Rådet för finansiell rapportering

The Swedish Financial Reporting Board

04. Sitzung IFRS-FA am 27.04.2012
04_02e_IFRS-FA_Letter_SFRB_Zusatzinfo

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

Dear Sirs,

Re: Defined benefit plans – an inconsistency between measurement of plan assets and defined benefit obligations

Dear Mr Hoogervorst,

We strongly believe that IASB should give priority to the project on post-employment benefits. IAS 19, Employee Benefits, contains several weaknesses in the measurement of plan assets and defined benefit obligations and there is an inconsistency between the approaches for measuring assets and liabilities within a defined benefit pension plan.

The pension liability is calculated based on expected future service and salary increases discounted to present value. On the other hand plan assets are measured at the present fair value. This results in an asymmetric relationship, which should be addressed. We do not believe that the effect of future service and salary increases should be reflected in the measurement of the pension obligation. Instead, we believe that only pensions that the entity is presently committed to pay should be reported as liabilities, not pensions that the entity might become committed to in the future. This means that we believe that the pension liability should be calculated using accrued service and present salaries. We believe that the current approach is inconsistent with the treatment of expected increases in other elements of remuneration – such as salaries and bonuses – which are accounted for in the period in which they occur.

For benefit plans in which the benefit depends on the future return on assets, guaranteed by the employer, this asymmetry is particularly obvious. This fact is also acknowledged by the IASB. The Discussion Paper "Preliminary Views on Amendments to IAS 19 Employee Benefits", published in March 2008, states that IAS 19 does not result in a faithful representation of the liability for benefit promises that are based on contributions and a promised return on assets (paragraph IN7). Similar language can also be found in BC 147 of the amended IAS 19 published in June 2011.

Rådet för finansiell rapportering

IAS 19 requires entities to measure the defined benefit obligation for a benefit that depends on future returns on assets by projecting forward the benefit using its best estimate of the rate of return on the specified assets and then discounting that amount using a high quality corporate bond rate. If the promised return is based on a notional portfolio of for example 50% shares and 50% corporate bonds the estimated return on that portfolio may equal 6% while the discount rate (high quality corporate bond rate) may amount to 4%. Using the current IAS 19 approach to these defined benefit plans will automatically lead to deficits where the expected rate of return on the notional portfolio exceeds the discount rate. There is an obvious mismatch between the measurement of the plan assets (that does not take into account future returns) and the plan liabilities (that take into account future returns on the assets). Economically, this approach leads to an immediate overstatement of the liability already when the pension benefits start to be earned. The expectation is that the entity will not have to make any further payment to meet the liability that has been recognized, which is very counter-intuitive and produces misleading information to users of financial statements.

Finally, we would welcome a review of the guidance on determining the discount rate for the measurement of defined benefit obligations. It is misleading that entities in countries where no deep market in high quality corporate bonds exists should recognize a much higher pension obligation than peer entities in countries where such a market exists. The spread between government bond rates and corporate bond rates is significant.

We would welcome the opportunity to discuss these views with you in further detail. If you have any questions regarding our comments, please address our Executive member Claes Janzon by email to claes.janzon@radetforfinansiellrapportering.se.

Stockholm, 16 March 2012

Yours sincerely

Anders Ullberg
Chairman

The Swedish Financial Reporting Board
Box 7680 SE-103 95 STOCKHOLM Sweden
Tel: +46-8-50 88 22 79 Fax: +46-8-32 12 50
www.radetforfinansiellrapportering.se