

Comments on the IASB Exposure Draft ED/2010/3

Recognition

Question 1. *The exposure draft proposes that entities should recognise all changes in the present value of the defined benefit obligation and in the fair value of plan assets when they occur. Do you agree? Why or why not?*

We agree with the immediate recognition of changes in funded status in the financial year when they arise, as this is more transparent and objective. However, this recognition should be through the “Remeasurements” rather than the Profit and Loss.

Question 2. *Should entities recognise unvested past service cost when the related plan amendment occurs? Why or why not?*

Whilst we are supportive of immediate recognition of all past service costs, irrespective of vesting requirements, particularly when it is consistent with the way that current service cost is recognised, we do have a concern that it may act as a discouragement for companies granting augmentation to members’ benefits, which is the major source of past service cost.

Disaggregation

Question 3. *Should entities disaggregate defined benefit cost into three components: service cost, finance cost and remeasurements? Why or why not?*

Yes, we are supportive of the disaggregation of defined benefit cost into the three components: service cost, finance cost and remeasurement.

Defining the service cost component

Question 4. *Should the service cost component exclude changes in the defined benefit obligation resulting from changes in demographic assumptions? Why or why not?*

We do not have a strong view on this.

Defining the finance cost component

Question 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?*

Without going into a technical debate of whether the Finance Cost should be defined as the “interest on the scheme’s funded status”, as it’s the unwinding of the time value of money, or it should be defined as the difference between the Interest Cost and Expected Return on Assets as currently defined in the IAS19, we like to draw your attention to the practical impact on Hong Kong companies / retirement schemes should the Exposure Draft is implemented as it is.

In Hong Kong, most retirement schemes are lump sum schemes with a relatively short duration. As such, retirement schemes in Hong Kong tend to invest a higher proportion of assets in equities (compared to an annuity scheme which may invest a significant proportion of assets in bonds to match the annuity payments). Therefore, with all other things equal, a lump sum scheme will tend to have a higher “Expected Return on Assets” assumption than an annuity scheme, as we expect equities to outperform bonds in a long run.

On the other hand, Hong Kong has always been considered as having “no deep market in high quality corporate bonds”. As such, the standard practice in Hong Kong is to use the yield of the Exchange Fund Notes to set discount rate for the purpose of IAS19. (Exchange Fund Notes are Hong Kong dollar debt securities issued by the Hong Kong Monetary Authority). The yield available on which is much lower than the Expected Return on Assets assumptions that companies often set for their retirement schemes. Historically, the difference between the Expected Return on Assets assumptions and the discount rate can be up to around 400+ basis points.

Another observation of the retirement schemes in Hong Kong is that a lot of them are well funded with surpluses.

Considering all the factors above, the implementation of the Exposure Draft as it is will give rise to a very significant increase to the Finance Cost for the Hong Kong companies.

We would urge the IASB to consider reviewing the way that discount rates are set in countries with “no deep market in high quality corporate bonds”, as it has started with the Exposure Draft ED/2009/10.

Presentation

Question 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?*
- Why or why not?*

Yes, we are supportive of the proposed presentation.

Settlements and curtailments

Question 7

- (a) Do you agree that gains and losses on routine and non-routine settlements are actuarial gains and losses and should therefore be included in the remeasurement component? Why or why not?*
- (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?*
- (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? Why or why not?*

The current Exposure Draft suggests that all settlements should be treated as remeasurements, and curtailment should be recognised as a negative past service cost (i.e. through the Profit and Loss).

We would like to suggest IASB issuing clearer guidelines on how curtailment and settlement is distinguished in some cases. For example, closure of a section of a lump-sum retirement plan following redundancies may lead to members receiving leaving service benefits on departure. Should the difference between the Defined Benefit Obligation (“DBO”) prior to redundancies and the actual benefits paid be regarded as a curtailment or a settlement?

One may argue that it is a curtailment as on redundancies, the DBO has reduced from the original amount to members’ Leaving Service Benefits. And there will be no settlement gains / losses when the benefits are paid.

On the other hand, one can also argue that the payment of benefits have settled the DBO and hence the difference between the original DBO and benefit payments should be viewed as a settlement gain / loss.

Disclosures - Defined benefit plans

Question 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.*

Are these objectives appropriate? Why or why not? If not, how would you amend the objectives and why?

We believe these objectives are appropriate.

Question 9.

To achieve the disclosure objectives, the exposure draft proposes new disclosure requirements. Are the proposed new disclosure requirements appropriate? Why or why not? If not, what disclosures do you propose to achieve the disclosure objectives?

- (a) information about risk, including sensitivity analyses;*
- (b) information about the process used to determine demographic actuarial assumptions;*
- (c) the present value of the defined benefit obligation, modified to exclude the effect of projected salary growth;*
- (d) information about asset-liability matching strategies;*
- (e) information about factors that could cause contributions to differ from service cost.*

We do not have major concerns on the above disclosure items except for (d), where it's rather difficult to conclude what an appropriate asset-liability matching strategy is for a lump sum plan, as the cash flow (particularly benefit outgo) is a lot more uncertain than a pension plan. This is particularly the case for Hong Kong retirement schemes where leaving service benefits are paid in cash to members at exit – they do not need to wait until Normal Retirement Age before getting the payout.

Multi-employer plans

Question 10.

The exposure draft proposes additional disclosures about participation in multi-employer plans. Should the Board add to, amend or delete these requirements? Why or why not?

We do not have any major concerns over this.

State plans and defined benefit plans that share risks between various entities under common control

Question 11.

The exposure draft updates, without further reconsideration, the disclosure requirements for entities that participate in state plans or defined benefit plans that share risks between various entities under common control to make them consistent with the disclosures in paragraphs 125A–125K. Should the Board add to, amend or delete these requirements? Why or why not?

We do not have any comments on this.

Other comments on disclosures

Question 12.

Do you have any other comments about the proposed disclosure requirements?

We have no additional comments on the proposed disclosure requirements.

Other issues

Question 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.*
- (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.*
- (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.*
- (d) The return on plan assets shall be reduced by administration costs only if those costs relate to managing plan assets.*
- (e) Expected future salary increases shall be considered in determining whether a benefit formula expressed in terms of current salary allocates a materially higher level of benefits in later years.*
- (f) The mortality assumptions used to determine the defined benefit obligation are current estimates of the expected mortality rates of plan members, both during and after employment.*
- (g) Risk-sharing and conditional indexation features shall be considered in determining the best estimate of the defined benefit obligation.*

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

- a) We believe this is reasonable.
- b) We believe this is reasonable.
- c) We agree that the tax payable by the plan should be included in either the return on plan assets / measurement of DBO depending on the nature of the tax.
- d) We agree that administration cost should only be reduced from the plan assets if they are related to managing plan assets. [but how do we allow for the other expenses?]
- e) We don't believe this is a material issue.
- f) In principle we agree to this but we don't believe it is a material issue for Hong Kong schemes, where most of them are lump sum schemes.
- g) We don't think this is applicable in Hong Kong.

Multi-employer plans

Question 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. 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?

We have no comment on this.

Transition

Question 15.

Should entities apply the proposed amendments retrospectively? (Paragraphs 162 and BC97–BC101) Why or why not?

We believe that it is useful for the amendments to be applied retrospectively for comparison purpose. This is particularly the case for companies which are currently deferring recognition of actuarial gains / losses through amortisation.

However, we believe some additional disclosure items such as sensitivity figures should be waived from the retrospective disclosure.

Benefits and costs

Question 16. *In the Board's assessment:*

(a) the main benefits of the proposals are:

(i) reporting changes in the carrying amount of defined benefit obligations and changes in the fair value of plan assets in a more understandable way.

(ii) eliminating some presentation options currently allowed by IAS 19, thus improving comparability.

(iii) clarifying requirements that have resulted in diverse practices.

(iv) improving information about the risks arising from an entity's involvement in defined benefit plans.

(b) the costs of the proposal should be minimal, because entities are already required to obtain much of the information required to apply the proposed amendments when they apply the existing version of IAS 19.

*Do you agree with the Board's assessment? (Paragraphs BC103–BC107)
Why or why not?*

We agree with the main benefits of the amendments that the Board has suggested. However, we do not believe that the cost of the proposal is "minimal", given the amount of extra disclosure items required. In contrary, some of the proposed disclosure items will incur significant cost to some of the local (Hong Kong) entities.

Other comments

Question 17.

Do you have any other comments on the proposals?

We have no further comments.