CRUF
The Corporate Reporting Users' Forum

To: Andrea Pryde
Senior Technical Manager
International Accounting Standards Board
30 Cannon Street
London, EC4M 6XH

By email: apryde@ifrs.org

30th September 2010

Dear Ms Pryde

**Re: Exposure Draft, Defined Benefit Plans – proposed amendments to IAS 19**

The Corporate Reporting Users' Forum (CRUF) welcomes the opportunity to respond to the International Accounting Standards Board's Exposure Draft (ED) on Pensions.

We welcome the publication of the pensions exposure draft and view it as a pragmatic effort to improve financial reporting in this area in the short term. However, we believe that accounting for defined benefit pension schemes remains one of the key areas requiring further work in order to provide better information for users of accounts, and we would encourage the IASB to continue to focus on this topic, building on the excellent work already done as part of the PAAinE/ASB pensions project. In an ideal world it would be helpful to achieve complete convergence with US GAAP in this area.

We have set out our comments in relation to the ED proposals below.

***Immediate Recognition of Actuarial Gains and Losses (Question 1)***

There is broad support within the CRUF for the exposure draft's proposal to remove the 'corridor' approach, and require immediate recognition of pension remeasurements in Other Comprehensive Income (OCI). Elimination of this deferred recognition option will enhance the comparability of financial statements among companies applying IFRS, and also with those companies using US GAAP, and will enhance the decision-usefulness of IFRS financial statements. We have campaigned for this improvement for a long time and view this change as overdue.

However, it is important to note that the majority of CRUF members are against the immediate recognition of actuarial gains or losses in profit and loss. In the context of such long term liabilities deriving 'spot' estimated values can create problems, and in particular, the volatility that results may not be representative of changes in the underlying expected cash flows. That said, we believe enhanced disclosures are preferable to arbitrary 'smoothing' mechanisms such as the corridor approach to solve this particular problem.

***Financing Cost and Expected Return on the Pension Asset (Question 5)***

Many CRUF members welcome the changed approach to calculating the expected return on pension assets. They believe the proposed solution (in effect, charging interest on the deficit) represents an acceptable pragmatic compromise that will provide useful information to users of accounts whilst avoiding some of the distortions that the current approach facilitates.

However some CRUF members, particularly those based in Japan, do not believe that this proposed change represents an improvement, and would encourage the IASB to defer considering this particular change until they undertake a more fundamental review of pensions accounting.

Many CRUF members believe that the expected return assumptions provide relevant information about the long term investment policy of the pension fund and would like to see this information disclosed (as opposed to a return based upon the liability discount rate which would not represent the underlying investment approach of the majority of schemes around the world).

***Presentation of pension cost (Question 6)***

CRUF members welcome the clear requirement to split the pension cost in the P&L between operating and financing, although we are unclear how this will subsequently be affected by the Performance Reporting project.

We urge the IASB to continue its work on Other Comprehensive Income to ensure that this part of the Performance Reporting statement does not simply become a dumping ground for 'difficult stuff'.

***Recycling remeasurements recognized in OCI***

The exposure draft stipulates that the remeasurements of the net defined benefit liability (asset) shall be presented in other comprehensive income (OCI) and not be reclassified to profit or loss in a subsequent period (119A).

Opinion among CRUF members is divided regarding the merits or otherwise of recycling. We have commented before that we are against piecemeal bans on recycling and would prefer a more thorough discussion of the topic.

In the context of this Exposure Draft, members of CRUF (Japan) are not in favour of these proposals. They think that the amount presented in OCI should be recycled to net income in subsequent periods. CRUF members outside Japan are content with the approach currently followed in IAS 19, whereby actuarial gains and losses are not subsequently recycled to profit or loss following immediate recognition in OCI.

The arguments presented by CRUF (Japan) members are included as an appendix to this letter.

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***Presentation of Settlements (Question 7)***

The exposure draft proposes that gains and losses at settlement are actuarial gains and losses and should therefore be included in the remeasurement. As the CFUFJ supports recycling of actuarial gains and losses as mentioned above, it thinks gains and losses at settlement should be accounted for in profit and loss.

***Disclosures (Questions 8-12)***

We agree with the IASB's general approach to allow companies to use their judgement in deciding on disclosures, based on the materiality of the scheme to the company concerned. Excessive prescription would risk imposing an unwarranted burden on preparers, and would potentially reduce the usefulness of the information provided by making it more difficult for users to identify important disclosures.

We are concerned that some of the narrative disclosures required will result in excessive 'boiler-plate' without providing hard information, and will unnecessarily expand the page-count in published financial statements.

In terms of specific requirements in the Exposure Draft regarding disclosures we have the following concerns/comments:

- **Para 125C(a) – information regarding the characteristics of the defined benefit plan.** This is likely to result in fairly lengthy narrative that will be the same for all companies with schemes in that country and will not change from year to year. It would be better to require information about any unusual characteristics.
- **Para 125C(b) – narrative description of the risks that the plan poses for the entity.** If the plan is material, these risks will be obvious from the numerical disclosures, and if it is not material then the disclosure is not necessary anyway. This requirement should be dropped.
- **Para 125C(c) – narrative description of plan amendments etc.** Because these events are not routine, this disclosure should be helpful provided it only covers material changes.
- **Para 125D&E – reconciliations of opening to closing balances** for plan assets and liabilities are essential where the scheme is material but should not be required for immaterial schemes. The reconciliation should make clear the actual returns earned on plan assets.
- **Para 125F – disaggregating the plan assets.** This level of detail is very useful where the scheme is material to the company such that movements in the underlying values of different asset classes could affect the overall value of the company. Distinguishing between quoted and unquoted bond portfolios is unlikely to be useful but investments in private equity should be distinguished from quoted holdings.
- **Para 125G(b) – demographic actuarial assumptions.** The simplest way to convey information about mortality assumptions is to disclose life expectancies for 60-year olds and 40-year olds (or pensioners and non-pensioners).
- **Para 125H – Accumulated Benefit Obligation.** This disclosure is required by US GAAP and provides useful insight for users.

- **Para 125I – sensitivities to assumption changes.** A number of UK companies provide clear and useful sensitivity analysis based on the suggestions in the UK Accounting Standards Board Reporting Statement on pensions. We are concerned that Para 125I will result in extensive narrative disclosures which will not provide useful or comparable information. We also believe that the relevant reporting criterion is significance at the end of the reporting period not the beginning, both for the defined benefit obligation and for service costs going forward.
- **Para 125J – disclosure of ALM strategies, longevity swaps etc.** Such disclosures will be useful only if they help users to understand how the asset performance (and/or liability risk) is likely to be changed by such strategies (so these disclosures should be integrated with the asset allocation disclosures required by Para 125F).
- **Para 125K – narrative discussion regarding cash contributions.** This disclosure is unlikely to be useful in its current form. Users are particularly concerned with requirements for companies to commit cash or other funding to pension plans in the future – where agreements have been made, or legislation requires such a funding plan, the details (amounts and timing of contributions) should be disclosed (and should not be limited to the first five years). Such disclosures are incomplete without information on the assumed investment returns (or similar variables that justify the repayment schedule) and on the risk that the schedule might change.

**Users also require information on duration and a time analysis of material pension liabilities.** A disclosed (mathematical) duration in years would provide a quick and simple reference point for comparing pension liabilities; it would also provide more insight into potential sensitivities to changes in interest rates and inflation. Numerical disclosures of estimated pension payments by (say) 5-year time buckets obviously gives far more insight into the length of time required to run off the liability (which is usually decades longer than the mathematical duration). Some UK companies already provide a cash flow chart to convey this information and we believe this information is available to all plan sponsors.

Such disclosures would help to convey the fact that while the liability may be large, annual cash payouts are much smaller, and so would meet some of the criticisms levelled against IAS 19 as being focused on short-term measures. Disclosing the expected pension payments and the expected return rates relating to different asset classes would also enable users to assess the extent to which the pension assets might provide matching inflows, thus offering a greater insight into the investment risks being taken or hedged.

These comments reflect the views of CRUF participants from Japan, the UK and the US with the exception of the comments specifically identified as being made by members of CRUF(Japan) which are not necessarily supported by signatories from other localities. We have signed in our individual capacities rather than as representatives of our employer organisations.

Yours faithfully,

The Corporate Reporting Users' Forum

Terri Campbell, CFA

Peter Elwin

Elmer Huh, CFA, FRM
Director
Portfolio Valuation and Corporate Finance

Toshinori Ito, CMA
Managing Director
Senior Analyst
UBS Securities Japan Ltd

Makoto Kaimasu
Senior Vice President
The Securities Analysts Association of Japan

Sei-Ichi Kaneko
Executive Vice President
The Securities Analysts Association of Japan

Masayuki Kubota, CFA, CMA Japan
Senior Fund Manager,
Equity Management Group,
Daiwa SB Investments Ltd

Goro Kumagai, CMA
Senior Fellow
Strategic Research Department,
Mizuho Securities co. Ltd
Visiting Professor
Graduate School of Management
Kyoto University

Michael McKersie
Assistant Director, Capital Markets
Association of British Insurers

Peter Reilly
Head of Industrial Research
European Equity Research
Deutsche Bank

Hiroki Sampei
Director of Research
FIL Investments (Japan) Limited

Crispin Southgate
Institutional Investment Advisors Limited

Kazuhiro Yoshii
General Manager
Legal and Tax Research Unit of Capital Market
Research Dept. Daiwa Institute of Research Ltd.

Jed Wrigley
Portfolio Manager
Director – Accounting and Valuations
Fidelity Investments

***<u>Appendix – arguments presented by CRUF (Japan) members in favour of recycling remeasurements recognized in OCI</u>***

As a defined benefit pension plan is an important part of the total employee compensation, not recycling the remeasurements and charging them directly to retained earnings is equivalent to paying salaries directly from equity. On the other hand, when pension investments go well and the plan assets exceed the liabilities, according to the exposure draft, the difference shall not be reflected in the calculation of the pension expenses but shall be accumulated as equity of the entity, although legally it shall belong to the pension fund.

The exposure draft quotes IAS 19 and says 'The decision … not to recycle … is made because of the pragmatic inability to identify a suitable basis.' (BC45) The CRUFJ thinks cash contributions to the pension fund will make a suitable trigger for recycling. When the accumulated OCI for the pension is negative, soon or later, the entity must make cash contribution to the plan to supplement the deficit. Therefore, when an entity makes the cash contribution, the same amount should be recycled to net income until such time the accumulated OCI will be zero. This cash contribution trigger is a clear model backed by actual cash transactions and close to realization concept, and therefore relatively immune to be manipulated.

We should also carefully consider the case where the accumulated OCI is positive. In this case, typically an entity will withhold from contributing to the pension fund (pension holiday) and eventually the accumulated OCI will be zero. However, a pension fund may actually pay back excess cash to the entity. In this case, the same amount should be recycled to net income.

**<u>About the Company Reporting Users' Forum</u>**

The CRUF was formed in 2005 as a discussion forum with the aim of helping its participants in their approach to the debate on current and future corporate reporting requirements. In particular, participants are keen to have a fuller input into the deliberations of the International Accounting Standards Board and Financial Accounting Standards Board.

The CRUF is a discussion forum. Its participants take part in CRUF discussions and joint representations as individuals, not as representatives of their employer organisations. It does not seek to achieve consensus views, though at times some or all of its participants will agree to make joint representations to standard setters or to the media.

CRUF participants include individuals from both buy and sell-side institutions, and from both equity and fixed income markets. The forum includes individuals with global or regional responsibilities and from around the world. The CRUF meets on a regular basis in Australia, France, Germany, Japan, the UK, and the USA with facilities for remote participation from other countries.

More information and copies of previous comment letters can be found at www.cruf.com.