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International Accounting Standards Board
30 Cannon Street
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Comments on the Discussion Paper *Preliminary Views on Amendments to IAS19 Employee Benefits*

To the Board Members:

The Japanese Institute of Certified Public Accountants appreciates the continued effort of the International Accounting Standards Board (IASB) on the post-employment benefit promises project, and welcomes the opportunity to comments on the Discussion Paper of Preliminary Views on Amendments to IAS19 Employee Benefits (hereafter referred to as the "DP").

Presented below are our comments responding to the questions described in the "Invitation to Comment" section of the Discussion Paper.

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?

Comment:
We understand that the IASB initiated the first phase of the project and prepared the DP for the purpose of short-term improvements to the accounting for post-employment benefits which are needed to provide users with better information about post-employment benefit promises, and will perform, as the second phase of the project,

a comprehensive review of the accounting for post-employment benefit promises in order to respond to criticism raised on IAS19, through working with the FASB toward a common standard on post-employment benefit promises. We have considered those approaches, especially that the current proposed DP is the short-term project and later a comprehensive review of accounting for post-employment benefit promises will be performed. We suggest that the IASB should consider the following additional issues for the current proposed DP:

1. Consideration should be given to disclosure of sensitivity analysis on significant assumptions for determining the projected benefit obligation under the defined benefit plans, in notes to the financial statements.

The DP paragraph 1.2 states that "many users of financial statements do not understand the information that entities provide about post-employment benefit promises". We think one of the reasons of the difficulties for users to understand the pension information relating to post-employment benefit promises is that changes in actuarial assumptions on which defined benefit obligations are firstly measured affect profit and losses in subsequent years. Considering that one of the objectives of the initial phase of this project is to provide users with better information about post-employment benefit promises, we believe that the IASB should take into account the disclosures for sensitivity analysis arising from changes in significant assumptions for measuring the projected benefit obligations; thereby it would be informative and beneficial for users to understand possible effects on changes in significant assumptions of the projected defined benefit obligations.

2. Further analysis and discussion on hybrid plans should be performed.

This project addresses accounting for certain types of hybrid plans (in particular, currently available plans that provide benefits that are based on contributions and a promised return),

We believe that there may be a possibility that new types of hybrid plans (other than those currently available) may be created and designed in the future. Accordingly, we believe that the accounting proposed at the initial phase should not be based on the currently available plans, but after further research on hybrid plans, the IASB should provide a "principle based" accounting standard which takes into account consistency of the post-employment benefit accounting as a whole rather than proposed definitions and distinctions relating to a particular type of plan; examples listed in the DP should be interpreted based on this “principle based” accounting standard.

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 reasons for the Board to reconsider its preliminary views? If so, why?

Comment:

We believe that the IASB should also consider the following factors:

1. Further consideration of fair value model

An experimental study on “fair-value pension accounting”[1], which presented a comparison between the accounting method which provides that entities should recognize all changes in the value of plan assets and in the defined benefit obligation in the period in which they occur (the “fair value model”) and the current accounting method which provides that entities are permitted to defer recognition of gains and losses and to recognize them in profit or loss through an amortization method (“smoothing model”), pointed out that “the fair-value model does not improve the value relevance of the balance sheet and may impair that of income.” Based on these potential negative or positive outcomes that could result from using either the “smoothing model” or the “fair value model,” we suggest that additional consideration should be given or experimental studies performed on the usefulness of financial information under the “fair value model” before any changes are made to the current accounting method.

2. Global convergence of accounting standards for post-employment benefit promises

When the IASB proposes changes to the accounting standards during the initial phase of this project, we suggest that the IASB should consider convergence of the accounting standards from a global perspective.

It is our understanding that the DP is seeking short-term improvements and a comprehensive review of the accounting for post-employment benefit promises will be performed together with the FASB in a second phase. Under such approach, the proposed DP could be temporary for a short term period unless the proposed DP is assured to remain unchanged after the next phase of comprehensive review of the accounting for the post-employment benefit promises. We believe that it is not preferable for the IASB to issue such kind of temporary accounting standards which

[1] Rebecca Hann, Frank Heflin and K.R. Surbranmanyam, (March 2007), in more detail, please refer to further the article.

could affect investors and users for a short period and might result in negative consequences to them.

Further, we considered the criticisms raised to FAS 87 when FAS 158 was adopted, and noted that there are no significant differences from those raised between the FASB and the IASB. In this situation, it may not be appropriate that IASB issues a different accounting standard from FAS 158, taking into consideration that the proposed DP is a short term project and might change in the next phase. We are concerned that these proposed changes may confuse stakeholders from the global convergence perspective.

From a Japanese perspective, the deferred recognition concept is similar amongst the three standards although Japanese GAAP differs from IAS 19 and SFAS 158 in several ways. The Japanese accounting standards are in the process of converging with IAS/IFRS. Thus, once the proposed changes under IAS 19 go into effect, there could be observable differences between liabilities presented under Japanese GAAP and liabilities presented under IAS 19 for certain period of time. Please note that Japanese corporations are allowed to file their financial statements under US GAAP with the Japanese Financial Service Agency under certain specified conditions.

Based on those circumstances, we suggest that the IASB should adopt a standard similar to SFAS 158 that will be easily comparable for global investors. This includes requiring entities to recognize the defined benefit obligations in their balance sheet, to include gains and losses in other comprehensive income and to adopt a recycling method for current net earnings in profit or loss.

The bottom-line is that the post-employment benefit accounting published by IASB in the first phase should take into account the global convergence as much as possible.

Question 3

(a) Which approach to 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?

Comment:

We agree to the principle proposed by IASB that "entities should recognize 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" (Paragraph PV2). However, we disagree with the three approaches proposed by the IASB on the presentation of defined benefit promises. Alternatively, we propose the fourth approach ("Approach 4"), which "includes gains and losses arising from remeasurement of the defined benefit obligation and the plan assets in other comprehensive income and recycles them". Our rational is based on the following:

1. Close relation between plan assets and defined benefit liabilities

An entity's defined benefit obligation and plan assets are closely related in terms of fulfilling the entity's obligation to pay pension benefits to employees. It has been noted that taking into consideration the economic substance of the obligations and the assets under the pension fund, pension plans should be consolidated.[2] In addition, an experimental study indicates that "we find little consistent evidence that components of the pension asset and liability and of the net periodic pension cost are value relevance for security prices"[3]. We believe that the presentation of the financial information should be closely related to the accounting thereof. However, the comprehensive review of the pension accounting will be performed at the next phase. We therefore do not believe that it is appropriate to discuss only disclosure of "defined benefit costs" in the DP at first phase of the project, and suggest that the IASB should address these issues at the next phase. At this stage, we believe that changes in the defined benefit obligation and the value of plan assets should be accounted simultaneously.

2. Contents of Approach 4

Given our opinion (as described in paragraph 1 above), we believe that changes in the defined benefit obligation and the plan assets arising from remeasurement (due to gains and losses or plan changes) should be treated simultaneously at the end of the year, but not recognized immediately in profit or loss. The gains and losses and plan changes

[2] DP, Paragraph 11 and US SEC "Report and Recommendations Pursuant to Section 410(c) of the Sarbanes-Oxley Act of 2002 on Arrangements with Off-Balance Sheet Implications, Special Purpose Entities, and Transparency of Filings by Defined Issuers" —Recommendations related to Accounting Standards, B. Standards on Accounting for Defined Benefit Retirement Arrangements.

[3] Patricia Ledesma Liebana, Linda Vincent, Northwestern University "Financial Reporting for Defined Benefit Plans", (February 2004), p.27

(past service costs) should be recognized in "other comprehensive income" and recycled (recognized in profit or loss) to net earnings in profit or loss using the current amortization method provided under IAS19. While the DP does not present favorable comments related to deferred recognition, we believe that Approach 4 will provide useful information by measuring the defined benefit obligation and the plan assets at fair value and by recognizing changes in "other comprehensive income" in the balance sheet. Although the Approach 1 in the DP proposes that entities present all changes in the defined benefit obligation and the value of plan assets in profit or loss as they occur, we believe that the decision between the immediate recognition approach or deferred recognition approach should be made after further consideration of experimental studies. Thus we propose that the usefulness of information be considered in the discussion on substantial issues at the next phase and that, at this phase, the gains and losses and plan changes (past service costs) should be recognized in "other comprehensive income".

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?

Comment:

Since this question was presented in the same context as Question 3, our response to Question 4 should be read in conjunction with our response to Question 3.

(a) Although we considered three approaches proposed by IASB (as stated in our answer to the Question 3), we believe that the presentation approach for defined benefit promises should be reconsidered. The reason is that presentation of components of defined benefit costs in profit or loss (statement of comprehensive income) is closely related to the recognition of the plan assets and the defined benefit obligation. Therefore, since the first phase does not include re-examining the accounting for defined benefit plans (Paragraph.2.20), it is difficult to find an appropriate approach only on presentation for defined benefit promises.

(b) Based on the understanding above, we believe that current practice (permitting deferred recognition mechanism) should be permitted to be acceptable in presenting components of defined benefit costs in profit or loss (statement of other comprehensive income). Therefore, the IASB should consider the method to recognize change in benefit obligation and pension assets in other comprehensive income in equity and to recognize the amounts in profit or loss through a recycling method.

In addition, considering the accounting for post-employment benefit as labor obligations to employees, we think that it is appropriate to present change in defined benefit obligation as a compensation for work in operating income in the profit or loss statement to provide useful information. If this concept is implemented, a faithful presentation of changes in the value of plan assets and defined benefit obligation is achieved in the balance sheet. Further, recycling accounting maintains relation between net earnings and equity (clean surplus concept).

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?

Comment:

There are several concepts addressed in the scope that we do not fully agree with.

Primarily, the definition of contribution-based promises is categorized by risk profiles. We believe that this is not appropriate for the purpose of post-employment benefit accounting that requires entities to recognize the obligation related to post-employment benefits. In other words, the DP provides a questionable definition of contribution-based promises, which, we feel, requires further discussion on the substance of the post-employment benefit accounting.

Taking into account two facts; (1) this project provides an interim conclusion before discussion on substantial issues, and (2) accounting standards are desired to be based on current available plans, we can not agree to an approach that sets a new accounting standard based on the single factor which is a risk in the future inherent to post-employment benefit promises. As a conclusion, the IASB should discuss the accounting standard related to three separate categories of plans currently available: defined benefit plans, defined contribution plans and hybrid plans. A “Hybrid plan,” as referenced in this letter, is as a promise in which an employer pays the aggregate of actual or notional contributions and (floated or fixed) returns on plan assets as post-employment benefits to employees. We propose that the IASB consider a new accounting method that relates only to Hybrid plan, since the current accounting methods are applied to defined benefit promises and defined contribution promises.

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?

Comment:

In Japan, it is likely that a number of defined benefit promises will be reclassified to contribution-based promises. Since the reclassification may affect entities which adopt the current accounting standards, we are concerned with the likelihood of potential confusion in their practice. For example, the following promises which are not final pay related plans are likely to be reclassified to contribution-based promises.

(1) Earnings-related component of Employee's Pension Funds (based on earnings in all participation period)
(2) Accumulated point plans
(3) Certain defined benefit promises
(4) Cash balance plans

As discussed in Question 5, since we believe the definition for contribution-based promises is questionable, we feel that there is a possibility that the proposed standards may create confusion in actual practice upon adoption.

Many Japanese companies sponsor cash balance plans (which is one of the four promises identified above). In most cases, these promises are related to the yield of Japanese government bond. Therefore, calculating and accounting for the obligations of those plans by discounting method used for defined benefit promises will not overestimate the obligations. As a result, there is no rationale to change the current accounting to the new accounting for contribution-based promises.

In conclusion, considering the actual situation in Japan, we think that the proposed definition of contribution-based promises and reclassification will not significantly improve the post-employment benefit accounting.

Question 7

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

Comment:
We believe that the proposals in the DP will not achieve the goal.

Our rationale is that the post-retirement promises with different risk profiles will coexist in one category if certain defined contribution promises are included in contribution-based promises, which ignores the fact that risk profile of defined contribution promises are significantly different from non-defined contribution promises (which are not included in contribution-based promises). In other words, while the DP states that there are no significant changes to the current IAS 19 accounting for defined contribution promises (Paragraph ITC9), entities are required to disclose information such as the post-employment benefit obligations and the plan assets of the defined contribution promises which are newly categorized in contribution-based promises. We believe that such disclosure will be undesirable and the adoption of the proposal may confuse users of financial information.

We also believe that defined contribution promises should be redefined and reclassified in order to maintain the current accounting method even after certain defined contribution promises are classified to contribution-based promises, in light of the fact that the accounting and the disclosure for defined contribution promises are different from those for other promises.

Question 8

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

Comment:
Our comments relate to the comments in Paragraph PV11 of the DP.

We believe that it is desirable to disclose “the benefit that an employer would have to pay when an employee leaves employment immediately after the reporting date”, and that this is useful financial information.

Although the DP does not explicitly state the IASB’s position on accounting treatment when certain plans in certain countries require that an entity recognize post-retirement obligation equal to “the benefit that an employer would have to pay when an employee leaves employment immediately after the reporting date”, we suggest that the IASB identify the accounting standard for those cases. We also suggest that the IASB consider recognition in accounting for those cases.

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?

Comment:

(a) We believe that the measurement at fair value proposed in the DP will present several issues, and feel that it is not practical to measure the liability for a contribution-based promise at fair value because the measurement may present confusion in actual practice.

The measurement at fair value proposed in the DP may raise issues related to the verifiability of the assumptions and the reasonableness of the estimated value of post-retirement obligations, since the estimated value must be “the amount reasonably estimated” based on various assumptions. For example, there is a criticism that the fair value includes “modeled value” if a market does not exist.[4]

In addition, we feel that it is difficult in practice to reflect credit risk and demographic risk (longevity risk) in the measurement at fair value. In particular, in terms of credit risk we are of the view that “users could be misled when fair value is used at remeasurement of a liability because, in such a case, gains and net assets would increase due to the increase in credit risk of the reporting entity”.

Also, we feel that the IASB’s conclusion to create a new category called contribution-based promises for Hybrid plan and to measure the promises

[4] International Federation of Accountants, "*Financial Reporting Supply Chain –Current Perspectives and Directions*" (March 2008, p.30)

categorized in contribution-based promises at fair value will not be beneficial.

We think that it would be desirable for defined benefit promises and defined contribution promises to be measured by the current measurement approach, and that the new measurement approach that applies only to Hybrid plan which have both the features of defined benefit and defined contribution promises should be reconsidered.

(b) Measurement of risk

We believe that the IASB should consider and include the effects of risk as a component of the measurement at fair value with comprehensive consideration of various factors such as (1) cost and benefit to measure the risk, (2) usefulness of the information for investors, (3) feasibility in practice, and (4) superiority of fair value (here defined as "a value reasonably calculated)".

In actual practice of measurement at fair value, we believe that asset-based risk (market value volatility risk) should be included but credit risk should not because inclusion of credit risk falls in a debt paradox as stated in (a) above. "The risk that the entity would be unable to make the necessary payments" in the future should be classified based on the concept of liability in the Conceptual Framework by IASB and uncertain changes of benefit conditions should not be included in a component of measurement.

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?

Comment:

(a) We do not agree with the IASB's proposal. We believe that it will raise an issue with faithful representation and is not beneficial for users of financial reports due to the fact that the values of economically equal obligations vary as a result of selecting a measurement approach. In other words, we believe that benefit obligations in the payment and deferment phases should be measured reflecting their payment conditions and responsibility and that it is not practical for the obligations to fluctuate due to the differences of promises in the accumulation phase.

In addition, we consider that the proposed measurement of obligations in the accumulation phase will create an issue due to the obligations in the payment and deferment phases varying from those in the accumulation phase.

(b) We agree to the proposed concept itself that risk such as longevity risk should be included in the component of measurement of obligations but there are difficulties in objective measurement of the risk in practice. We believe that some of the difficulties in practice will be to apply different logic to the measurement of obligations as well as to maintain data for different categories of pensioners when a defined benefit promise is converted to a contribution-based promise. We think the IASB should consider those difficulties further.

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?

Comment:

(a) The question on information usefulness should be answered with comprehensive review of the way accounting standard should be, views of securities supervising authorities and experimental studies on financial information. For example, in the field of the post-employment benefit accounting, please refer to one of experimental study articles on relevant between the pension information and security prices (5) as discussed in the response (a) to the Question 3 per this letter.[5]

Fundamental issues on the post-employment benefit accounting will be addressed during the next phase of the project. We think that an issue on

[5] Op.cit., Patricia Ledesma Liebana, Linda Vincent, p.27

presentation of components of post-retirement benefit costs closely relates to a fundamental issue of recognition of plan assets and post-retirement benefit obligations in accounting.

In such situation, we feel that it is desirable to propose a conclusion on the issue of presentation in financial statements with consideration of disaggregation of information regarding post-employment benefit accounting based on discussion on those fundamental issues. If disaggregation of information leads to providing useful information for users, we feel that the IASB should require the disclosure of additional sensitivity analysis (as addressed with Question 1) during the initial stage and propose the disaggregation of information during the next phase. We believe that these two steps will ultimately result in practical information for users of financial statements.

(b) We agree to the proposal in the DP. Our rationale is that components and features of profit or loss from contribution-based promises differ from those of defined benefit promises due to differences in calculation logic under the proposed framework to measure contribution-based promise liabilities at fair value. Therefore, we concluded that it is not practical to disaggregate changes in the contribution-based promise liability into components similar to those required for defined benefit promises.

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?

Comment:

We believe that presentation of contribution-based promises and defined benefit promises should be as consistent as possible, given the fact that both provide post-employment benefit promises.

However, there are cases where it may not be practical to disaggregate changes in the contribution-based promise liability into components similar to those required for defined benefit promises (please refer to our response to Question 11).

We feel that the IASB should consider the overall framework of the post-employment benefit accounting (rather than considering particular issues alone) when making a decision on presentation.

Question 13

(a) What are the practical difficulties, if any, in identifying and measuring the 'higher of' option that an entity recognizes 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?

Comment:

(a) We agree to the preliminary view to measure higher of option at fair value. However, we believe that it will not be practical to implement from a benefit or cost perspective. This is because it requires entities to construct a complicated calculation model to evaluate the value of options based on cash flow at a given point in time with consideration to weighted probability.

(b) With consideration to the difficulties in practice stated in (a) and a matter of materiality, we believe that measuring at intrinsic value would be an acceptable concise method.

Question 14

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

Comment:

Please refer to our comment on Question 1.

Question 15

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

Comment:

We understand that the DP is the IASB's response to criticism on the current post-employment benefit accounting with limitations to the scope and feedback toward financial information. However we believe that the following issues should be discussed by IASB:

(1) The revision of the legal obligation or constructive obligation in IAS 37 may affect recognition of post-retirement benefit obligations.
(2) The issue of whether “pension plans (funds) should be consolidated or not” has not been discussed in the preliminary views, however the conclusion may affect the accounting of plan assets and post-employment benefit obligations.
(3) Issues to be addressed during the second phase or conclusions from other projects may change some of the preliminary views, since the initial phase was proposed while considering its inconsistencies with other accounting standards.

Taking the above various issues into account, we believe that it is premature to make final conclusions on all of the issues presented in the DP. Since it is our understanding that the IASB is planning to complete accounting standards in coordination with the FASB, we believe that the IASB should propose amendments which are more consistent with SFAS158 during the initial phase (please refer to our comment on Question 2).

Yours faithfully,

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