

Chapters 4 and 5 : Definition of contribution-based promises

Question 5: Do you agree that the Board has identified the appropriate promises to be addressed in the scope of this project? If not, which promises should be included or excluded from the scope of the project, and why?

We believe the scope of the promises covered by the definition is too broad. We address this below in terms of the principles and through examples in question 6.

We have strong reservations over the validity and consequences of the Board's proposal to create a separate and distinct approach to the accounting of a particular class of hybrid arrangements (the 'contribution-based promises' as defined in the discussion paper).

In our view, the difference in the accounting approaches for Defined Benefits and Defined Contribution promises arises from the fundamental difference between such arrangements

- DC promises : in return for services rendered to the employer, the employer is obliged to make a cash contribution into an investment account on behalf of the employee. On payment of that cash sum, the company bears no further risk (gain or loss) relating to the service period that the cash sum covers
- DB promises (meaning all promises that are not DC); in return for services rendered to the employer, the employer promises to pay a benefit to the employee in a future time period (e.g. during retirement). A reserve is established for that benefit based on certain assumptions made and the employer bears the risk that the reserve held may prove to be more or less than the amount required at the time the benefit is payable. The employer may choose to fund that promise into a trust or similar vehicle for reasons of law or prudence, however such payments do not change that the economic risk of under or over provisioning/funding falls on the employer.

In this regard, the limiting case of a DB promise (when the last instalment of the benefit promised to the now retired employee is actually paid) is a DC promise.

Hybrid arrangements, of which there are many forms in practice, can be viewed as comprising DB and DC type elements. We have a fundamental difference with the Board in that we consider that on economic grounds "contribution-based" promises are a sub-class of hybrid arrangements, not that DC arrangements are a sub-class of "contribution-based" promises. We believe that the appropriate way to account for all hybrid arrangements is a combination of the accounting approaches for DB and DC promises, judgement being applied given the nature of the particular promise. Given the IAA's unique experience of pension promises globally, we would be pleased to discuss practical options how to do this with the Board – we make some preliminary suggestions in our response to Question 15 below.

We do not see, and therefore do not support, the need nor the rationale to create a wholly different framework for the accounting of a particular type of hybrid arrangement. The concept of 'contribution-based' promises seems to us artificial. We fail to see how it can aid the understanding of users of financial statements.

In practical terms, the Board's proposal also seems to us to create more problems than it resolves

- Where potential inconsistencies occur today on the boundary between the definition of DB and DC plans, adopting a different framework that draws the line instead between DB and CB (contribution based) plans

does not remove the scope for inconsistencies. Instead, it just gives rise to different inconsistencies and in our view they are more complex and problematic than those that arise today with the current IAS19.

- A different accounting framework gives rise to non-sensical situations where two benefits which are economically the same (or almost the same) can give rise to fundamentally different presentations in the financial statements, e.g. a deferred benefit in a final salary plan (accounted for as DB) and an accrued career average benefit in a career average plan (accounted for as a 'contribution-based promise'). Both are DB promises in our view and correctly fall to be accounted as such under IAS 19.

If the Board has concerns over the appropriate measurement of DB promises this should be addressed as part of the fundamental review planned for 2011. It is not appropriate, and certainly not an improvement to the current deficiencies of IAS19, to introduce a different approach now and thereby pre-empt the more fundamental review in the process.