



AMERICAN ACADEMY of ACTUARIES

September 3, 2010

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

**Re: Defined benefit plans (Proposed amendments to IAS 19 *Employee Benefits*), ED/2010/3**

Dear Sir or Madam:

The Pension Accounting Committee of the American Academy of Actuaries<sup>1</sup> thanks the International Accounting Standards Board (IASB) for the opportunity to comment on its exposure draft of proposed amendments to IAS 19, *Employee Benefits*.

We commend the IASB for its well-conceived effort to improve employee benefit accounting and comparability in a limited-scope project. We appreciate the work done by the Board, and generally agree with its conclusions on most of the broader issues. We do have some concerns, however, regarding implementation and measurement details, particularly with regard to termination-of-employment curtailments and the handling of administrative expenses. In addition, we have concerns about the minimum funding requirement, and the disclosures of sensitivities, risk, and multiemployer plans. We have addressed these concerns, and have included our perspectives on the general actuarial issues raised by the exposure draft, in the answers to selected questions posed in the exposure draft. Please see our comments below.

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?*

We agree that the service cost component should exclude changes in the defined benefit obligation resulting from changes in demographic assumptions. Measurements of the service cost and the defined benefit obligation are best estimates, reflecting the facts and circumstances and management's judgment at the time. All subsequent changes in information, or changes in judgment based on new information (including demographic experience, changes in discount rate, actual asset returns, and other changes in estimate), should be recognized in a similar manner—and are qualitatively different from the value of benefits earned for the current year of service.

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)*

<sup>1</sup> The American Academy of Actuaries is a 17,000-member professional association whose mission is to serve the public on behalf of the U.S. actuarial profession. The Academy assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

We agree with the general concept of net financing cost, as it allows sponsors to take into account the prefunding of the plans in the income statement. As stated in paragraph BC32 of the exposure draft, using the discount rate to measure the expected return on assets has its limitations. We understand that there are limited options that reflect the time value of money on assets yet also retain some simplicity and comparability. We note that eliminating the explicit expected return on assets removes one quantitative, albeit imperfect, measure of the riskiness of the plan sponsor's investment policy. We believe, however, that the discussions about risk and risk management policies in our answers to Questions 8 and 9 provide more useful (and usable) information to investors than the expected return on assets calculation under the current standard.

This change in methodology also may allow plan sponsors to base decisions about plan asset allocation purely on economic and risk management grounds, without adversely affecting profit or loss. In fact, removing the immediate benefit of asset risk-taking from the income statement may reduce the willingness of sponsors to take that risk. At the very least, removing the immediate accounting impact from the income statement refines the focus to the true economics of the decision.

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 that these elements of pension cost are qualitatively different from each other, have different predictive value and would be used differently in analysis. They therefore should be reported separately.

Although it is beyond the scope of this discussion, we note that in a fully implemented balance sheet/total comprehensive income reporting model, properly identifying the characteristics of *operating*, *financing*, or *remeasurement* become more important than grouping some of them into *profit or loss* and others into *other comprehensive income*.

- 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?*

As discussed in our answer to Question 4, we believe that all changes in the defined benefit liability resulting from experience or from refinements as new information becomes available should be recognized similarly. We therefore agree with the Board's conclusion that the gain or loss that results from a routine or nonroutine settlement is an experience adjustment arising in the current period, with the effect of such a change presented in the remeasurement component of other comprehensive income. The change in the defined benefit liability resulting from a settlement is really a difference between the assumptions that the entity has chosen to measure the obligation and the actual settlement cost. In addition, the gain or loss due to nonroutine settlement would not have a particularly predictive value and should not be mixed with the elements of profit or loss that have predictive value.

- 7 (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)*

We also agree with the Board's conclusion that curtailments arising because a plan sponsor "amends the terms of a defined benefit plan so that future service by current employees will no longer qualify for benefits or will qualify for only reduced benefits" should be treated in the same way as a plan amendment, with the effect of such a change presented in profit or loss. Our primary reason for agreeing with this approach is that the change in the

defined benefit obligation (DBO) caused by such a curtailment results from a change in the benefit provisions being offered. In fact, given the other changes proposed in the exposure draft—particularly the elimination of unrecognized differences between the plan’s funded status and the net defined benefit liability—we no longer would include this type of event in the definition of a curtailment. In our view, it is just another example of the type of plan amendment that results in “past service cost” (although it typically will be a negative past service cost).

We reach a different conclusion, however, with respect to the presentation of the gain or loss resulting from a significant reduction in the number of employees covered by the plan as a result of a reduction in workforce. On balance, we believe that such gain or loss is more akin to other gains and losses and should be presented in the remeasurement component of pension expense:

- The change in DBO arising from such an event is not a change in the benefit provisions being provided, but rather a remeasurement resulting from actual experience differing from the fundamental assumption of an ongoing plan. In addition, the gain or loss due to a significant workforce reduction would not have particularly predictive value and therefore should be excluded from profit or loss and presented in other comprehensive income.
- The statement of rationale expressed in BC 47 is more applicable to this event, as the curtailment gain or loss results from employees actually terminating employment before they had been expected to do so in previous measurements of cost.
- Examples of actions that an entity can take that could affect the experience of the plan but are not currently considered a plan change include whether to grant a pay increase to a participant and whether to dismiss a participant for cause. A workforce reduction decision is similar to these examples and that it is more consistent with a settlement decision than a decision to change the benefits offered by the plan.

It is possible, however, that the decision may not be clear cut. There may be factors that would support the conclusion that the curtailment gain or loss associated with the termination of employment for a significant number of plan participants should be recognized as profit or loss. For example:

- The entity’s decision to involuntarily terminate a large group of participating employees amounts to an amendment to the implied contractual obligation to provide retirement benefits as reflected in the previous measurements of plan cost, and arguably could be recognized in prior service cost.
- A significant reduction in workforce might be part of a disposition of other assets or operating segments for which the gain or loss on the disposition is presented in profit or loss. The gain or loss for the curtailment relating to the disposition also should be presented in profit or loss (although the disposition question could be handled by separate standards for dispositions that would account for all gains and losses related to the disposition in the same way).
- For a plan in which the termination of employees or the sale of a business can completely eliminate the benefits attributable to past service (U.S. Retiree Medical plans, for example), it may be more appropriate to recognize the reduction in DBO through profit or loss than through other comprehensive income. This particular example also goes to the broader question of how such plans should be measured generally, which is beyond the scope of either the exposure draft or this comment letter.

*7 (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?*

In general, the proposed narrative description seems helpful. We suggest, however, specifically limiting the requirement to material or significant items (for example, replacing the word “any” with either “any material” or

“any significant”). This is to clarify that immaterial or insignificant events should not be disclosed so as to avoid confusing or misleading the users of financial statements..

We agree that, as a matter of comprehensiveness and clarity, the reconciliations of the net defined benefit liability, defined benefit obligation, and plan assets should include, where appropriate, the effects of plan amendments, curtailments, and nonroutine settlements. We note that the illustrative examples could be improved by adding a line item for curtailment effects to align more closely with the standard.

We also agree that, as proposed in paragraphs 125D and 125E, separate reconciliations should be shown for each element of the net defined benefit liability (plan assets, the DBO, and the effect of 115B). Separating the net liability into its components is necessary for users to understand the change in the net amount.

*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?*

While the above objectives are reasonable, there is some inconsistency between the objectives and the actual requirements of the statement. We suggest aligning them more closely, as described below:

- In objective (a), immediately after “characteristics of,” insert the phrase “and the principal risks associated with.” This will align the objective better with the statement’s focus on disclosing risks associated with DB plans. This focus is important enough to warrant being reflected explicitly in the objectives.
- Objective (c) is not totally consistent with the statement’s requirements. To make it consistent, we suggest leaving the objective as is, but modifying the requirements of 125I and 125K to be more consistent with the stated objective. Our proposed modifications to 125I and 125K are described in our answer to Question 9.

*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?*

125C(b)—We suggest rewording the first sentence of this paragraph to read “a narrative description of any unusual or significant risks to which the plan exposes the entity and of any significant concentrations of risk.” In

addition to focusing only on significant or unusual risks, this new wording omits the phrase “the extent of” because it is too difficult to quantify the extent of the risk, and because the paragraph is intended to require only a narrative description.

125I—As currently drafted, this paragraph requires entities to disclose the effect of changes to each significant actuarial assumption. We suggest deleting this requirement entirely because:

- Comparing sensitivities of individual assumptions provides little useful information about the overall risks of maintaining a pension plan—both liabilities and assets. It would be more relevant and useful to estimate the reasonably possible range of variation in the plan’s funded status or pension expense over a one-year period or the potential variation caused by one year of demographic experience vs. the assumptions.
- In our view the administrative cost of complying with 125I is significant and may overshadow any benefits to be gained.
- Since the discount rate is qualitatively different from other assumptions (it is more of a current market measure than an assumption about future events), we believe it may be appropriate to include a single sensitivity analysis on this particular item (including all related assumptions in the valuation that are driven by the discount rate).

125G(a)—We believe quantitative disclosure about the actuarial assumptions should be limited to the significant actuarial assumptions.

125G(b)—We believe the requirement to provide a description of the process used to select demographic assumptions is unnecessary and can be deleted. Such disclosure either would be generic and not useful or beyond the knowledge or expertise of general purpose financial statement users to properly evaluate. We do believe, however, that it is appropriate for the audit process to include a discussion of the documentation, support, and rationale for the assumptions.

125H—We agree with the requirement to disclose the present value (PV) of the DBO with no salary scale. We agree that this is appropriate, important, and useful. It provides users with a better estimate of the plan’s liability for benefits earned to date. It is also convergent with U.S. GAAP, and the additional calculation is generally available at reasonable cost.

125J—We agree with the requirement to disclose details regarding any asset/liability matching strategies used by the plan. This type of disclosure is entirely consistent with the overall objective to provide disclosures and information about the management of risk.

*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?*

Please see our answers to Question 14.

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)*

*Do you agree with the proposed amendments? Why or why not? If not, what alternative(s) do you propose and why?*

(a) In many jurisdictions, plan sponsors may not have an “unconditional” right to withdraw surplus if member approval, trustee approval, and/or regulator approval is required, which would narrow the economic benefit to the ability to take contribution holidays. A strict interpretation of the draft standard would suggest an entity can't account for any refund of surplus. But this seems unreasonable in some cases, such as those in which regulatory approval technically is required but for which there is no substantial risk of refusal if all the benefits have been paid. It may be more reasonable to modify the requirement to “the entity can reasonably expect to be entitled to the surplus when liabilities are settled.”

(b) We suggest either eliminating the additional liability for a minimum funding requirement (MFR) or limiting it to only those amounts that reflect an irrevocable, fixed contractual payment that exceeds the recognized balance sheet liability and does not have an effect on any future minimum funding requirement. A contribution schedule in a valuation report that is subject to renegotiation or remeasurement before it has finished, therefore, would not produce an onerous obligation.

As currently stated, the MFR rules effectively require a separate measurement of liabilities that is inconsistent with the underlying concepts, principles, and objectives for IAS 19 measurements.

Conceptually, IAS 19 specifies a measurement basis for determining an entity's benefit obligations. This measurement basis includes a specified approach for attributing benefits to periods of service and specified principles for setting assumptions, including the underlying presumption that both the plan and the entity are ongoing. In ordinary circumstances, it should not be expected that a measurement on an alternative basis (made for other purposes) would have any effect on the determination of the employer's obligation for financial reporting purposes.

As a result, our initial reaction would be to eliminate paragraph 115K in its entirety, since the current measurement already takes into account the funded status of the plan based on the financial reporting assumptions and the actual contributions made (whether contractual or voluntary). We could see, however, a rationale for the employer to record an additional liability for a minimum funding payment in the limited situation in which all of the following were true:

- The MFR was a current, fixed, contractual or legal obligation that was already incurred and could not be modified in the future.

- Payment of the MFR (and investment earnings thereon) would not affect the calculation of funding requirements at future valuation dates. If a future minimum funding requirement could be reduced because of investment gains on the current MFR, the current MFR would be excluded from consideration under this item.
- The MFR exceeded the deficit otherwise recorded under IAS 19 (or there was an IAS 19 surplus).

In this limited situation, it may be reasonable to say that the employer's liability should be the greater of the regular liability or the MFR. In other situations, we believe mixing and matching measurement bases is not appropriate.

(c) and (d) We believe that the handling of taxes and administrative costs could be clarified, and that BC84 and 85, in particular, leave the impression that companies should be capitalizing routine ongoing costs.

In general, taxes and administrative costs can be paid in one of two ways: directly by the employer or out of plan assets. In most cases, these costs relate to the ongoing costs of maintaining an employee benefits plan (that is, for transactions or services that are yet to be provided). Note that the transactions or services yet to be provided are not necessarily *employee* services—they could be services to be provided by an outside entity, such as an asset manager or contract plan administrator. In any event, these services relate to the employer's ongoing decision to maintain a plan (within the fundamental conceptual framework of an ongoing business and plan). In rarer cases, these costs can relate directly to the benefits attributable to employee services already performed.

In most cases, taxes and administrative costs are not *clearly* and *nearly entirely* attributable directly to benefits related to employee service already rendered (taxes on trust investment income, which don't apply in the United States, would be one exception; the expenses associated with benefits provided through an insurance contract, such as health care or annuities, would be another). We recommend that, absent strong compelling evidence that taxes and administrative costs were attributable to past service, they should be considered ongoing maintenance, a consequence of the continuing decision to operate a plan, and should be recognized when paid. This approach would put plan maintenance and administration costs on a level footing with other recurring costs of running a business (such as rent and salaries). We believe the appropriate time to capitalize such costs would be at plan termination or windup, which changes the fundamental assumption of an ongoing plan.

Rather than trying to segregate costs into "administrative" and "investment" components, it would be simpler and more informative to separate them into "explicit" and "implicit" payment types. Explicit payments include all those costs that result in a separate, specifically identified charge (for example, an identified payment for a specific service). Explicit costs would be recognized, when paid, as a component of profit or loss, consistent with other costs of operating a business. Explicit costs could include both investment and administrative components.

Implicit costs will usually (but not always) be investment-related. They would include things such as the bid-ask spread on asset transactions or fund investments that extract some management costs out of the fund value before reporting it to the plan. Since the only available measure in these situations is the actual return on assets, these expenses would be recognized, when paid, through the actual return on assets component of other comprehensive income.

As an alternative, all administrative costs paid by the trust could be netted against the actual return on assets and recognized in other comprehensive income, with administrative costs paid directly by the company expensed as incurred. Or the IASB standard could allow expected administrative costs paid by the trust for the period to be added to the current service cost and recognized in profit or loss, letting administrative costs paid directly by the company to be expensed as incurred. Either of these approaches would be simpler to implement and more transparent to investors.

We recommend that the IASB clarify the treatment of administrative costs as outlined above, and clearly indicate that the intent was not to expand the definition of costs that would be capitalized in the DBO, but only

to acknowledge that because the asset return can no longer be reduced for administrative costs the only available options were to include them in the service costs or the measurement of the DBO.

*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?*

Before we discuss the specifics of this issue, we note the practical problem likely to be encountered by large companies that may be participating in dozens of different multiemployer plans. Gathering information on all of those plans in a short period of time could be an arduous task.

The exposure draft proposes that an entity account for its participation in a defined benefit multiemployer plan based on its proportionate share of obligations and assets, if sufficient information is available. It is highly unlikely that employers participating in a defined benefit multiemployer plan in the United States will have sufficient information to do defined benefit plan accounting as assets are not segregated by participating employer. Additionally, the process of selecting appropriate actuarial assumptions—especially the discount rate—is unclear. Should assumptions be plan based or employer based? This process could be costly to the employer. The client of a multiemployer pension fund actuary is the fund, not individual employers. The employer, therefore, will have to hire its own actuary to perform the calculations and in their view the cost of this analysis may outweigh the benefits.

The increased disclosure requirements for employers required by the exposure draft are generally reasonable, with one possible exception. Paragraph 33A(d) is not clear as to whether amounts to be paid on withdrawal are to be disclosed in all cases or only if agreed upon. We concur that agreed-upon amounts should be disclosed. Requiring the disclosure of potential amounts payable on withdrawal in other situations, however, may be both costly and misleading for a number of reasons.

When withdrawal occurs and significant amounts are owed in the U.S., the actual amounts are often determined through legal proceedings. While it is true that the multiemployer fund may have provided an estimate (or determination) of a number known as “withdrawal liability,” that number is subject to challenge by the employer and has not been agreed upon.

Because of various limits, caps, and other constraints in U.S. law, a multiemployer fund’s initial estimate of a withdrawal liability may have little to do with an employer’s ultimate obligation to the multiemployer plan. Arriving at a reasonable estimate of that obligation—even within a broad range—is a complex and costly calculation involving specialized expertise. (We appreciate that the language in 33A(d) does not say withdrawal liability and agree that the phrase “amounts payable on withdrawal” is more appropriate than “withdrawal liability.” But we are concerned that the distinction is quite nuanced and would suggest that it be described in the basis for conclusions.)

Even if withdrawal liability provided a reasonable and usable basis for determining amounts payable on withdrawal, and although U.S. law requires the multiemployer fund to provide a participating employer with its hypothetical withdrawal liability upon request (no more than once per year), the multiemployer fund is permitted to charge a fee for that information. Given the timing of liability valuations, the amount provided may be a year

out of phase. For example, should financial statements for the fiscal year ending December 31 2010, published in early 2011, disclose the potential withdrawal liability for a withdrawal in 2010 (which can no longer happen) or in 2011 (an amount that likely will not be available until late in the year)? Since withdrawal liability can be volatile from year to year depending upon asset performance and, in some cases, changes in market-based interest rates, disclosure of the prior year's amount may be, at best, useless, and, at worst, misleading.

We would be happy to discuss any of these items with you at your convenience. Please contact Jessica M. Thomas, the Academy's pension policy analyst (202-785-7868, thomas@actuary.org) if you have any questions or would like to discuss these items further.

Sincerely,

A handwritten signature in black ink, appearing to read "Stephen A. Alpert". The signature is fluid and cursive, with the first name being the most prominent.

Stephen A. Alpert, FSA, FCA, MAAA  
Chair, Pension Accounting Committee  
American Academy of Actuaries

Copy: James F. Verlantz, FSA, FCA, MAAA