The ACT defines and promotes best practice in treasury and makes representations to government, regulators and standard setters.

We are also the world's leading examining body for international treasury, providing the widest scope of benchmark qualifications and continuing development through training, conferences and publications, including *The Treasurer* magazine and the annual *Treasurer's Handbook*, and online.

Our 3,600 members work widely in companies of all sizes through industry, commerce professional service firms.

Further information is available on our website (below).

Our policy with regards to policy and technical matters is available at
http://www.treasurers.org/technical/manifesto

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