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26th September 2008

International Accounting Standards Board
30 Cannon Street
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Dear Sir or Madam

## Discussion Paper Preliminary Views on Amendments to IAS 19 Employee Benefits

We welcome the discussion paper and appreciate the opportunity to respond. Concerning the key issues raised, we support the recognition of plan surplus or deficit in the balance sheet, but believe that the income statement should not reflect immediate recognition of the periodic impact of plan volatility on an entity's resources.

Post-employment benefits represent an extremely long-term liability for which there is uncertainty as to the ultimate settlement amount. Therefore the change in a single-point measure of the net asset/liability between two given dates is not an appropriate basis for income statement presentation.

Our response nevertheless also considers the implications of immediate recognition and highlights development of an appropriate revised performance statement as being crucial. It is seen as essential that an entity's net income should be clearly distinguishable from the volatile impact of immediately recognising actual plan asset returns and actuarial gains or losses.

Please find below our replies to the specific questions asked.

**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?*

We agree that the project should be focused in order to rapidly target specific priority issues, but would suggest the addition of recycling to the project scope. Rather than being a new concept that should only be addressed in Phase 2 (ED paragraph 1.19 refers) we see this as a logical intermediate approach – consistent with the revised

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US GAAP - in which previously unrecognised amounts are now "recycled" into net income from other comprehensive income, rather than from the off-balance-sheet position required under IAS 19.

**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 understand why the plan surplus or deficit is considered the amount most usefully reported to financial statement users as an asset or liability respectively, rather than values reflecting deferral of gains and losses. We believe that the Board has taken account of all relevant factors and that its preliminary views on plan surplus or deficit recognition should not be reconsidered.

We would note that this does not necessarily require that the impact of changes in plan assets and liabilities be also recognised immediately in the income statement: for example, gains and losses could instead be deferred within equity as per the current US GAAP requirements (our response to Question 3 below also refers).

**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?*

We do not believe that immediate recognition of gains or losses in the income statement provides useful information, since this frequently does not reflect the impact on an entity's resources in cash flow terms. Plan deficits are often not funded immediately but may instead be eliminated over a number of years. Similarly, the benefits of a plan surplus are likely to be realised only gradually, through reduced contributions. Our preference would therefore be to reflect this by the gradual recognition of gains or losses through income on a recycled basis.

We note also that the existing income statement presentation was introduced mainly for practical reasons, pending resolution of the performance reporting issues that arise from immediate recognition. If the income statement were instead to immediately reflect the impact of changes in plan assets and liabilities, it would first be essential to develop an appropriate presentation of the components in the performance statement. In particular, these components should be clearly distinguishable from an entity's net income to ensure that this is not "swamped" by pension volatility. Additional disclosures would be needed to put this volatility into context, for example by showing the expected effect (if any) on an entity's future cash flows.

We believe this to be a key user requirement. We agree with the ED (paragraph 2.8) that "a measure should be volatile if it represents faithfully transactions and other events that are themselves volatile," but believe that appropriate presentation of such volatility is crucial. Financial statement users should not have to "strip out" pension values in order to arrive at meaningful results, with consequent likely prevalence of non-IFRS performance measures.

We do not agree that the benefits of immediate recognition are sufficiently great to merit implementation if presentation issues are not resolved. [paragraph 2.6 refers]

Concerning the approaches discussed in the DP, the presentation in the financial performance statement of a single, net value for pension expense (paragraph 3.24) is in our view consistent with presenting a net position in the balance sheet.  It seems misleading to separately report items that – from the employer viewpoint – may be managed and settled on a net basis as a component of employee compensation.  We suggest that, as at present, the predictive needs of financial statement users could instead be met by disclosure in the notes.

This response is however made in the context of the present IAS 19 accounting requirements.  If immediate recognition were to be required in the income statement (and our above arguments against this refer), we would prefer a modified Approach 3:

We agree that service cost should continue to be reported within net income as best representing the regular, current cost of providing pension benefits to employees, but this should not in our view include the effect of changes in any actuarial assumptions.  We believe that financial statement users would exclude such re-estimation effects from operating performance and that IFRS should similarly report them in other comprehensive income.

We note the Board's concerns (paragraph 3.14) that this might encourage misestimation of service costs to achieve an accounting result but would expect this – as for all other reporting areas – to be addressed by entity financial controls and the audit process.

Of the alternatives offered for calculating interest income, we would prefer the use of the expected return on plan assets, as currently required by IAS 19.  Unlike the other options, this would allow for both capital growth and income returns.

For the reasons given above, we believe that it would be essential to initially report immediately-recognised actuarial gains/losses - including plan asset revaluations - outside net income.  Approach 3 (with the modification discussed above) meets this requirement.

Whilst this is similar to the current IAS 19.93 "SORIE" option, we would additionally favour the recycling of gains and losses through net income for the reasons discussed above.  Consistent with the current requirements (IAS 19.93) we suggest recognising gains/losses in the performance statement over average remaining working lives, but with the simplification of removing the IAS 19.92 "corridor test."

**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?*

Please see our response to Question 3 above.

**Questions 5 to 13 (Chapters 4 to 10): contribution-based promises**

We have only limited comments, since our retirement plans generally do not contain the post-employment benefit promises identified in paragraph 4.2 as having caused particular problems in practice.

We welcome the decision not to alter the measurement of typical final salary defined benefit pension plans at this stage, given the intention to complete the project within a short timescale (paragraph 4.12).

We would also suggest that the measurement of the proposed contribution-based promise category should diverge from the existing IAS 19 defined benefit plan requirements only so far as is necessary in order to address the problems identified in paragraph 4.9.  This would reduce complexity and minimise the differences in accounting outcome for economically-similar promises:  In this context we suggest that:

- Contribution-based promises should use a single estimate of the cash flows (such as the most likely outcome) consistent with IAS 19, rather than an expected value approach (paragraph 7.14). [We note also that such statistical methods are sometimes limited in their ability to produce meaningful outcomes for small populations and should be used only when appropriate.]
- The measurement of contribution-based promises should not include the effect of entity own credit risk (paragraphs 7.26 to 7.29 and the paragraph 8.6 example). We do not agree that including such risk within the measurement of the liability itself is relevant and useful information (paragraph 7.27). We believe that an entity's financial statements will provide information from which credit risk can be evaluated.

**Question 14**

*ITC16 The Board intends to review the disclosures required about post-employment benefit promises in a later stage of this project. As part of that review, the Board intends to consider best practice disclosures in various jurisdictions. For example, explicit requirements to disclose information about the mortality rates used to measure post-employment benefit liabilities could be introduced to allow users to understand the inherent uncertainties affecting the measurement of those liabilities.*

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

We support the introduction of an explicit requirement to disclose information about mortality rates, as this is now generally recognised as being a key actuarial assumption.

Given that post-employment benefit disclosure requirements are already extensive, we suggest that further additions proposed only if considered to be a priority area by financial statement users and where they can be justified on a cost/benefit basis.

**Question 15**

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

We have no further comments.

Yours sincerely.

Bob Deere

Vice President Accounting and Reporting