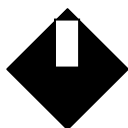

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International Accounting Standards Board
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Comments on the Exposure Draft of *Defined Benefit Plans*

To the Board Members:

The Japanese Institute of Certified Public Accountants ("we" and "our") appreciates the continued efforts of the International Accounting Standard Board (IASB) on the project to improve the accounting for employee benefits and welcomes the opportunity to comment on the exposure draft of *Defined Benefit Plans.*

The Exposure Draft of *Defined Benefit Plans* (proposed amendments to IAS 19) (referred to as the "ED"), which is a part of the IASB's comprehensive employee benefit accounting project, proposes amendments that are mainly centred on recognition, presentation and disclosure of the defined benefit plans, in order to bring about the specific improvements within a set period of time set forth in its Discussion Paper, *Preliminary Views on Amendments to IAS 19 Employee Benefits* (referred to as the "DP"), published in 2008. It is assumed that essential problems related to accounting for employee benefits will be comprehensively discussed in the future under this project, including problems that are not covered in the ED.

We are not in favour of frequent amendments to the accounting standards in a short period of term since it will create some difficulty in practice, although we understand

the approach of tentative revision owing to time constraints. In addition to maintaining consistency with other standards, such as the conceptual framework and the financial statement presentation project, as a tentative revision, it is of the utmost importance to give due consideration to U.S. GAAP and Japanese accounting standards, which are moving towards convergence with IFRSs.

Our comments on the ED are based on our position stated above and are made by taking into consideration the ED and the comprehensive project, to discuss the essential problems of the accounting for employee benefits, that will commence subsequent to the tentative revisions, together with the trend of the IFRS after the issuance of the DP.

The following is our response to the items in 'invitation to comment' with which we disagree or have questions or concerns.

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. (Paragraphs 54, 61 and BC9–BC12) Do you agree? Why or why not?

Comment:

We agree with the proposal 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 in the statement of financial position and other comprehensive income. However, we do not agree with the proposal that actuarial gains and losses recognised in other comprehensive income should be transferred immediately to retained earnings and not be recycled, for the following reasons.

(1) We believe that deferred recognition in the current IAS 19 (BC10) is a weakness and needs improvement. This could be done simply by prohibiting deferred recognition in the statement of financial position.

(2) Accounting in which actuarial gains and losses are immediately recognised in the statement of financial position and other comprehensive income is already applied in the U.S. GAAP and will also apply in Japanese accounting standards. This accounting will avoid divergence of accounting standards and will contribute to the earlier realisation of international comparability.

(3) Presentation of other comprehensive income is still being discussed, as seen in the Exposure Draft on *Presentation of Items of Other Comprehensive Income*. It is not yet clear what is to be presented in the profit, loss or other comprehensive income (for instance Paragraphs BC15, BC16 and AV3 of the ED). Principles for cohesiveness and disaggregation of presentation in financial statements are also being discussed. Therefore, we understand that presentations of financial statements are still under discussion.

(4) We believe that it is not appropriate to discuss the presentation of pension cost in the ED because of the close link between employee benefit accounting and presentation, and the absence of essential arguments on employee benefit accounting that are expected in the next phase, subsequent to this stage.

(5) Because of the reasons stated above, we believe that the conditions for arguments on recognition and presentation in the statement of comprehensive income are not yet ready. Therefore, we believe that it is not appropriate to discuss methods of recognition and presentation in the statement of comprehensive income at the current stage.

(6) Under these circumstances and taking into consideration the points listed below, we believe that it is appropriate to recycle actuarial gains and losses recognised in the other comprehensive income as the tentative revision.

(a) It is not reasonable that the entire actuarial gains and losses are not reflected in the profit and loss, since the actuarial gains and losses include those generated by service costs and interest costs (refer to Question 4).

(b) U.S. GAAP, that is moving towards convergence, has already adopted recycling approach. Also the Japanese accounting standards is about to adopt recycling approach.

(c) We understand that comparability will be improved by eliminating some of the options for accounting for actuarial gains and losses currently allowed under IAS 19. However, according to *Financial Statement Presentation, Analyst Field Test Result* (IASB meeting, September 2009 and FASB Informational Board meeting, September 21, 2009), operating income and profit are relatively beneficial as major performance indicators. Considering these circumstances, we believe that it is not appropriate to allow only non-recycling approach at this stage.

(d) Concerning the timing of the transfer of actuarial gains and losses presented in other comprehensive income to profit, loss or retained earnings, the proposal of the ED for immediate transfer is acceptable as one of the options, since there is

no objective or rational indication. However, we consider it is also too early to unify such accounting and eliminate options at this stage. We do not believe that the immediate inclusion of actuarial gains and losses in retained earnings without recycling contributes to the improvement of the understanding of financial statements, since presentation is still under discussion as stated earlier and general understanding of comprehensive income has not yet been sufficiently discussed.

Question 2

Should entities recognise unvested past service cost when the related plan amendment occurs? (Paragraphs 54, 61 and BC13) Why or why not?

Comment:

We do not agree with the proposed amendment in the ED.

The proposal is closely related to essential arguments concerning the measurement of defined benefit obligations and the scope of recognition. Also, the proposal is not consistent with IFRS 2 *Share-based Payment* which requires expensing such costs during vesting period.

Therefore, the current IAS 19 should be retained in effect until the conclusion of the resolution of the key arguments and the deliberation of consistency with other standards.

Disaggregation

Question 3

Should entities disaggregate defined benefit cost into three components: service cost, finance cost and remeasurements? (Paragraphs 119A and BC14–BC18) Why or why not?

Comment:

We do not agree with the proposed amendment in the ED.

Although we understand the usefulness of the presentation of disaggregated information, the amendment should be made after the resolution of the essential arguments on the presentation of financial statements, including that of the defined benefit obligations and plan assets, taking into consideration the development of the Financial Statement Presentation project, in light of cohesiveness and disaggregation of presentation of

financial statements.

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? (Paragraphs 7 and BC19–BC23) Why or why not?

Comment:

We agree with the proposal. We also wish to propose that actuarial gains and losses be recycled, for the following reasons.

(1) Changes in demographic assumptions include various components such as changes caused by the intentions of the management and changes in short-term volatility and in trends. Therefore, it is not appropriate that all components are presented as a service cost or as an actuarial gain or loss. However, as it is difficult to distinguish between them, by considering their characteristics, it is more rational to recognise all of the components as an actuarial gain or loss than as a service cost.

(2) On the other hand, according to the proposal in the ED, changes in demographic assumptions will not be recognised as a profit or loss at all, once recognised as an actuarial gain or loss. We do not believe that such accounting is appropriate since actuarial gains and losses comprise various components.

(3) Therefore, we propose the recycling of actuarial gains and losses as a tentative revision at the moment.

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? (Paragraphs 7, 119B, 119C and BC23–BC32)

Comment:

We do not agree with the proposed amendment in the ED, because of the following reasons.

(1) Substantive investments are not reflected and there is no rational reason for using the discount rate for the rate of expected return. Consequently, there is a concern in light of faithful representation.

(2) It is too early to amend the presentation, considering the net defined benefit obligation and the net plan assets as the amount of the fund procured for a reporting entity to pay for the plan or to the employees (Paragraph BC29), since the ideal presentation for the defined benefit obligation and plan assets has not been investigated.

(3) The rate of the expected investment return currently required reflects the intentions and strategy of the management for plan asset investment, and is providing useful information to users of financial statements to understand the overall pension plans. Elimination of the requirement will impair the relevance of financial statements.

(4) If the discount rate is used for the rate of expected return, there is some merit in removing the subjective judgment of the management. However, we believe that the weakness mentioned above outweighs the merit.

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? (Paragraphs 119A and BC35–BC45) Why or why not?

Comment:

We do not agree with the amendment proposed in the ED. Please refer to the comments to Questions 1 and 3 for our reasons.

Settlements and curtailments

Question 7

(a) Do you agree that gains and losses on routine and non-routine settlement are actuarial gains and losses and should therefore be included in the remeasurement component? (Paragraphs 119D and BC47) 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? (Paragraphs 98A, 119A(a) and BC48)

(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? (Paragraphs 125C(c), 125E, BC49 and BC78) Why or why not?

Comment:

(a) We do not agree with the proposal.

We agree that gains and losses on routine settlements are to be actuarial gains and losses, but we believe that gains and losses on non-routine settlements should be reflected in the profit and loss, since they include defined gains and losses generated by the termination of plans as a result of restructuring implemented based on the management decision.

(b) We basically agree with the proposal.

However, there are many cases in practice where distinguishing between settlements and curtailments is difficult. Therefore, the proposed accounting will be difficult if accounting for settlements and curtailments differs, i.e. effects from settlements are recognised in other comprehensive income, and those from curtailments are recognised in profit and loss. We believe that gains and losses on settlements should be recognised in profit and loss.

(c) We agree with the proposal.

We believe that the disclosure is beneficial for users of financial statements unless the disclosed information is immaterial, since both settlements and curtailments bring non-ordinary effects to the financial statements.

Disclosures -Defined benefit plans

Question 9

To achieve the disclosure objectives, the exposure draft proposes new disclosure requirements, including:

(a) information about risk, including sensitivity analyses (paragraphs 125C(b), 125I, BC60(a), BC62(a) and BC63–BC66);

(b) information about the process used to determine demographic actuarial assumptions (paragraphs 125G(b) and BC60(d) and (e));

(c) the present value of the defined benefit obligation, modified to exclude the effect of projected salary growth (paragraphs 125H and BC60(f));

(d) information about asset-liability matching strategies (paragraphs 125J and BC62(b)); and

(e) information about factors that could cause contributions to differ from service cost (paragraphs 125K and BC62(c)).

Are the proposed new disclosure requirements appropriate? Why or why not?

If not, what disclosures do you propose to achieve the disclosure objectives?

Comment:

(a) We believe it is appropriate to disclose sensitivity analyses only of economic variables such as the discount rate. We agree that information about sensitivity analyses, which is already required by IAS 1 *Presentation of Financial Statements*, IFRS 4 *Insurance Contracts* and IFRS 7 *Financial Instruments: Disclosures*, is useful for users of financial statements to understand the characteristics of the risks of entities. However, in the case of the defined benefit obligation, since there are the following features in the demographic premises, we believe that information about sensitivity analyses is not useful.

   i. The management can intentionally change the rates of salary increases and of retirement. The risks imposed by these rates should not be regarded in the same way as other risks, such as interest rate risks that are beyond the control of the management.

   ii. Rapid change in demographic data such as in mortality rate is unlikely to occur during normal times insofar as the defined benefit obligation is based on the best estimate as at the end of term.

   iii. The usefulness of some of the results of analysis is dubious. In the case of the increase in the retirement rate due to reasons such as restructuring, the effect of termination of benefits on financial statements will be greater than that of the

change in the defined benefit obligation.

(c) We do not believe that it is appropriate to disclose the present value of the defined benefit obligation (accumulated benefit obligation), modified to exclude the effect of projected salary growth. We believe that the accumulated benefit obligation, which may be relevant to specific regions and specific users of financial statements, lacks universality since it is a concept relying on plans. We believe that it is more relevant that disclosure will be based on the amount of benefits that employers are obliged to pay if employees leave the company on the day following the day of the financial report, which we proposed in our comment letter to the DP.

(e) We propose that the current requirement of disclosure of contribution expected in the following year be retained. We believe that proposed disclosure in the ED is expected to be extremely subjective as the guidelines such as that for the degree of separation from the service cost requiring disclosure are insufficient. On the other hand, the disclosure required by the current standard is relatively objective and provides useful information concerning the effect on the future cash flow of entities to users of financial statements.

Disclosures - 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? (Paragraphs 34B, 36, 38 and BC70) Why or why not?

Comment:

We propose further reconsideration to clarify whether or not the same disclosure as stated in Paragraph 46 of the current IAS 19 is required for state plans that are defined contribution plans.

The ED proposes the treatment of state plans as multi-employer plans in accounting and as the disclosure of the information stated in Paragraph 33A (Paragraph 36). However, paragraph 33A of the ED includes requirements only concerning the defined benefit multi-employer plans. Therefore, it is not clear whether or not the same disclosure as stated in Paragraph 46 of the current IAS 19 is required for state plans that are defined

contribution plans.

We believe that clarification of this matter should also be considered.

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. (Paragraphs 115A–115K and BC73)

(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. (Paragraphs 7 and BC80)

(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. (Paragraphs 7, 73(b), BC82 and BC83)

(d) The return on plan assets shall be reduced by administration costs only if those costs relate to managing plan assets. (Paragraphs 7, 73(b), BC82 and BC84–BC86)

(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. (Paragraphs 71A and BC87–BC90)

(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. (Paragraphs 73(a)(i) and BC91)

(g) Risk-sharing and conditional indexation features shall be considered in determining the best estimate of the defined benefit obligation. (Paragraphs 64A, 85(c) and BC92–BC96)

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

Comment:

(b) We do not agree with the proposal. The proposed definition does not clarify 'minimum funding requirement', since there are various interpretations of 'enforceable' in the instance of state plans in Japan.

(c) and (d) :

We do not agree with the proposals. There are cases in Japan, where it is difficult to

distinguish between administrative costs for plans that are or are not related to plan assets. Therefore, an amendment should be proposed by taking into consideration the taxation and the actual conditions of administrative costs for plans in each jurisdiction.

(f) Although amendment of mortality rates is proposed in Paragraph 73 (a) (i) of the ED, the intention of the amendment to 'current estimates of the expected mortality rates of plan members' is not clear. We believe that the intention of the amendment should be clearly stated to clarify what kind of amendment will occur.

(g) We do not agree with the proposal. There are various plans in different jurisdictions to share the risk generated through the operation of defined benefit plans between employers and employees. Therefore, we believe that the amendment should be made only after gaining a thorough understanding of the circumstances, sufficient deliberations, discussions and guidance.

Other issues - 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. (Paragraphs 32(a) and BC75(b))

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?

Comment:

In Japan, in the case of corporate pension plans jointly operated by multiple employers, the obligations, plan assets and the costs for the individual employer are not generally calculated. Therefore, we believe that there is no consistent and reliable basis for allocating the obligations, plan assets and costs to the individual entities participating in a plan.

Transition

Question 15

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

Comment:

We do not agree with retrospective application, even if the proposed amendments in the ED are incorporated as the final standard. We assume that retrospective application of the amendments will result in complicated and difficult work but little expected benefit in practice. We also have concerns that retrospective application, proposed in the ED, may prevent some financial statements for prior years from appropriately showing the actual state of the pension plan.

(1) Since the proposed amendments include non-presentation of actuarial gains and losses in the income statement and change in the recognition of the past service cost, there may be significant impact on many entities in practice, such as, by amendment of the income statement for prior years, reworking of the cost accounting and retrospective amendment of carrying amount of inventories to reflect actuarial gains and losses in prior years, if entities are required to apply the proposed amendments retrospectively.

(2) If actuarial gains and losses are immediately recognised in other comprehensive income and transferred to retained earnings, financial statements of prior years may be significantly changed. We have concerns that it can be misleading as a result of the above in light of damage to credit and infringement of debt covenants caused by significant changes in financial indicators, appropriate basis of dividends payments and profit or loss generated by plan amendments.

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?

Comment:

We do not agree with the assessment of the IASB for the following reasons.

We believe that, at this stage, there are sufficient benefits with immediate recognition of actuarial gains and losses in the statement of financial position and other comprehensive income.

(1) Some of the proposed amendments in the ED may be revised after recommencement of essential deliberations. If so, we are concerned that disadvantages of further amendments of accounting standards in a short period may be greater than the benefits anticipated by the IASB.

(2) The ED proposes accounting that differs from the current Topic No. 715 and the accounting concept that will be adopted in the accounting standards in Japan. As we stated, we believe that limited revisions will be made by considering international convergence of accounting standards. In view of the above, tentative revisions are not necessarily beneficial..

Other comments

Question 17

Do you have any other comments on the proposals?

Comment:

The ED proposes to delete the requirements of exemptions in Paragraphs D10 and D11 in Appendix D of IFRS 1 *First-time Adoption of International Financial Reporting Standards*. However, we believe that these requirements of exemptions should be retained regardless as to whether or not the proposed amendments in the ED become effective.

We understand that the requirements of exemptions were set since retroactive application would be difficult if entities adopting the standards for the first time were to use the corridor approach. Therefore, the ED proposes to abolish the corridor approach and, concurrently, these requirements of exemptions.

However, in cases of entities adopting the standards for the first time, it is assumed that a lot of work will be performed in practice if such entities include actuarial gains and losses in cost accounting of inventories in accordance with the previous GAAP, that is, retroactive revisions of the cost accounting of inventories will be required, as we stated on our response to the Question 15. Even if the recycling is adopted as we propose in this letter, the same problem may occur.

Therefore, we believe that the option should be retained for recognition of the total amount of accumulated actuarial gains and losses on IFRS transition date.

Yours faithfully,

Keiko Kishigami
Executive Board Member－Accounting Standards
The Japanese Institute of Certified Public Accountants