acteo
Association pour la participation des entreprises françaises à l'harmonisation comptable internationale

Mouvement des Entreprises de France
MEDEF

A F E P

Association Française des Entreprises

EFRAG
14 avenue des Arts
Bruxelles
Belgium

Paris, September 5, 2008

***Re: <u>The financial reporting of Pensions</u>***

ACTEO, AFEP & MEDEF welcome the opportunity to comment on the EFRAG – PAAinE research paper on the financial reporting of Pensions. ACTEO, AFEP and MEDEF are very complimentary about the quality of the work carried out by EFRAG under its Pro-Active Activities in Europe.

Although we agree the existing IAS 19 leaves room for simplification, clarity and improvement, we do not believe that it is completely flawed and in some significant areas we do not share the views expressed in the paper. We believe however that the analysis conducted in the paper provides a very clear framework to assess the merits of existing requirements.

We believe more particularly that the projected unit method which is required by the existing IAS 19 should be retained in the future. We are surprised that the invitation to comment contains no question on this issue, as if the authors had no doubt that everyone would agree with them that such a method should be discontinued.

We believe that the existing requirements have been designed with three basic objectives:

- to reflect the best estimate of the entity's future outflows,
- to take into account the long-term nature of the obligation in a context of continuing operations,
- to present as meaningful measures of performance as possible in the income statement.

We believe that these three basic objectives should continue to influence future pension accounting requirements and are neither spelt out nor appropriately reflected in the paper.

We provide a detailed analysis in the appendix to this letter, in response to the invitation for comment and in providing supplementary comments.

Should you wish any supplementary comment or explanation, please do not hesitate to contact us.

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| ACTEO | AFEP | **MEDEF** |
| Patrice MARTEAU<br>Chairman | Alexandre TESSIER<br>Director General | **Agnès LEPINAY**<br>Director of economic and financial affairs |

## Appendix to the ACTEO & MEDEF letter of comments on the EFRAG PAAinE paper « The financial reporting of Pensions »

*Question 1*

***Should a liability to pay benefits that is recognised be based on expectations of employees' pensionable salaries when they leave service, or on current salaries (including non-discretionary increases)?***

In our view, liabilities should be measured at the best estimate of future cash-outflows, and on the basis of the going-concern assumption. As a result, we believe that expectations of employees' pensionable salaries when they leave service should be taken into account whenever the benefit formula promise is based on the future salaries. The increases to be taken into account include non-discretionary increases (including those arising from potential constructive obligations) but should not be limited to those. They should also include the salary increases that an employer has to grant to its employees in order to maintain its workforce at the levels of quality and effectiveness it enjoys at the balance sheet date. These salary increases should be measured on the basis of market inputs to the extent relevant and available, i.e. in order to reflect the salary increases an entity has to grant in order to remain in operations.

*Question 2*

***Should financial reporting be based on the premise that a liability is owed to an individual employee or to the workforce as a whole? What consequences do you consider your view has for the recognition and measurement of pension obligations?***

We believe that financial reporting should be based on the contracts that are signed between the entity and its employees. If those contracts identify rights that are granted on an individual basis, we believe the obligation that arises is due to individual employees, not to the workforce as a whole. However we believe that the workforce as a whole is relevant to recognition (see our answer to question 3) and the measurement of the liability (with possible impacts on recognition) that arises from individual employee contracts.

*Question 3*

***Do you agree that recognition should be based on the principle of reflecting only present obligations as liabilities?***

We agree that recognition should be based on present obligations only.

We have already stated in our answer to question 1 that we believe that future salary increases should be taken into account in the measurement of the liability at the end of the period.

As the authors conclude, we believe that unvested rights qualify as present liabilities of the entity as the entity stands ready to pay benefits if vesting conditions verify. Although we agree that in theory the entity has the discretion to fire all employees before any of them satisfies vesting conditions, we do not believe that such a scenario is consistent with the entity continuing its operations and maintaining an appropriate workforce.

We therefore deny that this scenario is relevant to the recognition of the liability. That is why we believe the workforce as a whole becomes relevant to the recognition of the liability. (Please note that our argument here is consistent with our view that future salary increases should be taken into account – see answer to question 1).

We are unsure however that we agree with the conclusion summarised in S12 that the present requirements for attributing benefits to periods of service are unsatisfactory. We believe that present requirements are in line with the principle that only present obligations should be recognised. We also believe that meeting the objective of a single category would be good to have, but not at the expense of disregarding real differences in economic substance. We therefore believe that the authors have not developed and argued this issue thoroughly enough.

***Question 4***

***Do you agree that the consolidation of pension plans should be subject to the same principles as are usually applied in determining whether consolidation is appropriate?***

Ideally, consolidation of pension plans should be subject to the same principles as applied to all other entities. However we cannot take position on this issue before we have fully assessed the potential impact on pension plans that the conclusions of the consolidation and element definition projects may have.

***Question 5***

***Do you agree that changes in assets and liabilities relating to pension plans should be recognised immediately, rather than deferred and recognised over a number of accounting periods or left unrecognised provided they are within certain limits "a "corridor approach"?***

We agree that pension liabilities should be recognised immediately rather than being deferred or left unrecognised. However we believe that presentation issues remain unsolved and that appropriate disaggregation in the income statement should be analysed and debated in order to ensure that meaningful measures of performance remain GAAP measures. In the meanwhile we believe that the existing options in IAS 19 should remain available. Once satisfactory presentation principles are designed, they should apply to changes in assets and liabilities relating to pension plans as they should for other gains and losses in the income statement. Whether, *in fine*, other comprehensive income and recycling (the corridor approach applied to the income statement requires recycling once the liability is recognised in full) are maintained depend on the outcome of that debate. No argument developed on pensions in isolation from the debate on the presentation of financial statements can be valuably considered.

***Question 6***

***Do you agree with the paper's views in the measurement of liabilities to pay benefits? In particular, do you agree that:***

- *Regulatory measures should not replace measures derived from general accounting principles?*

- *The discount rate should reflect the time value of money only, and therefore should be a risk-free rate?*

- *Information about the riskiness of a liability (i.e. the risk that the amount of pension benefits will differ from today's expectations) is best conveyed by disclosure rather than by adjusting the amount of the reported liability?*

- *The liability should not be reduced to reflect its credit risk?*

- *Expenses of administering the plan's accrued benefits should be reflected in the liability?*

We agree with almost all the views summarised in the above question. However we disagree with the discount rate being a risk-free rate. We believe the existing discount rate (highly rated corporate bonds) should be maintained. There is no relationship between entities and employees that is free from risk and, as a result, we do not believe that the risk-free rate best reflects the economic transaction and agreement reached between entities and employees.

***Question 7***

***Where employees have options to receive benefits in different ways, should the liability be reported at the highest amount or at an amount that reflects the probability of different outcomes?***

We believe that the basis for measuring the liability should be made on the assumption that employees will always select the way that they perceive as being the most favourable to them. If past practice reveals that employees do not always select the most efficient economic outcome for themselves (aversion to risk, or other behavioural factors playing a role), we believe that the measurement of the liability should take those behavioural factors into account, on the basis of past practice. If there are conditions to be met that allow employees to choose, we believe that the probability of different outcomes should be reflected in the liability amount. Such a measurement is meaningful and can be relied upon, as it is based on the workforce as a whole.

***Question 8***

***Do you agree that assets held to pay benefits should be reported at current values?***

Yes we do. However we believe that understanding changes in value on long term liabilities and assets dedicated to their financing need specific disaggregation and presentation of changes in value, to ensure that fully understandable and useful information is provided to users.

***Question 9***

***Do you agree that a "net" asset or liability should be based on the difference between the amounts at which the assets and liabilities would be measured if they were measured directly?***

Yes we do, as we believe that those assets and liabilities respond to different economic drivers.

*Question 10*

***Do you agree that different components of changes in liabilities and/or assets should be presented separately?***

The answer to this question should be derived from the project on the presentation of financial statements. We believe that it is useful to disaggregate the changes in liabilities and/or assets into several components, i.e. service cost, interest cost and income, actuarial gains and losses.

*Question 11*

***Do you agree that the performance of an entity should reflect the actual return on assets, rather than the expected return, and that the expected return should be required to be disclosed?***

We agree that actual returns should be reflected in comprehensive income. However we believe that the existing dichotomy between expected returns and actual returns provide users with meaningful information in the income statement. Providing this information as disclosure condemns users to systematic restatement of the information reported. As we mentioned in response to question 5, we believe fundamental work remains to be done to determine appropriate disaggregation in the income statement.

*Question 12*

***Do you agree with the objectives of disclosure that are identified in this chapter? Are there specific disclosure requirements that should be added to or deleted from those proposed?***

We have not assessed the disclosures proposed in enough detail to provide a sensible answer to this question. Based on an overview, the disclosures proposed seem very comprehensive. We therefore believe that such proposals should undergo a thorough cost/benefit analysis before being pushed forward.

*Question 13*

***Do you agree that multi-employer plans should be reflected in an employer's financial statements using the same principles?***

In principle we do. However no accounting requirement should ignore the specificities of multi-employer plans here and there, making compliance with the accounting requirement problematic.

*Question 14, 15 and 16*

We have not considered these aspects of the paper.

*Question 17*

***Are there further specific issues relating to the cost and benefit of the proposals that should be taken account of in their further development?***

We believe that the authors have dismissed the projected unit credit method too rapidly and without appropriate arguments. We believe that the greatest strength of an accounting method is to bring users the most meaningful and predictive information as possible. One of the greatest merits of bringing pension obligations on the balance sheet is to give users the best insight possible into future cash outflows resulting from pension obligations and a measure of the funding available to meet such outflows. If we consider two identical entities having granted their employees identical post-employment benefits except that one plan grants benefits more slowly than the other, we believe that it is useful for users to measure the post-employment benefit obligation eliminating the difference in benefit accrual rhythm:

- the cash outflows the entity faces after employees terminate are the same,

- as a result needs for funding are the same.

Moreover the cost for each year of service is the same. Earnings as a result improve in sustainability, a characteristic whish is deemed desirable by users.

This in our view illustrates that the projected unit credit method has merits that need to be considered further. Pension obligations, because of their long term nature and of the whole workforce being relevant to their recognition and measurement, illustrate one of those circumstances where depicting assets and liabilities as they precisely stand at the balance sheet date does not provide the most useful information to users.