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06 September 2010

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

Email: CommentLetters@iasb.org

Dear Sir/Madam

SAICA SUBMISSION ON EXPOSURE DRAFT ON *DEFINED BENEFIT PLANS - PROPOSED AMENDMENTS TO IAS 19*

In response to your request for comments on the IASB's exposure draft on *Defined Benefit Plans - Proposed amendments to IAS 19,* attached is the comment letter prepared by The South African Institute of Chartered Accountants (SAICA). Please note that SAICA is not only a professional body, but also secretariat for the Accounting Practices Board (APB), the official standard-setting body in South Africa. The SAICA comment letter results from deliberations of the Accounting Practices Committee (APC), which is the technical advisory body to the APB. This comment letter also includes comments received from actuaries.

We thank you for the opportunity to provide comments on this document.

Please do not hesitate to contact us should you wish to discuss any of our comments.

Yours sincerely

Sue Ludolph
Project Director – Accounting

cc: Moses Kgosana (Chairman of the Accounting Practices Board)
Prof Alex Watson (Chairman of the Accounting Practices Committee)

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SAICA SUBMISSION ON EXPOSURE DRAFT ON DEFINED BENEFIT PLANS - PROPOSED AMENDMENTS TO IAS19

GENERAL COMMENTS

Overall we support the Board's proposals to amend the accounting treatment for Defined Benefit Plans in IAS 19 – *Employee Benefits* ('IAS 19'). We believe that the elimination of the corridor method is a significant improvement in financial reporting. However, some of our constituents are not supportive of some of the proposals, which we have noted in our responses to the individual questions below. In particular, some of our constituents do not support recognising some components in other comprehensive income and some are concerned with the proposals for determining the net interest expense (income) on the net defined benefit liability (asset).

SPECIFIC COMMENTS

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?

We agree with the Board's proposal above. We concur with the Board's view, as indicated in the basis for conclusions, that immediate recognition of the changes provides the most useful information to users of the financial statements. The corridor method produced some 'anomalous' balance sheet results such as recognising greater liabilities due to unrecognised actuarial gains or recognising assets due to unrecognised actuarial losses. In such instances, the figures were not considered to be meaningful.

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

We agree with the Board's proposal to recognise unvested past service cost when the related plan amendment occurs. We believe that this is consistent with IAS 19's requirement to attribute the benefit based on the benefit formula. Therefore, to the extent the amendment attributes benefit to past service periods, such liability should be recognised. The measurement of such a liability should reflect the possibility of forfeiture should the vesting conditions not be met in the future.

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?

We agree with the Board's proposal to disaggregate defined benefit cost into the components stated above. The proposal represents an improvement and clarification to current IAS 19 requirements, and should achieve comparability in presentation of financial statements between entities. We agree that the components have different predictive value and should therefore be presented separately.

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 7 and BC19–BC23) Why or why not?

Yes, we believe that the changes resulting from changes in demographic assumptions should be presented separately from the service cost component.

Although, generally, changes in estimates are recognised in the same place as the original estimate under IFRS, we are persuaded by the Board that it would be more useful to present these changes in estimates separately given their different predictive value. In fact, this argument could apply to the presentation of other changes in estimates under IFRS.

While we agree that the effects of the changes in demographic assumptions should be presented separately from the service cost for the current period, the question is whether they should be presented separately in profit or loss or other comprehensive income ('OCI'). In addition, we do not see any basis for recognising the effects of changes in demographic assumptions differently from changes in financial assumptions (such as salaries). Therefore, we agree that the effects of changes in both demographic and financial assumptions should be presented separately from the service cost component, but in the same place as each other. Please refer to our answer to question 6 regarding where these items should be presented.

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.

Most constituents agree with the Board's proposal 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). Accordingly, these constituents support the proposal of effectively splitting the return on plan assets into an element that arises from the passage of time and another element that results from all other changes in fair value. While some of our commentators questioned the appropriateness of using a high quality corporate bond rate (in essence a risk-free rate) for the plan assets, based on the reasoning in BC 32, overall they believe that the proposed approach is reasonable and workable.

Some constituents disagree with the Board's proposal in that it is not based on any principle, but requires the use of an arbitrary measure of income on plan assets. In addition, the proposed treatment has little predictive value. The difference between income on this basis and the actual income on plan assets will be included in re-measurements, when it is argued that some or all of this difference should be excluded from such re-measurements. With actuarial assumptions remaining the best estimate of the variables that will determine the ultimate cost of providing long-term employee benefits, applying a discount rate to a net defined benefit liability (or asset) is arguably not how an entity actually expects events to unfold. Actuarial assumptions are required to be unbiased and so, if an entity actually expects the return on assets to exceed the discount rate, then the proposed method would result in the use of biased assumptions. While the entity might have a net liability in the statement of financial position, the underlying asset and liability are subject to different returns and accordingly they should be accounted for differently. The proposed approach does not distinguish between types of assets; for example, if the assets in the defined benefit plan were cash or equities, which may have different returns, then it is believed this should be reflected accordingly in comprehensive income to assist users to predict future cash flows.

For example, if an entity expects the return on assets to exceed the discount rate, it could pay an amount into a defined benefit plan on this basis (i.e. the amount paid to the plan is less than the present value of the defined benefit obligation). If the expectations are met, then, in terms of the proposals, a net finance charge would be included in profit or loss, with a re-measurement gain that exceeds this charge being included in other comprehensive income, when it is argued that the entity was expecting the liability to reduce over time and that the profit or loss should reflect this. The expectation is that actuarial gains and losses would more or less balance over time, but the proposals could distort this expectation as a result of probably moving some of the expected return on assets to other comprehensive income. On this basis, it is suggested that the expected return on plan assets should be retained in profit or loss, as required by the present IAS 19.

We believe that the net defined benefit liability (asset), for purposes of calculating the net interest, should be net of any additional liability required in terms of paragraph 115K. However, based on the wording in the definitions, it is not clear whether this is the case. Paragraph 115K refers to making adjustments to the net defined benefit liability (asset), yet the definitions do not refer to this paragraph. The definitions define the net liability (asset) as being the total of the deficit or surplus and the effect of the limit in paragraph 115B. The deficit or surplus, in turn, is defined as the present value of the defined benefit obligation less the fair value of plan assets (if any). Therefore, it is unclear whether the definition of the present value of the defined benefit obligation implicitly includes the paragraph 115K adjustment, or whether there is an omission from the definition of the net defined benefit liability (asset). We recommend that the definitions clarify the inclusion of this adjustment explicitly, either as part of the present value of the defined benefit obligation or as part of the net defined benefit liability (asset).

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 with the Board's proposal to recognise service cost and net interest on the defined benefit liability (asset) in profit or loss. With regard to the Board's proposal to recognise re-measurements in OCI, the majority of our commentators are not opposed.

Among constituents there is a concern that within IFRSs generally there are no established principles for determining which items should be recognised in OCI. This makes it difficult to assess for specific items, such as these re-measurements, whether they should be recognised in OCI or not. However, notwithstanding this, the majority of our commentators were persuaded by the Board's argument that the re-measurements have different predictive value, especially with regard to the uncertainty of future cash flows, and should be presented outside of the current period's profit or loss. Most felt that these changes are not reflective of the entity's underlying operations and should therefore not form part of profit or loss. Also, IAS 19 currently allows actuarial gains or losses and the effects of the asset ceiling to be recognised in OCI.

Although there was general agreement for re-measurements to be recognised in OCI, some concerns were raised about recognising different components in different places. For example, an entity may decide to enhance benefits due to the positive performance of the plan assets. The positive return on the plan assets (except for the time value element) would be recognised in OCI, while the cost of the enhanced benefit would be recognised in profit or loss. Some suggest that, in this case, the portion of the return on plan assets used to enhance benefits should be recognised in profit or loss rather than OCI because there is no net cost to the entity. However, it is acknowledged that such an approach would make the IAS 19 treatment complex.

A minority of our commentators believe that the re-measurements should be recognised in profit or loss, similar to changes in other estimates under IFRS. They do not see any conceptual basis for excluding such items from profit or loss.

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?

Generally, we agree with the Board's proposals above. However, we believe that it is possible that, as part of a settlement, there could also be a change in benefits promised. If there is a change in the benefits promised, we believe that the change in benefits should be accounted for similarly to other changes in benefits, e.g. past service that is recognised in profit or loss. Therefore, we recommend that gains and losses on routine and non-routine settlements should be disaggregated into actuarial gains and losses and changes in benefits. Only actuarial gains and losses should be included in the remeasurement component.

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?

We agree with the Board's proposal above. We believe that the objectives are consistent with the general objectives on preparation of financial statements as described in the *Framework for the Preparation and Presentation of Financial Statements.*

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?

Generally we agree with the Board's proposal above. However, we have the following concerns:

(a) The disclosure proposed in 125I (as referred to in part (a) above) only focuses on the defined benefit obligation. We believe that there are risks relating to plan assets as well. As a result, we recommend that similar disclosures should also be required separately for the plan assets (i.e. not for the net defined benefit liability (asset) since we concur with the Board's view in BC64). We believe that such disclosure is essential for an understanding of the entity's ability to meet defined benefit obligations.

(b) We do not support the disclosure required in part (c) above. In certain jurisdictions, for example South Africa, the disclosure required in part (c) will not necessarily reflect the amount payable if the plan were to be terminated because of certain prescribed minimum benefits that would be payable. The Board states that this figure would also be useful to those who believe that the measurement should exclude projected salary growth. By requiring this disclosure, it potentially undermines the Board's view that the measurement should include projected salary growth. Although the Board concludes that it will not be costly to produce this information (BC 60(f)), in our jurisdiction we do not believe that such disclosure will be useful.

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 agree with the Board's proposal.

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?

We agree with the Board's proposal.

Other comments

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

None.

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)
(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)
(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)
(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?

We agree with the Board's proposals above; however, we are concerned with part (d). Part (d) requires that the return on plan assets be reduced by administration costs that relate to managing plan assets. In practice, it is not always clear which portion of administration costs relates to the management of plan assets and which portion relates to administering claims and benefit payments.

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?

We have not identified 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 multi-employer plans. In the South African environment, multi-employer plans are most commonly used by Municipalities, and generally the information is not available to account for the plan as a defined benefit plan.

Transition

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

We agree with the Board's proposal that the amendments should be applied retrospectively as the information required to apply the amendments retrospectively should be available.

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 with the Board's assessment above.

Other comments

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

Classification of contributions paid in the statement of cash flows:

Given the proposals to disaggregate the changes in the net defined benefit liability (asset), we encourage the Board to clarify in its financial statement presentation project how contributions paid to an employee benefit fund should be classified in the statement of cash flows. Currently, such contributions would be classified as operating cash flows.

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