<u>Answers to the questions asked in the Discussion Paper</u>

Chapter 1: Introduction

Question 1:
Given the objective of the IASB project to address specific issues in a limited time frame, are there additional issues which you think should be addressed by the Board as part of this project? If so, why do you regard these issues as a matter of priority?

As to the limited scope we would like direct the Board’s attention to the matter in what category of result within the P&L-statement the post-employment benefit income/expenses should be recognised. In our opinion this issue has a higher importance for practical accounting and comparability than outlining a new class of plans/promises.

To define our position we would prefer a comprehensive classification of the expenses and income due to post-employment benefits into operating profit (service cost, prior service cost, and effects from curtailments and settlements) and financial result (interest cost, expected return on plan assets as well as the amortization of net actuarial gains/losses).

Chapter 2: Deferred recognition of changes in the liability (PV 2- PV4)

Question 2:
Are there factors that the Board has not considered in arriving at its preliminary views? If so, what are those factors? Do those factors provide sufficient reason for the Board to reconsider its preliminary views? If so, why?

We disagree with the Board’s PV 2 (immediate recognition of **all** changes in the value of plan assets and in the post-employment benefit obligation in the financial statements in the period in which they occur).

Out of our meetings with rating agencies and financial investors we understood that they are most interested in information and presentation of sustainable profit and losses and equity too. They disengage from the recognised and disclosed impacts and calculate for their own purposes with financial assumptions eliminating accidental and unsustainable impact on income and balance.

In our opinion the character of long-term liability of any post-employment benefit obligation does not match to a re-evaluation with a key-date interest rate. Such obligations have in a certain way a financing function as typical financial liabilities. They were not re-evaluated every year either but generally with the terms that were valid at the day of occurrence.

To remedy the impact of any more insignificant changes in interest rate resulting from rather short-term and temporary shifts obviously not lasting on the capital-market we think the “corridor method” (for unrecognised actuarial gains/losses) to be one reasonable method to prevent the reader and user of the financial statement getting misguided or even confused.

A similar method to avoid period-to-period changes despite the opportunity becoming reversed or offset each other (like a clock pendulum) would be to use a yield curve generated as an average over a representative space of time (maybe between five or ten years). So, for every maturity the yield curve would show an average interest rate of the last X (e. g. five to ten) years.

Over and above why must be just the interest rate to be strictly a (more or less accidental) one-key-date rate; other actuarial assumptions as drivers for the present value of the obligation are more focussed on estimations for sustainable specifications.

So we support the arguments against the full recognition in financial statement (see item 2.5 of the DP) with respect to misguidance of any user by accidental not sustainable changes in the capital market.

It has been argued that the threatening short-term volatility might not be useful for users of financial statements and therefore decrease the quality of financial reporting by overwhelming the results of the operating business. Besides any key figure related to equity and/or profit may oscillate like a clock pendulum and nebulise the real and sustainable economic performance.

As the board only noted but to sum it up rejected these arguments under cipher 2.8 of the DP we really advise to take empirical tests before deciding about far-reaching and incisive change in accounting principles. As we heard from other companies the approach 1 ("… all changes…. in profit and loss.") major German companies of the German DAX 30 index would have reported divergent figures for their 2007 net profit/loss of up to 40%, primarily as a result of changes in the discount rate and actual returns on plan assets different from those expected. Such a distortion of the results driven by accidental changes could be strengthened for the quarterly financial statements.

We are convinced that any oscillating, temporary significant volatility in earnings and the depending constricted comparability of reported earnings over a period of several years period will not lead to the kind of useful information required by paragraph 12 of the IASB Framework intended to be a reliable basis for economic decisions. Such temporary fluctuations in earnings as well as earnings per share may initiate financial analysts and other decision makers to eliminate the volatility arising from accidental not sustainable impacts by a pro forma calculation in order to come to such a quality of a decision basis that IAS originally wanted to generate.

By trying to remedy the short-term volatility risk for earnings which must not necessarily reflect the long-term risk situation of the benefit plans the reporting entities could be forced to make economically inefficient decisions. Closing existing benefit plans would significantly change the compensation packages companies provide. Should many plan sponsors shift their allocation of plan assets in order to reduce the accounting volatility, e.g. by the implementation of liability-driven-investment concepts, it could lead to serious distortions in different segments of the capital market. Controlling these short-term volatility risks will likely increase the long-term costs of providing the post-employment benefits already promised.

Replying to the arguments against the all through profit or loss approach, the Board objected as follows: "Inappropriate accounting should not be continued to disguise the 'true state' of defined benefit plans. The role of accounting is to report transactions and events in a neutral manner ..." (item 2.8 of the DP). The argument that the net position of a plan (post-employment benefit obligation minus plan assets) reflects the “true state of a benefit plan” might be convincing for the balance sheet. But for the purpose of the income statement we do not agree with the Board’s conclusion. Accounting for the net position of a plan using fair value amounts implies an immediate settlement perspective. But the standard case for providing the promised benefits is to continue the plan, and not to settle the existing plan liabilities immediately. Thus, for the income statement, the immediate recognition of all changes following the immediate settlement perspective does not necessarily reflect the “true state of a benefit plan” for an individual reporting period.

We disagree with the Board’s PV 3 (entities should not divide the return on assets into an expected return and an actuarial gain or loss). One of the Board’s arguments against the application of the expected rate of return is that this method is too subjective. This argument is not further discussed. We think, however, that there are various other areas which require companies to use significant levels of management judgement to perform the accounting. Whether a company sets the appropriate expected rate of return on plan assets is a matter that the auditors and regulators should carefully examine and judge. We take the view that sufficient objective evidence is available to validate the appropriateness of expected return rates (e.g. current and future expected asset allocation, long-term actual portfolio results and historical total market returns, estimation of banks and asset portfolio managers regarding future returns). In addition, enhanced disclosures in the notes (e.g. discussion of the methods and supporting factors used in determining the expected return rate(s), sensitivity analysis showing the effects of changes of the expected return rate(s) on total benefit cost, direct comparison of expected and actual return rates over a longer time horizon) would provide investors and other financial statement users with the necessary information to better understand and assess the appropriateness of expected return rates.

As described in the DP, Approach 3 requires a methodology to “estimate” (actual) interest income on plan assets. With respect to this matter, we do not see that from the described methods one is superior over the expected-return-method. As discussed below, the disadvantages associated with the second and the third method do by far outweigh the presumed weakness of the expected-return-method.

The second method of Approach 3 (dividends received on equity securities and interest earned on debt securities) has the disadvantage that it would not capture (unrealized) capital gains (losses) on equity securities. The DP is additionally silent on how to treat realized capital gains (losses). This alternative would result in different treatments for dividend paying and non dividend paying equity investments. We think that this approach would not faithfully represent the actual economic situation of a company investing in plan assets and would potentially distort pension scheme investment policies.
The third method of Approach 3 (imputed interest income based on market yields on high quality corporate bonds at the reporting date), however, has the disadvantage that it also does not represent faithfully the actual economic situation (the individual asset allocation) of a company that invests in plan assets. This method is also somewhat arbitrary and might even encourage companies to invest more in higher risk investment opportunities knowing that there is no downside risk with respect to their future earnings. We missed a discussion on this point of view in the DP.

Regarding PV 4 (recognise the unvested past service cost in the period of a plan change), we also take the view that there is a conceptual inconsistency with the relevant requirements set forth in IFRS 2. Nevertheless, we agree with the Boards PV 4.

Chapter 3: PRESENTATION APPROACHES FOR DEFINED BENEFIT PROMISES

Question 3

(a) Which approach to the presentation of changes in defined benefit costs provides the most useful information to users of financial statements? Why?

(b) In assessing the usefulness of information to users, what importance do you attach to each of the following factors, and why:
- **(i) presentation of some components of defined benefit cost in other comprehensive income; and**
- **(ii) disaggregation of information about fair value?**

(c) What would be the difficulties in applying each of the presentation approaches?

Generally, we find it rather difficult to decide on the three presentation approaches without knowing the future requirements with respect to financial statement presentation. However, out of the three presentation approaches considered, we prefer Approach 3 in combination with the expected-return-method for calculating interest income.

We believe that key performance measures presented on the income statement should not be diluted or undermined by gains or losses resulting out of “artificial” effects which in general will (or most likely will) reverse over the long-term period of the underlying obligation.
Based on this reason, we disagree with Approach 1 (all through profit and loss) because it would be difficult to preserve the predictive quality of certain key performance measures (e.g. net profit (loss) or earnings (loss) per share) without considering additional reconciliation information on how the accounting of post-employment benefit obligations affected those measures. With respect to the composition of post-employment benefit cost, decision useful information which is highly covered by analysts are, for instance, service cost and interest cost, whereas information out of predominant scope are the actual return on plan assets and the period’s actuarial gains and losses resulting from the measurement of the benefit obligation and plan assets. The disaggregated information would presumably be presented in the notes to the financial statements thereby relegating financial statement users to the notes, a fact pattern that the Board itself criticises. Furthermore, we think that preparers and users of financial statements most likely would make different adjustments to strip out the elements of pension cost with low predictive information, thereby reducing the comparability of financial information among companies. Providing adjusted earnings numbers in companies’ management reports, excluding the effects of pension cost elements with low predictive information, would presumably also result in a widespread use of different adjustments. Irrespective of this, companies that are listed on a US-stock exchange are not allowed to present adjusted earnings numbers in their filing documents.

We disagree with Approach 2 since the exclusion of the interest cost on the pension obligation and, if funded, the exclusion of the returns on plan assets from the income statement would ignore the economic differences between a funded and an unfunded pension obligation. As no costs of financing are recognised in the profit and loss statement at all the unfunded plans (financing costs without being offset with yields of plan assets) are presented too well in comparison to the funded plans (financing costs with being offset with yields of plan assets). In addition, this approach would be absolutely inconsistent with the accounting for other provisions recognised on a discounted basis.

Since Approach 3 in conjunction with an average interest rate (of the last X years) best focuses on income relevant information from the operating business, we strongly prefer this approach. To determine interest income on plan assets, we highly recommend to retain the use of the expected-return-method (for the arguments, please refer to our answer to Question 2).

Question 4

(a) How could the Board improve the approaches discussed in this paper to provide more useful information to users of financial statements?

(b) Please explain any alternative approach to presentation that provides more useful information to users of financial statements. In what way does your approach provide more useful information to users of financial statements?

a) As an alternative (interim) approach, we would prefer the currently allowed recognitions of the corridor-aprroach under IAS 19. We absolutely agree with the Board to eliminate the possible choice between several options.

b) By elimating possible options the information base would be increased strongly. To hold on at the corridor-approach, which is still widely used and accepted, the Board would have to necessary time to perform field studies assessing the potential effects the three presentation alternatives might have on the quality of financial statements. In addition, during the second phase of the post-employment benefit project, the Board would also be able to consider further aspects arising out of the financial statements presentation project and convergence efforts with the FASB, thereby reducing the risk that future revisions may be necessary.
In addition, we missed a broader discussion of the arguments why a recycling of actuarial gains and losses from OCI into profit or loss is conceptually not pure and acceptable. For the second phase of the project, during which the Board intends to work with the FASB towards a common standard on post-employment benefit

promises, we would prefer a detailed discussion of the arguments for and against a recycling mechanism for actuarial gains and losses from OCI into profit or loss.

Chapter 5: DEFINITIONS - Definition of contribution-based promises

Question 5
Do you agree that the Board has identified the appropriate promises to be addressed in the scope of this project? If not, which promises should be included or excluded from the scope of the project, and why?

We disagree with the Board's preliminary views about the new categorization of post-employment benefit arrangements and the new definition of 'contribution bases promises' as well as the intended measurement attribute 'fair value'.

We are convinced that the existing characterisation of post-employment benefit promises based on the risk they pose to the reporting entity (risk approach) continues to reflect well the differences in economic substance between the two types of promises, remains conceptually well-founded and is easy to understand. We think that the possibility of a relative simple risk assessment as to whether benefit promises will impose ongoing risk to the reporting entity certainly is something that is for the benefit of financial statement users. In contrast, the definition of Contribution Based (CB) promises is artificial, difficult for the uninitiated to understand and not founded on economic substance (i.e. the risk approach). The proposed new category of CB promises unnecessarily includes promises that have sat perfectly logically in the Defined Benefit (DB) category (e.g. career average plans) and will now, on artificial grounds, be reclassified and be subjected to different measurement and presentation regimes.

According to an analysis performed by a working group of the German Actuarial Association, the new classification would result in a huge change in the accounting for post-employment benefits in Germany. Under the current definitions, 70% of the post-employment benefit plans fall within the DB category with the remainder falling under the Defined Contribution (DC) category. Under the proposed approach, the working group estimates that only 30% of the benefit plans will be classified with the DB category, while 70% are expected to fall under the new CB category. Since there are still a significant number of pensioners receiving their benefit from erstwhile final salary plans, the split for active employees would turn out to be even come more closer to an estimated 10% DB and 90% new CB in Germany.

We have great concerns regarding the measurement attribute (i.e. fair value) for CB promises. First of all, there is no active market for post-employment benefit promises where the reporting entities could easily and in an objective way survey fair values. We think the fair value concept raises several questions, for instance, should the fair value for post-employment benefits be based on the exit value (pension obligations usually are not settled before retirement) or should the fair value imply the anticipated settlement at retirement? Further, should the fair value include a risk premium a potential acquirer most likely would charge? In addition, the performance risk is intentionally excluded from the determination of fair value making the measurement attribute somewhat arbitrary. Alternative methods to derive the fair value of a benefit promise would be technically complicated, not standardized and would miss a certain degree of transparency and therefore require broader disclosure, especially if the entity's own credit risk is to be considered. Considering the entity's own credit risk is by nature highly questionable (the worse the credit rating the lower the obligation whereas the settlement amount at maturity will be unaffected by credit ratings) but also imposes highly complex calculations. In Germany, for instance, parts of the pension benefit obligations may be legally insolvency insured (there are maximum amounts). In addition, the entity's own credit risk associated with post-employment benefit promises may be different, depending on whether the entity has plan assets available or not. Furthermore, in the case of plan assets, the risk profile of the asset portfolio would need to be considered. Altogether, considering an entity's own credit risk in determining the fair value of a benefit promise is not only highly questionable from a conceptual point of view but also seems to be very complex, costly for preparers and may provide misleading information to analysts.

In our opinion, the requirement to consider an entity's own credit risk for contribution based promises, whereas for defined benefit promises a different discount rate has to be used (based on corporate bonds), is also questionable from a conceptual point of view. We also do not see any economic reason that would justify different measurement attributes for these two types of benefit promises. As such, comparability among companies may suffer. Therefore, we find the Board's PV to measure the benefit promise in the deferment and payment phase according to the classification of the promise in the accumulation phase not convincing since economically similar benefit promises could be measured differently in the deferment and payment phase depending on their initial classification during the accumulation phase.

Based on the arguments presented above (see our answers to Question 2 and 3), we would disagree with the immediate recognition of all fair value changes in the income statement.

However, we agree with the Board that there are certain kinds of promises ("trouble-some plans") that necessitate short term improvements in the accounting for post-employment benefits (within phase 1 of the pension project).

To our understanding only promises that depend upon or are linked to the return from an asset, group of assets or an index are "troublesome plans" and face potential valuation / accounting difficulties. All other benefit promises being mentioned in Chapter 5 and Appendix A of the DP - including career average plans and promises with a fixed return - do not pose measurement difficulties under the current IAS 19 and should be excluded from the scope of the project. These "troublesome plans" should be valued with the fair value of the underlying or notional assets. In case of a fully funded benefit promise the liability and asset amounts would be equal.
As far as a benefit promise contains a "higher of" option (e.g. a guaranteed minimum return of 3% p.a.) the host benefit promise should be recognised as a regular Defined Benefit promise, i.e. by applying the PUC-method or by applying the method described in the preceding paragraph. In addition the option should be valuated and recognised at fair value (if appropriate by means of option pricing models).

Finally, postponement of the discussion regarding the proposed classification of post-employment benefit promises and of the related attempt to introduce fair value accounting during phase 1 of the project would provide the Board with more time to perform field studies (e.g. regarding the practical difficulties of considering an entity's own credit risk), to consistently address improvements in post-employment benefit accounting (e.g. define a consistent requirement regarding the discount rates used for DB and CB promises), and to take convergence considerations into account.

Question 6

Would many promises be reclassified from defined benefit to contribution-based under the Board's proposals? What are the practical difficulties, if any, facing entities affected by these proposals?

As outlined above, German companies would be **severely affected** by this proposed classification of post-employment benefit promises (see our answer to Question 5). Practical difficulties (detailed comments also presented above) would certainly include the assessment of an entity's own credit risk (especially for companies with no assigned credit rating), the presentation of the specific risks associated with post-employment benefit obligations to the users of financial statements, and the immediate recognition of the fair value changes of pension liabilities and plan assets in the income statement.

Question 7

Do the proposals achieve that goal? If not, why not?

We do not see major differences.

Chapter 6: RECOGNITION ISSUES RELATING TO CONTRIBUTION-BASED PROMISES

Question 8

Do you have any comments on those preliminary views? If so, what are they?

We have no further comments on **PV 9** and **PV 11** since we generally disagree with the new definition of contribution based promises. Apart from this, assuming that several benefit promises currently falling under the DB-category would be classified as part of the new CB-category (e.g. career average plans), **PV 10** would create a further inconsistency in the accounting for DB and CB promises.

Chapter 7: MEASUREMENT OF CONTRIBUTION-BASED PROMISES – CORE ISSUES

Question 9
(a) Are there alternative measurement approaches that better meet the measurement objectives described in this paper? Please describe the approaches and explain how they better meet the measurement objectives.

(b) To what extent should the effect of risk be included as a component of the measurement approach at this stage of the Board's post-employment benefit promises project? How should this be done?

(a) Please refer to our answer to Question 5.

(b) We believe that from a practical point of view the effect of an individual promise's risk is difficult to include as proposed and as such the proposed treatment should not be implemented during phase 1 of the project. In addition, we have general concerns with the requirement to consider an entity's own credit risk when determining the benefit obligation. For further details, please refer to our answer to Question 5.

Chapter 8: MEASUREMENT OF BENEFITS AFTER THE ACCUMULATION PHASE

Question 10
(a) Do you agree that the liability for benefits in the payout and deferment phases should be measured in the same way as they are in the accumulation phase? If not, why?

(b) What are the practical difficulties, if any, of measuring the liability for a contribution-based promise during the payout phase at fair value assuming the terms of the benefit promise do not change?

We disagree with the Board's preliminary views about the new definition of contribution based promises and the intended measurement attribute 'fair value'. As stated in our answer to Question 5, we support the view that the measurement attribute for economically similar benefit promises should be equivalent. If not, comparability among companies would suffer. Therefore, the Board's intent to measure the benefit promise in the payment and deferment phase according to the classification of the promise in the accumulation phase is in our opinion not convincing, since economically similar benefit promises could be measured differently in the payment and deferment phase depending on the initial classification during the accumulation phase.

Our recommendation to the Board is to focus on “real” troublesome pension plans (see our answer to Question 5). This would significantly reduce the number of plans being affected by this improvement project. For the remaining plans, however, it is worth to avoid the contentious issue addressed in this question.

Chapter 9: DISAGGREGATION, PRESENTATION AND DISCLOSURE OF CONTRIBUTION-BASED PROMISES

Question 11
(a) What level of disaggregation of information about changes in the liability for contribution-based promises is useful to users of financial statements? Why?

(b) Do you agree that it is difficult to disaggregate changes in the contribution-based promise liability into components similar to those required for defined benefit promises? If not, why not?

No further comments.

Question 12

Should changes in the liability for contribution-based promises:

(a) be presented in profit or loss, along with all changes in the value of any plan assets; or
(b) mirror the presentation of changes in the liability for defined benefit promises (see Chapter 3)? Why?

No further comments.

Chapter 10: BENEFIT PROMISES WITH A ‘HIGHER OF’ OPTION

Question 13
(a) What are the practical difficulties, if any, in identifying and measuring the ‘higher of’ option that an entity recognises separately from a host defined benefit promise?

(b) Do you have any other comments on the proposals for benefit promises with a ‘higher of’ option? If so, what are they?

No further comments.

OTHER MATTERS

Question 14
What disclosures should the Board consider as part of that review?

We generally take the view that disclosures regarding post-employment benefit obligations are already quite extensive in today’s practice and that the cost incurred to provide this level of information has to be balanced with the information content of the required disclosures. Additional disclosures of minor information might bear the risk of an information overload. Our recommendation is therefore to carefully balance possible further disclosure requirements.

Anyhow, as outlined in greater detail in our answer to Question 2, enhanced disclosures in the notes to the financial statements regarding the expected rate of return would enable investors and other financial statement users to better understand and assess the appropriateness of expected return rates.

Question 15

Do you have any other comments on this paper? If so, what are they?

No further comments.