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YOUR REF. OUR REF. FC-GAR/FRG/PFG VEVEY, 14 October 2008

DISCUSSION PAPER – PRELIMINARY VIEWS ON AMENDMENTS TO IAS 19 EMPLOYEE BENEFITS

Ladies and Gentlemen,

Please find below our answer to your invitation to comment on the above mentioned discussion paper

1. GENERAL COMMENTS

We welcome the issue of this discussion paper (the DP) because the current requirements of IAS 19 are indeed a cause of concern to the users and of complexity to the preparers. However we consider that reaching a short term solution to improve employee benefit accounting does not require most of the fundamental changes proposed in the DP but only to fix specific issues of IAS 19.

In particular, we consider that the "corridor" should be removed because it obscures the value of employee benefit assets and liabilities on the balance sheet and is based on arbitrary criteria. Moreover, the current classification as defined benefit plans of plans that are basically defined contribution plans with certain guarantee features such as, e.g., a minimum guaranteed return, could be reviewed. Such plans could well be classified as defined contribution ones with the guarantee measured as a distinct element. Such a change would be a welcome simplification for the preparers and would also allow the users to assess the obligation element of such plans.

Unfortunately, the Board has embarked into a fundamental revision of the classification of employee benefit schemes by creating the notion of contribution-based promises which regroups current defined contribution plans and those defined benefit plans that are in fact defined contribution plans with an obligation element. We consider that, while such proposal has some merits, it cannot be part of a short term programme designed to fix the current problems of IAS 19 and to simplify employee benefit accounting. Instead, this proposal should be part of a long term project to fundamentally rethink employee benefit accounting.

2. ANSWERS TO SPECIFIC QUESTIONS

Scope of the project

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 accounting for employee benefits lacks some transparency and that the users have difficulties in assessing how enterprises report their employee benefit schemes and that a short term solution has to be found.

However, we believe that some of the proposals made for contribution-based promises would result in added complexity, contrary to the stated objectives of this DP, through reclassification of many defined benefit plans into the referred category. We, therefore, think that the definition of a contribution-based promise should be excluded from the scope of this DP. The retention of contribution-based promise in the DP would not reduce the number of available options under the current IAS 19.

Furthermore, we recommend discussing changes in the presentation of defined benefit liabilities in the project on financial statements' presentation, given the similarities in the nature and the long-term horizon of these proposals.

Recognition and presentation of defined benefit promises

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 think that the proposed immediate recognition of changes in values of the plan assets and defined benefit obligation in the income statement would distort this performance statement. We therefore disagree with this proposal for presentation of defined benefits promise, as snapshot valuations do not reflect the long-term nature of these benefits. At the same time, we think that without a deferral mechanism there is a need for a long-term solution to this issue that could both enhance the usefulness of rather complex fair value estimates for both cash flow projections and actual performance reporting.

We strongly believe that the expected returns and the actuarial gains or losses should be separated, as it is the case for the underlying performance management of the pension funds. Many users consider such information to be valid. The financial reporting of pensions should, accordingly, reflect the performance in-line with the underlying economics, where historic actual returns are used in identifying expected future returns, thus isolating the effect of changes in actuarial values.

We agree with the proposal to recognise unvested part service costs immediately upon plan's amendment and think this would be consistent with the immediate recognition of all gains and losses on defined benefit plans' assets and liabilities.

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?**

Please see our answer to question 4.

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?**

While we would agree with the removal of the "corridor", we consider the approaches proposed in chapter 3 do not represent valid alternatives and we would like to make a counter proposal.

Approach 1 of presenting all changes in employee benefit assets and liabilities in the income statement when they occur would create unwarranted volatility than does not reflect the economics of employee benefit schemes which have a long term horizon.

Approach 2 of presenting the cost of service in the income statement and all other costs in other comprehensive income (OCI) is arbitrary as some costs would never impact the income statement.

Approach 3 of presenting the changes of financial assumptions in OCI and other costs in the income statement is as arbitrary as approach 2.

Therefore we agree with the conclusions of the DP § 3.17 that approaches 2 and 3 are inconsistent with IFRS but we disagree with this paragraph as far as approach 1 is concerned because such approach does not address the faithful representation and substance over form qualitative characteristics as specified in §§ 33 to 35 of the Framework.

Instead of the above approaches, we consider that actuarial gains and losses should continue to be recognised in Other Comprehensive Income (OCI / SORIE) but we would propose that they are recycled to the income statement. In section 3.9 of the DP, the Board considers whether actuarial gains and losses should be recycled and then says that there is no suitable basis for recycling. We would not agree with this and consider that reliable recycling bases could be found on the basis of the economics of pension plans, viz. :

- cumulative actuarial gains and losses related to plan members, e.g., changes in demographic assumptions would be recycled over average remaining service years,
- cumulative actuarial gains related to financial assumptions such as changes in discount rates and return on assets would be recycled over the average maturity of pension liabilities.

We consider that such a recycling mechanism allows to maintain pension assets and liabilities at fair value on the balance sheet while acknowledging that, due to the long term nature of the obligations it is not possible to recognise the changes in value of these assets and liabilities immediately in the income statement. This recycling proposal should obviously be implemented concomitantly with the contemplated changes in the presentation of financial statements. Accordingly, we disagree with references to the long-term goal of removing the other comprehensive income and subsequent recycling to the income statement.

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 think for the purposes of short-term improvements, the DP does not define contribution based promises and defined benefit promises in detail appropriate for unambiguous interpretation. Should these proposals be finalised in their current form, the application could result into wider divergence in practice. We, therefore, believe that these definitions should be addressed under the long-term project for employee benefits.

Contrary to the above, the current IAS 19 contains clear definitions, particularly for defined contribution plans, and might be better adjusted for achieving a short-term simplification. For example, by permitting certain defined contribution plans with minimum guarantees to be valued as sum of two components (a defined contribution plan plus a separate guarantee obligation), the Board would enable many users to avoid complex defined benefits' style valuations for plans, which are more of defined contribution nature.

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?

We think that the linkage to an asset, groups of assets or index criterion within the definition of the contribution-based promise could, indeed, bring to reclassifications from the defined benefit plans to contribution-based promise category. However, we question whether the proposal would lead to significant improvements in the reporting. Rather we would propose to reclassify those plans as defined contributions with certain specific obligations being measured (please see our answer to question 5).

Question 7

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

We think that a short-term simplification driven proposal like this DP aims to be, should make no difference to a straightforward defined contribution promises without any additional guarantees and where the amount is paid in full, upon the end of the relevant service period and is irrecoverable. However, in this context we are concerned with proposal to determine the fair value of the promises (even if it turns out to be zero) introduced in this DP and the potential for application difficulties and divergence in the practice this might bring.

<u>Recognition issues related to contribution-based promises</u>

Question 8

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

We have no additional comments with reference to this.

<u>Measurement of contribution-based promises</u>

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?

There is certainly a need to reflect relevant risks in the measurement, but the definition of risks and the methods for quantifying the former should be clearly defined. Unfortunately, the DP stops short of explanation behind the referred concepts of risks. Given the goal of short-term simplification and in the absence of clear concept and method definitions, we are convinced that these matters should be addressed under the long-term project on employee benefits.

As an example in line with the above thinking, we do not support the preliminary view on inclusion of credit risk into the measurement of contribution-based promise. In the absence of issue specific credit ratings, that are unlikely for contribution-based promises, we are not aware of any objective method of quantifying the credit risk in practice for inclusion into the measurement of contribution-based promises.

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 support the consistency of valuation view and think that there should be no changes in measurement between accumulated and payout phases. In the absence of dynamic markets for pension liabilities, we believe that the DP should provide specific guidance for fair value measurements and not limit it to prescribing the use of fair value, which could result in divergence in practice and increase subjectivity in valuations, thus reducing usefulness of resulting financial information.

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?

As already said we consider that the definition of contriburtion-based promises should be deferred to a long term project. Neverthess we could agree that the disaggregation of the contribution-bases promise between service cost and other value changes would enhance the quality of financial reporting and provide decision useful information.

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?

Still in the contex of a long term project on contribution-based promises, we believe that presentation of the contribution based promise should mirror that of the define benefit based promise. This, amongst others, would eliminate current problems in allocating assets and results between two types of promises for numerous plans funded with a unique portfolio of assets.

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?

While seeing the rationale behind comparison between financial option and the "higher of" option, we have serious doubts about simplicity of resulting valuations. At the same time, we would not expect the value of an embedded contribution based promise option to be material in the overall value of the host defined benefit promise.

Other matters

Question 14

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

In our opinion, the existing presentation and disclosure requirements for employee benefits can be considered as adequate. We would also like to emphasise that any increase in the volume of requested disclosures would create issues at large preparers with number of separate plans.

Question 15

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

We have no further comments.

Thank you very much for your attention to the above.

Yours very truly,

NESTEC Ltd.

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