Hong Kong Institute of
Certified Public Accountants
香港會計師公會

**14 May 2008**

**To: Members of the Hong Kong Institute of CPAs**
**All other interested parties**

# INVITATION TO COMMENT ON IASB DISCUSSION PAPER ON *PRELIMINARY VIEWS ON AMENDMENTS TO IAS 19* EMPLOYEE BENEFITS

***Comments to be received by 25 August 2008***

The Hong Kong Institute of Certified Public Accountants' (Institute) Financial Reporting Standards Committee (FRSC) is seeking comments on the IASB Discussion Paper which has been posted on the Institute's website at:
www.hkicpa.org.hk/professionaltechnical/accounting/exposuredraft/content.php.

The discussion paper represents the first step in a comprehensive project on the accounting for post-employment benefits. It addresses the main concerns expressed by a wide range of interested parties that the accounting model set out in IAS 19 *Employee Benefits* is inadequate and should be reviewed. Constituents have pointed out that:

- the deferral of the recognition of gains and losses in defined benefit plans leads to misleading figures in the statement of financial position;
- the multiple options for this deferral lead to impaired comparability across companies;
- the definitions of post-employment benefit plans lead to inconsistencies and impaired comparability for those benefit promises that include a promised return on contributions linked to an asset or an index; and
- the required measurement method is inadequate for such benefit promises.

The IASB's preliminary views on how to address those main issues are:

- remove the optional "corridor" deferral method for recognition of actuarial gains and losses in defined benefit plans and recognise all changes in the value of plan assets and the post-employment benefit obligation in the financial statements in the period in which they occur; and
- redefine post-employment benefit plans as contribution-based promises and defined benefit promises, with new measurement for contribution-based promises.

A summary of the key changes proposed in the discussion paper is set out in the Appendix.

The discussion paper focuses on improvements to IAS 19. In the longer term, the IASB intends to work with the US FASB towards a common standard on post-employment benefit promises. The IASB will review the responses to this paper, and modify or confirm its preliminary views. An exposure draft of amendments to IAS 19 will then be developed for public comment.

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In accordance with the Institute's Convergence Due Process, comments are invited from any interested party and the FRSC would like to hear from both those who do agree and those who do not agree with the proposals contained in the IASB Discussion Paper.

Comments should be supported by specific reasoning and should be submitted in written form.

To allow your comments on the IASB Discussion Paper to be considered, they are requested to be received by the Institute on or before **25 August 2008**.

Comments may be sent by mail, fax or e-mail to:


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Comments will be acknowledged and may be made available for public review unless otherwise requested by the contributor.

**Appendix**

## About the Discussion Paper

- IAS 19 *Employee Benefits* is a complex standard covering short tem, long-term and termination employee benefits and post-employment benefits. This Discussion Paper is limited in scope to a consideration of some aspects of post-employment benefits and addresses the following issues:

  (a) the deferred recognition of some gains and losses arising from defined benefit plans.

  (b) presentation of defined benefit promises.

  (c) accounting for benefits that are based on contributions and a promised return.

  (d) accounting for benefit promises with a 'higher of' option.

  All the other issues associated with recognising, measuring and disclosing employee benefits will be the subject of future consultation.

- IAS 19 allows a company many different options for recognising gains and losses. The IASB believes that there should be only one approach for recognising gains and losses and that immediate recognition of all gains and losses in the period they occur is the best approach. Three approaches for doing this, with different effects on profit or loss, have been suggested.

- IAS 19 has two types of post-employment benefit plans – defined benefit and defined contribution. However, some benefit promises such as cash balance plans or promises linked to contributions with a minimum guaranteed return appear to have characteristics of both. As a result, some plans that are defined benefit are sometimes classified incorrectly. The IASB thinks that a good solution, given the targeted approach being considered, would be to introduce a new category of benefit promises to deal with cash balance and similar plans (contribution-based promises). These are promises that can be expressed in terms of a known contribution (ie a fixed amount or an amount independent of future salary increases) and a promised return linked to an asset or an index.

- The IASB's preliminary view is that the measurement of the entity's liability for contribution-based promise should be based on current best estimates, unbiased, probability-weighted amounts and observable market values where they exist. Also, the entity should assume that the benefit promise does not change. The IASB believes that the measurement attribute *fair value assuming that the benefit promise does not change* best expresses this approach.

## Summary of the key changes proposed in the Discussion Paper

### *1) Change of approach from 'plans' to 'promises'*

The overall approach of the Discussion Paper is to change the unit of account from being based on a plan to being based on a promise. If a post employment benefit plan includes more than one type of benefit promise, the entity should identify and account for each type of promise separately.

The Discussion Paper proposes to eliminate the definition of "defined contribution plans" and introduce a new definition of contribution-based promises. It also proposes renaming "defined benefit plans" to "defined benefit promises".

The main objective of the definition of contribution-based promises is to separate promises that depend on the return on assets or indices from promises that do not. A “contribution-based promise” would include promises with a promised return. Some examples of contribution-based promises are promises:

- that are classified currently as defined contribution plans;
- of a return based on notional contributions;
- that guarantee a fixed return on contributions; and
- expressed as a fixed lump-sum at retirement that is not dependent on service.

“Defined benefit promises” are defined as any post-employment benefit promise that is not a contribution-based promise.

*2) Accounting for Defined Benefit Promises*

*(a) Recognition*

IAS 19 permits entities to recognise some changes in the value of plan assets and in the defined benefit obligation in periods after the period in which they occur. For example, actuarial gains and losses that exceed a “corridor” threshold can be recognised over the service lives of the employees, and unvested past service costs are recognised over the vesting period.

The Discussion Paper proposes that entities should recognise all changes in the value of plan assets and in the defined benefit obligation in the financial statements in the period in which they occur. It also proposes that unvested past service costs be recognised in the period of a plan amendment.

*(b) Presentation*

The Discussion Paper illustrates three possible approaches for presenting changes in the value of plan assets and defined benefit obligations.

*Approach 1*
Present all changes in the defined benefit obligation and in the value of plan assets in profit or loss.

*Approach 2*
Identify separately the changes in the value of plan assets and defined benefit obligations resulting from the cost of service. Service costs, including adjustments made as a result of changes in assumptions relating to service costs other than those arising from changes in discount rate, would be presented in profit or loss. All other costs would be presented in other comprehensive income.

*Approach 3*
Present remeasurements that arise from changes in financial assumptions in other comprehensive income, with all other changes presented in profit or loss.

For curtailments and settlements of defined benefit plans, IAS 19 already requires entities to recognise gains or losses in profit or loss when the curtailment or settlement occurs. The Discussion Paper proposes that entities should recognise gains or losses on curtailment or settlement in accordance with each of the three approaches as described above. A gain or loss on curtailment is considered to be a service cost, and therefore recognised in profit or loss. However, a gain or loss on settlement is not a service cost and could result in a different treatment from current IAS 19 requirements. Under approaches 2 and 3 the gain or loss would be presented in other comprehensive income.

*3) Accounting for Contribution-based Promises*

The Discussion Paper proposes that both vested and unvested contribution-based promises are recognised as a liability as is presently required by IAS 19 for defined benefit plans. Liabilities arising from contribution-based promises, i.e., unpaid contribution amounts and promised returns, if any, would be measured at “fair value assuming the terms of the benefit promise do not change”.

The Discussion Paper proposes disaggregation of changes in the value of the liability for a contribution-based promise into a service cost and other value changes. All changes in the fair value of the liability for a contribution promise and all changes in any plan assets would be presented in profit or loss.

*4) Accounting for “Higher of” options*

Certain promises provide the employee with an option of the higher of a defined benefit promise or a contribution-based promise. For these types of promises, the Discussion Paper proposes that entities should:

- recognise and account for the “host” defined benefit promise in the same way as a standalone defined benefit promise and recognise the “higher of” option separately;

- measure the “higher of” option at “fair value assuming the terms of the benefit promise do not change”; and

- disaggregate the “higher of” option into a service cost and other changes in value and present both components in profit or loss.