13 August 2010

The Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West Victoria 8007
AUSTRALIA

E-mail: standard@aasb.gov.au

Dear Kevin

**Comments on ED 195 Defined Benefit Plans**

Thank you for the opportunity to comment on AASB ED 195 ED/2010/3 Defined Benefit Plans. CPA Australia, The Institute of Chartered Accountants (The Institute) and the National Institute of Accountants (the Joint Accounting Bodies) have jointly considered this exposure draft (ED) and our comments follow.

The Joint Accounting Bodies represent over 180,000 professional accountants in Australia. Our members work in diverse roles across public practice, commerce, industry, government and academia throughout Australia and internationally.

We have commended the IASB for tackling accounting for defined benefit plans and broadly support the ED's proposals relating to defined benefit plans, subject to the detailed comments listed in the Appendix. This support is to be read in the context of this ED being a short term project to improve the current AASB 119 *Employee Benefits*. We currently see no conceptual basis to distinguish which gains and losses should be recognised in Other Comprehensive Income (OCI) versus the profit or loss. However for practical reasons we believe this issue should be dealt with as part of other IASB projects and should not delay completing this project to improve AASB 119.

We note the ED also proposes changing accounting for other employee benefits such as annual leave and long service leave that would impact all Australian reporting entities. We cannot support these proposals because, in our view, the resulting accounting treatment is inappropriate and these changes have not been clearly communicated. Annual leave and long service leave provisions involve continuous remeasurement adjustments that are properly reflected in salary/wages expenses in the profit and loss. The proposal that these remeasurements be included in other comprehensive income does not result in information that is relevant for decision making.

Our detailed comments in response to the AASB's questions are attached, as is our submission to the IASB.

If you have any questions regarding this submission, please do not hesitate to contact either Mark Shying (CPA Australia) at mark.shying@cpaaustralia.com.au, Kerry Hicks (The Institute) at kerry.hicks@charteredaccountants.com.au or Tom Ravlic (NIA) at tom.ravlic@nia.org.au.

Yours sincerely

| | | |
|---|---|---|
| Alex Malley | Graham Meyer | Andrew Conway |
| **Chief Executive Officer** | **Chief Executive Officer** | **Chief Executive Officer** |
| **CPA Australia Ltd** | **Institute of Chartered Accountants in Australia** | **National Institute of Accountants** |

## Appendix: Responses to AASB Questions

**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 understand from our constituents in government that ED 195 moves IFRS closer to GFS. Hence this is a good outcome for government constituents.

**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 that the proposed amendments add clarity to the treatment of superannuation contributions tax in accounting for defined benefit obligations.

We note there remains ambiguity in relation to the treatment of investment tax, as this is not clearly resolved by the ED and the discussion in BC 84 to 86 does not clarify the meaning of the amendments in relation to investment tax.

**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 are in the best interests of the Australian and New Zealand economies.**

We are not aware of any regulatory or other issues arising in the Australian environment that may effect the implementation of the proposals. However, we request that in future submission requests, the AASB asks a specific questions regarding disclosures applicable to entities that have adopted the Reduced Disclosure Regime.

Overall we believe the proposals in relation to defined benefit plans are in the best interest of the Australian and New Zealand economies, subject to the detailed comments we have included in our submission to the IASB.

We do not believe the proposals as they impact on annual leave, long service leave and similar obligations are in the best interests of the Australian and New Zealand economies. This is because these proposals would result in remeasurement adjustments relating to annual leave and long service being included in other comprehensive income, whereas these are business benefits/expenses that should be included in profit and loss.

13 August 2010

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

Via "Open to comment" page on www.iasb.org

Dear Sir David

**Comments on ED/2010/3 Defined Benefit Plans**

Thank you for the opportunity to comment on the IASB Exposure Draft ED/2010/3 Defined Benefit Plans. CPA Australia, The Institute of Chartered Accountants (The Institute) and the National Institute of Accountants (the Joint Accounting Bodies) have jointly considered this exposure draft (ED) and our comments follow.

The Joint Accounting Bodies represent over 180,000 professional accountants in Australia. Our members work in diverse roles across public practice, commerce, industry, government and academia throughout Australia and internationally.

We commend the IASB for tackling accounting for defined benefit plans and broadly support the ED's proposals relating to defined benefit plans, subject to the detailed comments listed in the Appendix. This support is to be read in the context of this ED being a short term project to improve the current IAS 19 *Employee Benefits*. We currently see no conceptual basis to distinguish which gains and losses should be recognised in Other Comprehensive Income (OCI) versus the profit or loss. However for practical reasons we believe this issue should be dealt with as part of other IASB projects and should not delay completing this project to improve IAS 19.

We note the ED also proposes changing accounting for other employee benefits such as annual leave and long service leave that would affect all Australian reporting entities. We cannot support these proposals because, in our view, the resulting accounting treatment is inappropriate and these changes have not been clearly communicated. Annual leave and long service leave provisions involve continuous remeasurement adjustments that are properly reflected in salary/wages expenses in the profit and loss. The proposal that these remeasurements be included in other comprehensive income does not result in information that is relevant for decision making.

Our response to matters on which specific comment is requested is included in the attached Appendix 1. We have only included answers on questions relevant to areas our members are involved in.

If you have any questions regarding this submission, please do not hesitate to contact either Mark Shying (CPA Australia) at mark.shying@cpaaustralia.com.au, Kerry Hicks (The Institute) at kerry.hicks@charteredaccountants.com.au or Tom Ravlic (NIA) at tom.ravlic@nia.org.au.

Yours sincerely


Alex Malley
**Chief Executive Officer**
**CPA Australia Ltd**

Graham Meyer
**Chief Executive Officer**
**Institute of Chartered Accountants in Australia**

Andrew Conway
**Chief Executive Officer**
**National Institute of Accountants**

## 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, as this is relevant information and should be recognised in the period it occurs. We see no conceptual basis for the deferral or smoothing of actuarial gains and losses.

**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 that entities should recognise unvested past service cost when the related plan amendment occurs as the change relates to a past event.

## 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 that splitting the defined benefit cost into three components provides useful information on the cost of operating the defined benefit plan.

However, the principle remains that these are employee costs and this needs to be clear from the disclosures. In particular, the finance cost relating to a defined benefit plan is essentially a cost of employing personnel, resulting from actuarial assessments and the variables that impact on a defined benefit plan, rather than arising from the financing structure of the entity. Users of the financial statements must be presented with information clearly differentiating between the cost of financing the entity, and finance cost that has been calculated in relation to a defined benefit plan.

## 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)**

We do not agree the net interest on the defined benefit liability (asset) should be determined by applying the discount rate specified in paragraph 78. The reasons for our position are threefold.

- A deep market in corporate bonds does not exist in all countries, as explained in our submission on ED 2009/10 Discount Rate for Employee Benefits, thus entities in some countries will be required to discount at the government bond rate. Whilst this has the benefit of simplicity, the fact that entities in some countries can use the corporate bond rate and others the government bond rate will restrict comparability. It will conceivably also result in a higher defined benefit liability in countries using the government bond rate, putting entities in these countries at a competitive disadvantage.
- Conceptually we also disagree that the corporate or government bond rate is necessarily appropriate, as plans are managed to achieve growth and outperform the bond rate. A plan that outperforms the government bond rate will be disadvantaged such that the gains cannot be reflected in the profit or loss, but must be taken to other comprehensive income. We cannot see how this makes conceptual logic.

- Paragraphs 54 and 56 states the amounts recognised as a defined benefit liability (asset) are measured by the sum of a number of variables that include the present value of the defined benefit obligation at the end of the reporting period and the fair value at the end of the reporting period of plan assets out of which the obligations are to be settled directly. Paragraph 102 explains that when no market price is available to measure the fair value of plan assets, their value is estimated, for example, by discounting future cash flows using a discount rate that reflects both the risk associated with the plan assets and the maturity or expected disposal date of those assets. We consider it will only be by chance that the discount rates applied to plan assets and the defined benefit obligation will be the same. Accordingly, requiring the use of the discount rate specified in paragraph 78 will on occasions result in the reporting of a finance cost component that includes net interest that does not represent the underlying position.

We recommend that entities be permitted to use a rate that is appropriate to their plan management. Where this rate cannot be reliability measured the default rate should be the corporate or government bond rate. As the net interest is included in profit or loss, and remeasurement in other comprehensive income (OCI), it is important the interest is a realistic measure.

## 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 fully support abolishing the corridor approach as we see no conceptual basis for the deferral or smoothing of actuarial gains and losses. Although there is an argument that remeasurements as well as the service cost and net interest should be presented in profit and loss, we support including remeasurements in OCI as a pragmatic step in moving towards an improved standard. A conceptual rationale for distinguishing what should be recognised in OCI versus profit or loss should be determined by another project, so as not to delay the outcome of this project to improve IAS 19.

As mentioned in the answer to question 5, we are concerned that including net interest on the net defined benefit liability as part of finance costs could be misleading. We support including the net interest in profit or loss, with clear disclosure that it is related to the defined benefit plan rather than a cost of financing the entity.

## 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?**

Our concerns with these proposals are identified below.

Firstly, we are concerned about the new distinction between routine and non-routine settlements. As paragraph 110 has not been amended and simply refers to "settlements" this would mean that it has to be applied to all settlements, regardless whether they are routine or non-routine. That is, every time a superfund makes a lump sum payment they would have to remeasure their DBO and the related plan assets and determine a settlement gain or loss! We do not believe this is the intent of the proposed changes. As far as we can ascertain, the distinction between routine and non-routine is only relevant for the disclosures, as new paragraph 125E only requires separate disclosure of any actuarial gains and losses that are the result of a non-routine settlement.

In our view, 'settlements' should be defined to include only non-routine settlements.

We also do not believe that settlements and curtailments should be accounted for differently. In either case, you have to remeasure the DBO and plan assets before determining the effect of the settlement or curtailment. The result of this remeasurement would be presented in OCI. The impact of the curtailment or settlement is determined in a second step and in our view both should be recognised in profit or loss. The decision to settle for a higher amount (or negotiations that may result in lower costs) is a decision made by management or the plan trustees. Any gain or loss on settlement is the result of an active decision and not due to factors outside of the control of the entity. It should therefore be presented in profit or loss in the same way as any curtailment gain or loss. This would also avoid the need to clearly differentiate between curtailments & settlements, which is not always possible.

## 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 these objectives.

### 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 are concerned that the disclosures are onerous and overly complex, and will therefore lose relevance.

We disagree that information about risk and sensitivity analyses is always relevant. Instead, we recommend a principles based approach be adopted similar to AASB 101 *Presentation of Financial Statements*, so these disclosures are required only when there is significant estimation uncertainty. We also disagree that disclosing the present value of the defined benefit obligation modified to exclude the effect of projected salary growth is always relevant. If the objective of this note is to disclose the liability payable if the defined benefit liability be settled within 12 months of year end, then only those entities where this is foreseeable should be required to make this disclosure. We are also concerned that disclosing a second measure of defined benefit liability in the notes is confusing and undermines the credibility of the information in the Statement of Financial Position.

We do not support mandating information about asset-liability matching strategies as we understand some entities do not manage their defined benefit plans that way.

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

As mentioned above, we are concerned that the disclosures are becoming onerous and overly complex, and will therefore lose relevance.

This is exacerbated by the fact that some annual leave and all long service leave balances in Australian entities will fall under the definition of long-term employee benefits and a significant number of entities will be required to make the same disclosures as defined benefit plans. IAS 19 does not currently require specific disclosures about this type of long-term employee benefits. In our view, this proposal is onerous and costly for entities without providing any additional relevant information to users. We explain further how annual leave and long service leave operates in Australia in our answer to question 17.

## Transition

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

We understand entities will be able to apply the proposed amendments retrospectively where entities use actuaries to calculate the amounts. This applies in relation to defined benefit plans and some long service leave balances.

We do not agree that the disclosures should be retrospective as these are overly complex and providing historical information will not be relevant.

## 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 part a) (i) to (iii) as explained above. We do not agree that the proposed disclosures will improve information about the risks for the reasons we have explained in question 9.

We do not agree that the impact of the proposals should be minimal due to the impact on annual leave and long service leave (and similar) balances, and the onerous disclosures, as explained in question 12.

## Other comments

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

We do not support the proposed changes to the definition of short-term employee benefits, and the inclusion of all long terms benefits in the same category as they affect annual leave, long service leave and similar employee benefits.

<u>Lack of clear communication</u>

We do not believe clear communication has been accorded to these proposals as they affect annual leave, long service leave and similar employee benefits, given that constituents have not been forewarned of the proposals in the Introduction to the ED, and there are no specific questions asked in relation to these changes. These proposals will have a widespread and significant impact on many Australian reporting entities and as such, we recommend the proposed change should be clearly communicated and constituent comments sought. If the changes proceed as planned, some may be concerned about the adequacy of the Board's due process if they feel they have not been fully consulted with. By way of background, around 400 large entities in Australia have defined benefit plans, whereas all Australian reporting entities (numbering in the many thousands) have long service leave and annual leave balances that are generally material.

<u>Impact on annual leave</u>
In Australia, annual leave is cumulative and vesting and in many instances, employees accrue leave for many years, so for many reporting entities the annual leave liability is a material amount. We are aware that there is diversity of practice in Australia with some entities measuring this liability at the nominal value and others discounting the amount to present value. However given that an entity does not have an unconditional right to defer settlement, annual leave is generally classified as 'current' in accordance with AASB 101 *Presentation of Financial Statements.* We welcome the IASB's addition of clarity on this issue and support the proposal that annual leave that is not expected to be settled within 12 months should be discounted to present value.

However, the proposed change to the definition of long-term employee benefits will result in annual leave not expected to be settled within 12 months being accounted for in the same way as defined benefit plans, such that the remeasurement component is included in OCI. We cannot support this proposal as annual leave is a business expense and it is most relevant for this cost to be included in profit or loss. We also do not believe the prescribed disclosures for long-term benefits are necessary for annual leave balances.

<u>Impact on long service leave</u>
We also do not agree with the proposal to apply the same requirements to all long-term employment benefits, based on the treatment of post-employment benefits. In Australia, this would mean including long service leave liabilities in the same category as other post employment benefits, resulting in long service leave calculations and disclosures become unnecessarily complex without any increase in relevance for the users.

Currently remeasurement of long service leave balances is included in profit or loss, whereas under the proposals remeasurement would be included in OCI. We cannot support this proposal as long service leave is a business expense and must be included in profit or loss to give relevant information.

Included in Appendix 2 is one explanation of how long service leave arrangements operate in Australia.

<u>Taxation of the Investment Income of a Superannuation Plan</u>
Although the proposed amendments to the definition of 'return on plan assets' and paragraph 73(b)(iv) add clarity to the treatment of superannuation contributions tax in accounting for defined benefit obligations the treatment of taxes on investment income remains unclear. In 2009, the Australian Accounting Standards Board was alerted to the range of different approaches in place. We encourage the IASB to provide the necessary clarity in the finalised standard.

<u>Presentation of the ED</u>
We would like to comment on the presentation of the ED. Given the substantial changes proposed throughout IAS 19 *Employee Benefits*, it would have been much easier to read and analyse the ED if it was in the form of a full marked up version of IAS 19, rather than just the portions that were changed. For example, the impact of the change to paragraph 73 (measurement of the cost of providing long-term benefits) is only apparent when reading it in conjunction with paragraph 78 (discount rate), yet paragraph 78 was not included in the ED as it is not proposed to change.

We recommend that future EDs proposing a number of changes that rely on other parts of a standard be issued as a fully marked up version of the standard.

Extract from the AASB's Australian guidance on IAS 19, now deleted by the AASB

**Long service leave requirements**

G4. Whilst differences exist between the various Acts, Awards and Workplace Agreements specifying long service leave entitlements in Australia, the following entitlement categories are common:

(a) an unconditional legal entitlement to payment arises after a qualifying period of service (usually ten or fifteen years). Accumulation of long service leave entitlement continues after this point, until the leave is taken. This entitlement is termed the "unconditional" entitlement category;

(b) in certain circumstances (for example, death, retrenchment, or early retirement under some Awards), a legal entitlement to pro rata payment in lieu of long service leave arises (sometimes only after a qualifying period of service). This entitlement is termed the "conditional" entitlement category; and

(c) no legal entitlement to any payment or leave exists before the accumulation of the period of service necessary to qualify for the entitlement described in (a) or (b) above. This entitlement is termed the "pre-conditional" entitlement category.

At any point in time, an employer could have employees in more than one of the above categories.

G5. To the extent that it is probable that long service leave entitlements accumulated by employees in the unconditional, conditional and pre-conditional entitlement categories during the reporting period will result in cash outflows by an employer in future reporting periods, they satisfy the criteria for recognition of a liability. The employer has consumed employees' services during the period and the entitlement accumulates with the provision of employees' services.

G6. It will often be possible for employers to estimate the present value of the future cash outflows associated with their long service leave liabilities by using "short-hand" measurement techniques. For example, experience may indicate that accrual of an employer's long service leave liability based on remuneration rates current as at the reporting date for all employees with five or more years of service provides an estimate of the long service leave liability not materially different from the estimate determined by using the present value basis of measurement and detailed group-based estimates.

G7. Whilst most employers provide long service leave benefits to employees directly, some employers participate in industry-based long service leave schemes. Where an employer has an obligation to contribute to any funding shortfalls of such a scheme, that obligation satisfies the definition of liabilities. This is because the employer has a present obligation to make future cash outflows as a result of the long service leave scheme arrangements. Accordingly, an employer's obligations to industry-based long service leave schemes are recognised as a liability of the employer.

G8. Some industry-based long service leave schemes operate so that employers directly meet their long service leave obligations to employees, and subsequently receive reimbursement from the scheme for all or part of the payments made to employees. In such cases employers recognise separately as liabilities the amount of payments expected to be made to employees and as assets the amount expected to be reimbursed by the scheme.