IASB EXPOSURE DRAFT OF A PROPOSED AMENDMENT TO IAS 19, EMPLOYEE BENEFITS: THE ASSET CEILING

CICA ACCOUNTING STANDARDS BOARD STAFF COMMENTS

The following comments represent the views of members of the staff of the CICA Accounting Standards Board (AcSB) on the IASB Exposure Draft of a Proposed Amendment to IAS 19, Employee Benefits: The Asset Ceiling. These comments have not been reviewed or endorsed by the AcSB and, accordingly, do not necessarily represent the views of the AcSB or its individual members.

GENERAL COMMENT

Our Canadian Standard on employee future benefits is similar to that of the IASB in that it also imposes an upper limit on the amount that can be recognized as an asset. In fact, a numerical example[1] within our Standard illustrates a similar issue to that described in your exposure draft — the interaction of the asset ceiling with deferred recognition of actuarial gains and losses resulting in a gain (loss) recorded in income as a result of an increased (decreased) asset due to actuarial losses (gains) experienced in the period.

As a result of the downturn in the stock market in 2001, some Canadian entities with defined benefit pension plans also experienced significant actuarial losses that substantially eroded or eliminated a previously accumulated plan surplus. In addition, the general decline in interest rates triggered a similar result since entities discounted the accrued benefit obligation at a lower rate than in the prior year, resulting in an actuarial loss.

As a consequence of some of these Canadian entities questioning the appropriateness of the result of the numerical example, the AcSB discussed this issue in July 2001 and agreed to communicate its view that the result is not anomalous, although it may require explanation. The AcSB also noted that the issue was not new — the question had been answered in the past under EIC-1, *Pension Surplus Recognition* [now withdrawn as a result of the new Canadian Standard].

To address this issue AcSB staff issued Q&A 89.1 (enclosed) in late 2001, as an Addendum to the *Supplement to the Employee Future Benefits Implementation Guide*.

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[1] Year 2 in the numerical example that follows EMPLOYEE FUTURE BENEFITS paragraph 3461.110 of the *CICA Handbook – Accounting*

ANSWER TO QUESTIONS IN INVITATION TO COMMENT

Question 1

Is the issue identified of sufficient importance to warrant a limited amendment to IAS 19?

AcSB staff agrees only that the issue is sufficiently important to *warrant explanation* of the result of the consequence described in paragraph 2 of the Background to the exposure draft. AcSB staff disagrees that the consequence requires an amendment to IAS 19, especially given that some practitioners have been aware of the consequences for some time. The issue only arose as a consequence of significant declines in the equity markets making the accounting consequences a reality. We see no justification for making an amendment to IAS 19 other than a possible desire to alleviate concerns from constituents about the consequences of the interaction and the "artificial" corridor approach with the asset ceiling test. The approach in IAS 19 itself is not conceptually based. An accommodation was made in developing IAS 19 to permit deferral of certain gains and losses in the corridor. However, we do not see any precedent for extending that accommodation to support deferral and amortization of amounts that represent changes in the valuation allowance. Some might justify the proposed approach in the exposure draft by viewing the asset ceiling as other than the result of a valuation allowance. However, we believe that to do so, would be inconsistent with the original rationale in developing IAS 19. To introduce yet another rationale into IAS 19 would further weaken the limited internal consistency that presently exists in IAS 19. The IASB should wait for the broader project to address the issue of deferred recognition within IAS 19.

Question 2

If so, does the proposed amendment to IAS 19 (paragraph 58A) appropriately address the issue? Does it create any anomalies? If the proposed amendment is inappropriate, can you suggest an alternative?

AcSB staff believes the proposed amendment is inappropriate for the reasons stated in our response to Question 1.

An alternative to the proposed amendment would be to simply explain the consequence of combining deferred recognition of past service costs or actuarial gains and losses with an annual asset limit that adjusts immediately to income in the period. This alternative would be similar to Q&A 89.1 that confirms the treatment in our Standard. Q&A 89.1 explains:

> "The cumulative effects of profits and losses reflected in income as a result of fluctuations in the valuation allowance make most sense when viewed over a period of years. For example, a decrease in the valuation allowance offsets or reverses recognized higher charges to earnings in prior years and gets an entity back in the position it would have been if it had never recorded a valuation allowance in the first place. An entity would have recognized the amount of the valuation allowance reversal in income over time in the normal course of pension accounting rather than in a lump sum as it does when the valuation allowance changes."

Question 3

Should the limited changes become effective for accounting periods ending on or after 31 March 2002, with earlier application encouraged (paragraph 159A)?

AcSB staff understands that an effective date of March 31, 2002 would capture many UK and European entities reporting on their March 31 year ends and also capture entities in the southern hemisphere with mainly June 30 year ends. However, AcSB staff still question whether issuing an amendment with material consequences after the effective date has passed (i.e., issuing in April effective beginning with accounting periods ending on or after March 31, 2002) gives entities sufficient time to fully understand and educate its users. We see no difficulty with “encouraging” earlier application, but are concerned about the precedent of “requiring” application of a standard before it has been issued (or even re-deliberated) by the IASB.

Question 4

Do you agree that there should be no specific transitional provisions for the limited changes proposed in this exposure draft? Consequently, IAS 8 ‘Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies’ will apply to any changes in accounting policies that are made to comply with IAS 19 if amended as proposed (paragraph 160).

Yes, we agree.