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Dear Kevin

AASB EXPOSURE DRAFT ED 195 & IASB ED/2010/3 DEFINED BENEFITS PLANS (Proposed amendments to AASB 119 & IAS 19)

Grant Thornton Australia Limited (Grant Thornton) is pleased to provide the Australian Accounting Standards Board (AASB) with its comments on ED 195 which is a re-badged copy of the International Accounting Standards Board's (the Board) ED/2010/3 (the ED). We have considered the DP and set out our comments below.

Grant Thornton's response reflects our position as auditors and business advisers both to listed companies and privately held companies, and public and private businesses, and this submission has benefited with some initial input from our clients, Grant Thornton International which is working on a global submission to the IASB, and discussions with key constituents.

The views expressed here are preliminary in nature, and a more detailed Grant Thornton global submission will be finalised by the IASB's due date of 6 September 2010.

General Comments
Support for the Proposed Amendments

We welcome the ED and consider that most of the proposals represent improvements to the current version of IAS 19 *Employee Benefits*. In particular, we support the Board's proposal to eliminate the 'corridor' mechanism for smoothing the impact of actuarial gains or losses. We also support the proposals to disaggregate the net change in the defined benefit obligation and the fair value of plan assets into three components: service cost, finance cost and remeasurements.

Also, we support the recognition of service cost and finance cost in profit and loss with the remeasurement components to be recognised in other comprehensive income (OCI). Having said this, our support of this proposal is to be read in the context of this ED being a short-term project to improve the current IAS 19. We currently see no clear conceptual basis to distinguish which gains and losses should be recognised in OCI rather than through profit or loss. However, for practical reasons, we agree that this issue should be addressed as part of other projects and should not delay the outcome of this project to improve IAS 19.

We do not support the proposal to treat other long-term benefits in the same way as post-employment benefits. We do not agree that switching the recognition of remeasurements through OCI instead of profit and loss and adding significant complexity to the accounting and disclosure for such employee benefits is an improvement to the current requirements.

Non-Publicly Accountable Entities

We note that the IASB has not indicated whether it will amend the existing requirements for non-publicly accountable entities.

Grant Thornton does not believe that at this time AASB 119 should apply to non-publicly accountable entities and hence the proposals contained in the ED are not ones that we believe should be relevant. Adoption of IFRS recognition and measurement principles which the AASB believes necessitates an increase in disclosures compared to IFRS for SMEs, does add significant complexity and costs that would not be borne by similar structured overseas entities.

We expand on the above comments in our responses to the questions in the ED's Invitation to Comment Questions, and the AASB's request for comments, which are set out in the Appendix to this letter.

If you require any further information or comment, please contact me.

Yours sincerely
GRANT THORNTON AUSTRALIA LIMITED

Keith Reilly
National Head of Professional Standards

Appendix 1: Responses to Invitation to Comment Questions

Invitation to Comment questions

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. We see no conceptual basis for the deferral or smoothing of actuarial gains and losses. The options currently available to entities to defer recognition of actuarial gains and losses increase complexity, reduce comparability and result in the recognition of amounts in financial statements that have little relationship to economic reality.

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

Yes. We agree that the unvested benefits relate to past service and so form part of the defined benefit obligation at the reporting date. This proposal is consistent with the immediate recognition of all changes in the defined benefit obligation. It also increases consistency with the general approach in IAS 19 to allocate benefits to periods of service regardless of whether they have vested or not.

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?

Yes. This disaggregation results in the presentation of items of income and expense with different levels of predictive value separately. This is consistent with paragraph 28 of the *Framework for the Preparation and Presentation of Financial Statements*, which notes "the predictive value of the income statement is enhanced if unusual, abnormal and infrequent items of income or expense are separately disclosed".

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 agree that current and past service cost as defined in ED7 should only reflect the performance-related pension obligation aspects of the employee service. Demographic assumptions are not part of the performance-related aspects.

Also, we agree with the Board that there are different drivers to changes in the pension obligation which have different predictive values. Consequently we agree that the separation of changes in non-performance related factors such as demographic changes from those changes arising from employee service or benefits earned will enhance the ability of users to make their own assessments about the possible changes in the underlying assumptions and their impact on future costs.

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)?

Yes. Calculating a net interest rate applied to the net defined benefit liability (or asset) provides a consistent approach between statements of financial position and comprehensive income. Although we acknowledge the limitations of the proposed approach and in particular the use of the discount rate specified in ED78, we are convinced by the arguments presented in the Basis for Conclusions (BC23-BC32) that this provides a suitable short-term practical expedient.

In particular, using the same rate to calculate interest income on plan assets as the rate used to discount the liabilities provides greater consistency and comparability between entities. It also reduces the volatility in the profit or loss charge (or credit) from significant changes in the expected return on plan assets against the more prudent discount rate used based on the yield on high quality corporate bonds. However, there may be significant differences between the discount rate used to identify the net interest cost and the actual return on plan assets. We have some concern that such difference will never be reflected in profit or loss (see question 6 below).

As noted in our response to ED 2009/10 *Discount Rate for Employee Benefits*, we have some concerns regarding the appropriateness of using the yield on high quality corporate bonds as the discount rate. However, we appreciate that the current ED is intended as a short-term improvement project and so do not discuss this further here. In the longer term, we believe that a wider review of the measurement of post-employment benefit obligations and the accounting for post-employment benefit plans more generally is needed. In particular, we believe that the Board's basis for conclusions on the use of high quality corporate bonds to determine the discount rate (IAS 19.BC26-34) is worth revisiting.

If the use of the yield on high quality corporate bonds is to be expanded as proposed, then we recommend that the Board considers the need for more specific and relevant guidance on estimating the market yield and, in particular, guidance that resolves the issues that arise if there is no deep market for corporate bond's in the entity's jurisdiction. ED 2009/10 suggested that the current guidance in IAS 39 would be useful in this context. However, the current guidance in IAS 39.AG69-82 is insufficient and will not be of much practical use in situations where guidance is needed. This is because the IAS 39 paragraphs in question:

- apply in the context of valuing a single instrument but not in determining an overall or composite market yield. The latter exercise involves identifying the instruments to include in the reference basket - a matter not addressed in the IAS 39 guidance;
- are used for instruments held or issued by the reporting entity rather than instruments to which the reporting entity is not party to the contractual terms;
- does not offer any practical expedient or other guidance on what to do in jurisdictions in which there are no quoted or observable transaction prices in high quality corporate bonds.
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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?

Yes. The measurement of net interest cost based on the net defined benefit liability (or asset) has the advantage of a symmetrical treatment of interest cost on the defined benefit obligation and interest income on plan assets, presenting them both in profit or loss, which is consistent with most other IFRSs.

The question as to where remeasurements should be recognised is more difficult to answer as there is currently no clear conceptual basis to decide which gains and losses should be recognised in other comprehensive income (OCI) rather than through profit or loss. At this time, we acknowledge that the Board does not have the resources to complete such a project. The lack of guidance in this area should not delay improvements to other standards such as IAS 19. Therefore, although we support immediate recognition of actuarial gains and losses (including the actual return on plan assets), we accept that the presentation of those amounts in the statement of comprehensive income as currently accepted in IAS 19 should not be changed significantly at this time.

However, as noted in our response to question 5 above, there may be significant differences between the discount rate used to identify the net interest cost and the actual return on plan assets. Until there is a more fundamental review of the conceptual basis behind recognising gains and losses through OCI rather through profit and loss, it is difficult to comment on this proposal. Our preferred view is to agree that remeasurements should not be reclassified but we understand that some commentators may find this controversial.

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?

Generally, only routine settlements are provided for in actuarial assumptions and we agree that such settlements should therefore be recognised as remeasurements to be consistent with other actuarial gains and losses. However, non-routine settlements usually result from management action and decisions rather than routine remeasurements of actuarial assumptions and so in nature may be more similar to curtailments. Consequently, we feel these would be better accounted for in profit or loss. This would require a different and more robust definition of 'non-routine settlements. Perhaps something along the lines of "settlements not allowed for in the plan rules".

(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)

Yes.

(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 believe that separate disclosure of these items is useful in providing an understanding of the causes of gains and losses and/or changes in the value of the net defined benefit liability in the period.

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 of would you amend the objectives and why??

Yes.

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 that most of the disclosures proposed contribute to meeting the objectives stated in the ED (as outlined in question 8 above). However, we do not believe the disclosures in ED125I(a)(ii) (part of item (a) above) and ED125H (item(c) above) are appropriate.
We do not see the value of including in a sensitivity analysis of possible changes at the beginning of the period (ED125I(a)(ii)), as those changes clearly have not affected the service cost for the current period. Instead, information about actual changes in actuarial assumptions from the previous period will be included in the reconciliations required by ED125D-E.

As a general point, we believe that the items to be included in sensitivity analyses should be restricted to items outside the entity's control, such as interest rates, mortality rates, etc. Item (c) above (ED125I(a)(ii)) proposes to require disclosure of the present value of the defined benefit obligation adjusted to exclude the effect of projected growth in salary rates. The ED has reaffirmed (ED71A) the Board's belief that future salary increases should be included in the measurement of the plan obligation. We believe that disclosure should be restricted to matters relevant to the amounts recognised in the financial statements. We are not convinced by the argument in BC60(f) that the cost of providing this information is outweighed by user benefit.

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?

The disclosures proposed are useful to identify the additional risks faced by participants in such plans as outlined in the Basis for Conclusions.

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 this proposal as the information needs of users are the same regardless of the control structure.

Other comments

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

We believe that some disclosures relating to the reliability and source of the discount rate calculation (ie whether the rate is based on market rates or other valuation technique - see response to question 5 above) would enhance the information provided to users of the financial statements.

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?

In general, we agree with the proposals above, with the following comments:

(d) Administrative costs: This appears to be a reasonable approach and fits a principle that the return on plan assets should be net of the directly attributable costs of administering those assets, particularly as the fee structure in many plans is linked to a percentage of the return earned. However, we do question whether the benefits are sufficient to justify the additional costs likely to be incurred in trying to separate these costs clearly.

(e) Expected future salary increases: We agree for the reasons expressed in BC89. This provides a consistent result to that reflected in an average-salary type scheme which in substance provides the same benefits.

(g) Risk-sharing and conditional indexing features: Plans that share some risks between employers and employees do not fit easily into the traditional defined contribution or defined benefit accounting models. Consequently, the current requirements for measuring both types of scheme do not deal adequately with these types of schemes. We agree that such schemes should though continue to be accounted for as defined benefit schemes in the current regime and so risk sharing and indexation should be considered more fully in the measurement of the pension obligation. However, this sort of scheme demonstrates the need for a longer-term project to fundamentally review the accounting for modern day schemes.

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?

Where an entity can find a reliable basis for allocating the obligation, plan assets and cost then defined benefit accounting should apply as this provides more relevant information for users. However, we cannot identify a sufficiently consistent and reliable method for such allocation.

Transition

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

Yes.

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 that much of the information required is already needed to apply the existing version of IAS 19. However, actuarial input is required to identify the cost of the additional new requirements (especially related to allocating tax and administrative costs).

Other comments

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

Change of definition of 'other' long-term benefits.

There is no specific question addressing the change to the definition of other long-term benefits that will require such benefits to be accounted for in the same way as post-employment defined benefit plans. In particular, remeasurements would now be recognised in OCI rather than profit or loss; the change in the benefit obligation will need to be disaggregated into three components; and substantially greater disclosure will be required. Although this may increase consistency between the accounting for post-employee benefits and other long-term benefits, we do not believe that is necessary given the different nature of the benefit types. For example, a two- or three-year salary bonus scheme is not subject to the significant estimate-uncertainty and volatile remeasurement changes that support the more complex treatment of long-term post-employment benefit plans. This change will increase the cost and effort required to account for such employee benefits. We do not see the benefit of this change and do not consider this to be an improvement on the current requirements of IAS 19.

Definition of short-term versus long-term employee benefits.

We do not understand what is meant by 'expected to become due to be settled'. It is not clear if this means the contractual settlement date (due to be settled) or the expected settlement date. Greater clarity is needed. Additionally, it is not clear whether long-term benefits must be separated in to current and non-current elements in order to satisfy the requirements of IAS 1. The definition in ED7 of short-term and long-term benefits has been changed and the existing reference to 'wholly' has been deleted. However, the word wholly is included in the description of the types of long-term benefits in ED4. The inconsistency in the definition of current/non-current liability and short-term or long-term employee benefits adds to the confusion.

Illustrative Example - Example 6:

Why is the opening surplus restriction excluded from the opening totals yet movements in the restriction are included? Is this an error? The disclosures are complex so it is important that the examples are clear. A clearer link between examples 1 and 6 would be useful.

AASB Request for comments

The AASB would particularly value comments on the following:

1. The Preface to AASB 1049 Whole of Government and General Government Sector Financial Reporting notes that, as a result of potential amendments to the requirements in other Australian Accounting Standards, differences between Generally Accepted Accounting Principles (GAAP) and Government Finance Statistics (GFS) not contemplated in AASB 1049 may eventuate. Consistent with the AASB's comments in the Preface to AASB 1049 addressing this matter, the AASB will have regard to the implications for whole of government and GGS financial reporting in decided whether to amend the proposals in this ED or the requirements in AASB 1049 to either avoid or confirm the existence of a difference.

In that regard, do you think the proposed changes to the treatment of:
(a) past service cost;
(b) gains and losses arising from curtailments;
(c) net interest on the net defined benefit liability (asset); or
(d) remeasurements of the net defined benefit liability (asset);

would have implications for GAAP/GFS harmonisation and, if so, how do you think those implications should be dealt with in the context of the principles in AASB 1049?

We are not aware of any specific GAAP/GFS concerns.

2. Do you agree that the proposed amendments to the definition of 'return on plan assets' and paragraph 73(b)(iv) of IASB's ED/2010/3 Defined Benefit Plans clarify the treatment of superannuation contributions tax in accounting for defined benefit obligations? If not, please explain why.

We agree.

3. The AASB would particularly value comments on whether:
(a) in addition to the issues raised in relation to Question 1 above, there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, particularly any issues relating to:

(i) not-for-profit entities; and
(ii) public sector entities;

(b) overall, the proposals would result in financial statements that would be useful to users; and

(c) the proposals

(a) We are not aware that there are regulatory or other issues arising in the Australian environment, apart from our earlier comments on the proposals. We believe that there are regulatory and other issues arising in the Australian environment. for non-publicly accountable entities as the proposed requirements would add significant complexity and costs that would not be borne by similar structured overseas entities.

(b) We are not aware of any reasons that would impact on the usefulness of these proposals to users for publicly accountable entities, apart from our earlier comment son the proposals. However we do not believe that these requirements should apply to non-publicly accountable entities as the proposed requirements would add significant complexity and costs that would not be borne by similar structured overseas entities.

(c) For publicly accountable entities, apart from our earlier comments on the proposals, we are not aware of any reasons that would impact on the interests of the Australian economy and our New Zealand firm will comment direct to the AASB if there are any New Zealand implications. We do not believe that these requirements should apply to non-publicly accountable entities as the proposed requirements would add significant complexity and costs that would not be borne by similar structured overseas entities.