EFRAG

European Financial Reporting Advisory Group

23 July, 2004

Kevin Stevenson
Chairman IFRIC
30 Cannon Street
London EC4M 6XH
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Dear Kevin,

Re: IFRIC Draft Interpretation D6 *Multi-employer Plans*

On behalf of the European Financial Reporting Advisory Group (EFRAG) I am writing to comment on the draft of the IFRIC Interpretation D6 *Multi-employer Plans* (IFRIC D6). This letter is submitted in EFRAG's role of contributing to IASB's and IFRIC's due process and does not necessarily indicate the conclusions that would be reached in its capacity of advising the European Commission on endorsement of the definitive IFRIC on the issue.

We welcome further guidance on when a plan meets the definition of a multi-employer plan, how defined benefit accounting should be applied to such plans and when necessary information might not be available. However, we have several concerns as expressed in our response to the questions set out in the Draft Interpretation.

Our general concern is that interpretations issued by IFRIC can have the effect of changing existing standards without allowing sufficient time for deliberation with constituents as it would be the case for an amendments project by the IASB. We would prefer that fundamental changes to existing standards would be dealt with in a comprehensive due process allowing constituents sufficient time to provide comments.

With regard to the guidance provided by IFRIC D6 we express our support for the underlying principle that participants in multi-employer plans should apply defined benefit accounting whenever practical and when it leads to a reliable reflection of an entity's pension liabilities; however, we are convinced that in many cases it is not possible to get information necessary to apply defined benefit accounting in a reliable way in an employer's accounts.

Further, there is not sufficient justification in the Basis for Conclusions for narrowing down the definition of state plans in IAS 19 paragraph 37 as proposed by IFRIC D6. State plans in accordance with IAS 19 are accounted for as defined contribution plans. This requirement fits many plans which, in certain jurisdictions, are set up under statute or at a national level, although their management is entrusted to a separate legal entity. To narrow the definition of state plans would, in EFRAG's view, raise difficult practical issues. In the absence of any basis for conclusions, and because of the practical difficulties that are foreseeable, EFRAG believes that the existing definition of state plans should not be changed.

The Appendix sets out our answers to the questions raised in the exposure draft.

If you would like further clarification of the points raised in this letter, Paul Rutteman or myself would be happy to discuss these further with you.

Yours sincerely,

Stig Enevoldsen
EFRAG, Chairman

Question 1

In your experience, are participants in defined benefit multi-employer plans able to obtain the information necessary to apply defined benefit accounting? If not, what causes the information not to be available? How do such entities monitor and manage the risks involved in their participation in the plan?

EFRAG response:

Since such plans are managed as a whole and the risk is managed on the total plan rather than on a company by company basis, it is very difficult to allocate reliably assets and liabilities of the plan to specific entities which are part of the plan. Therefore, we believe it is very difficult to gather information necessary to apply defined benefit accounting on a consistent and reliable basis.

Nevertheless, we believe that this interpretation needs to address three different types of multi-employer plans:

i) Those where there is complete sharing of risks and benefits falling on employers. These include industry-wide plans where all employers are subject to the same financial terms. The economic principle is “solidarity”; it is in the interests of all to participate in the plan – indeed they may be required by legislation to do so. Often the plans are on a pay-as-you-go basis, with only minimal reserves to tide over an insufficiency of contributions in any one year to fund the benefits of that year. Employees in such plans change between participating employers without any transfers of costs being made between the old and new employers. Such plans are common in France, the Netherlands and some other European countries.

ii) Those with a relatively small number of dominant participating employers, whose financial terms are set on an individual employer basis, and (usually) a larger number of smaller participants whose financial terms are set on an aggregate basis. “Financial terms” include the rate of annual contributions, special contributions on joining or in response to particular actions by the employer concerned and an adjustment on leaving the plan. No one of these would necessarily be decisive but they should be reviewed as a whole to establish whether the employer is being treated on an individual or aggregate basis. Most UK local authorities have such mixed plans.

iii) Those applicable to entities under common control (group plans). Many, if not most, of these are similar to the first category in that there is a complete sharing of risks and benefits with no adjustments to past service costs when employees move between group companies.

We see no basis for attempting to allocate defined benefit amounts to entities in the first category. The annual contributions are in the nature of insurance premiums paid as a means of sharing with others the cost of uncertain future events. Participating employers may know that costs must rise over the long term but, because their competitors face the same costs, their position economically differs from that of an employer solely responsible for the costs of its own plan.

We see no objection to seeking to allocate costs to those entities within a category (ii) plan for which specific adjustments to costs are made under the terms of the plan. However, just because it may be possible to do this for dominant participants within the

plan does not mean that the same can be done meaningfully for other participants in the same plan for which no individual adjustments are made.

Often, or even usually, there is no reasonable basis for allocating defined benefit amounts to entities under common control (category (iii) plans). The freedom to move employees around the group without adjustments between their past and future employer in respect of their accumulated pension entitlements is regarded as part of the general benefits of group membership. Deficits within the group plan are usually recovered by adjusting the contribution rate paid by all group companies. This basis does not reflect the activities and decisions of the individual group company; moreover, the amount of the charge in the future for an individual company may change for reasons completely unrelated to that company or to the assets and liabilities held by the group plan as a result of the service of that company's employees. It is difficult to imagine what benefit a user could obtain from such an allocation. Far more useful is a simple disclosure of the company's participation in the group plan, the contributions paid (and any decision to change them for the future) and a statement of where a full accounting for the plan on a defined benefit basis is given – usually in the group financial statements.

Question 2

Does application of defined benefit accounting by participants in multi-employer plans provide useful information compared with the disclosure of substantial information about the plan as required by paragraphs 30(b) and (c) of IAS 19?

EFRAG response:

EFRAG takes the view that disclosure of certain issues is not considered a substitute for their recognition in the accounts. Therefore, if an entity is able to gather information necessary to apply defined benefit accounting to multi-employer plans on a consistent and reliable basis, we agree that this provides useful information. However, we are generally concerned about the application in cases where entities have difficulties in gathering the information needed.

Question 3

The consensus requires a participant in a multi-employer plan to apply defined benefit accounting by, if possible:

(a) measuring the plan in accordance with IAS 19 using assumptions that apply to the plan as a whole and

(b) allocating the plan so that the entity recognises an asset or liability that reflects the extent to which the surplus or deficit in the plan will affect its future contributions.

Do you agree that this is an appropriate way for a participant in a multi-employer plan to apply defined benefit accounting? If not, how should defined benefit accounting be applied?

EFRAG response:

(a) We agree.

(b) Based on paragraph 12 of IFRIC D6 it is our understanding that if it is impossible to analyse any change in the surplus or deficit into the cost components, this may be caused by the fact that actuarial assumptions are unknown. Although generally permitted, in such cases the corridor approach cannot be used and any change in value of an entity's share of the surplus or deficit shall be recognised in profit or loss. We ask IFRIC to confirm that our understanding of paragraph 12 as described is correct.

Further we believe that IFRIC D6 should not make use of the term "impossible" and instead should refer to the term "impracticable" as used in IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors paragraph 5. According to this definition the application of a requirement is impracticable when the entity "cannot apply it after making every reasonable effort to do so". In our view this would better reflect the real situation and should therefore be incorporated in IFRIC D6 paragraph 18.

Question 4

The appendix to the draft Interpretation sets out a proposed amendment to IAS 19, narrowing the scope of the definition of state plans and requiring them to be accounted for as defined contribution plans. Plans that are excluded from the definition of state plans will be multi-employer plans.
Do you agree with the narrowed scope of the definition of state plans?
Do you agree that state plans defined as proposed should be accounted for as defined contribution plans?

EFRAG response:

A multi-employer plan is very often based on an agreement with the government and the social partners (employers and employees). These plans and agreements are in many cases like state plans, because the plan is managed by a separate legal entity but the risk can still be with the state. We wonder whether it is necessary to narrow down the scope of the definition of state plans and preclude the use of defined benefit accounting for state plans, which is the effect of the amendments to paragraphs 36 to 38. We would rather prefer to keep these paragraphs unchanged.
If it was the intention to change this definition we believe that such a change of IAS 19 would require a longer (three months instead of the given two months) comment period, a broader debate and field visits where necessary.

However, in general we support the proposal to account for state plans as defined contribution plans.

Other comments:

1. In our view there seems to be a circular argumentation in IASB's definition of a multi-employer plan (IAS 19 paragraph 7) and IFRIC D6 paragraph 15 (b), which repeats the main body of IAS 19 paragraph 32. Whilst in the definition multi-employer plans are described as such that the contribution and benefit levels are

determined without regard to the identity of the entity that employs the employees concerned, the assumption in IFRIC D6 (or IAS 19 paragraph 32b) is that an identification of an entity's share of a plan with sufficient reliability is not possible if the plan exposes the participating entities to actuarial risks associated with the current and former employees of other entities.
The conclusion of the latter assumption would be that per definition defined benefit accounting cannot be applied to any multi-employer plan. We recommend IFRIC to clarify the argumentation is this respect.

2. With regard to the transitional provisions in IFRIC D6 paragraph 21 we wonder why it should not be allowed for first-time adopters that certain actuarial gains or losses remain unrecognised (as required by IFRIC D6 paragraph 12) while this is a general option under IFRS 1 *First-time Adoption of IFRSs*?