bp

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International Accounting Standards Board
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Dear Sir or Madam,

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Re: Invitation to Comment – Discussion Paper Preliminary Views on Amendments to IAS 19 Employee Benefits

We welcome the opportunity to comment on the discussion paper on Preliminary Views on Amendments to IAS 19 Employee Benefits, to which I am responding on behalf of BP p.l.c. Our responses to the specific questions in the discussion paper are attached.

We agree with the proposal to eliminate the corridor and deferral option currently available under IAS 19, but we do not agree that it is necessary to develop new approaches to the presentation of the components of defined benefit schemes to accompany this. In our view, the existing standard can deal appropriately with the immediate recognition of all actuarial gains and losses, and any change in the presentation of defined benefit schemes should be the result of a comprehensive review of the presentation of financial statements as a whole, and should not come from a short-term project aimed solely at a limited number of aspects of pension accounting.

Furthermore, we do not agree that such a short-term project is an appropriate vehicle to be used for introducing changes which could fundamentally change the accounting for post-employment benefits. We believe that the case for the creation of the new category of contribution-based benefit promises has not been made in the paper, and that the introduction of fair value as a measurement attribute for pension accounting should not be adopted without a wide-ranging review of all the implications. This, in our view, means that these matters should be the subject of the longer-term comprehensive project on pension accounting to be undertaking with the FASB.

If you would like clarification of any of the matters in our response, we would be pleased to discuss these with you.

Yours faithfully,

F W M STARKIE

ATTACHMENT

Response to IASB on discussion paper on IAS19

Question 1 - Scope of the project;
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?

There are no additional issues which we believe should be addressed by the Board at this time

Question 2 - Recognition and presentation of defined benefit promises
Chapter 2 describes the Board's deliberations on the recognition of defined benefit promises. The Board's preliminary views are summarised in paragraphs PV2–PV4. 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?

PV2: we agree that "entities should recognise 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". We support elimination of the corridor/deferral option which currently is allowed in IAS19.

PV3: we do not support the proposal that "entities should not divide the return on assets into an expected return and an actuarial gain or loss". We are comfortable with IAS19's current requirement in this regard. We support the use of the expected return for assets as this gives a long-term measure, commensurate with the timescales inherent in pension accounting, which is not distorted by short-term fluctuations. Furthermore, the expected return represents management's best estimate of the future economic performance expected of the plan's assets and is the basis upon which the assets are managed. We believe that these characteristics mean that this information is of more use to analysts in respect of pension arrangements than those returns which may be dependent upon the economic circumstances of the last day of an accounting period. We recognise, however, that expected return is a matter requiring careful judgement and can be open to abuse by the unscrupulous, although full disclosure of the expected returns of each class of asset can mitigate this, as this means that the user of the accounts can easily see where a company has made more optimistic asset return assumptions than its peers.

PV4: we support the view that "entities should recognise unvested past service cost in the period of a plan amendment".

Question 3 - Recognition and presentation of defined benefit promises
Chapter 3 sets out alternative approaches for the presentation of components of the defined benefit cost and analyses the relative merits of each approach. These approaches are summarised in paragraph PV5.
(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?

PV5: we do not support making changes to the presentation of pensions costs, as to us none of the three approaches suggested represent an improvement on the approach currently set out in IAS19. Adopting approaches 1, 2 or 3 would make the company accounts less understandable and less meaningful to the users of the accounts. The current approach provides meaningful information to users of the accounts to help them predict future earnings and cash flows arising from the company's pension balances.

Approach 1: we do not support this, as including all changes in the pension assets and liabilities in the year's profit and loss would introduce material volatility into the reported profit which we believe analysts would simply strip out. The current IAS19 approach reflects a fair charge for the pensions benefit and investing activities into the year's profit, the volatility is clearly set out in the pension disclosures, and the financial impact of the volatility reflected in the year-end balance sheet through SORIE (or other comprehensive income). We see no grounds for change the approach taken by companies which mark to market their pension balances.

Approach 2: we do not support the proposal to include only service cost in profit and loss. Continuing to include financing items (return on pension assets and unwind of discount of assets) in reported profit, as currently required under IAS19, is preferred as this reflects into the year's profit the expected financing impacts of pensions over the long haul. The advantage of the current IAS19 approach over this proposal is that, under IAS19 as it currently works, when a company funds its pension plan, the consequence is that reported profit is largely unaffected by the funding. The increase in expected asset return (resulting from having more pension assets) is offset by higher interest expense (resulting from the company having higher debt). This is a fair reflection of the economic burden of the pension plan. We do not support the "approach 2" in the discussion paper, as the company funding its pension plan would suffer from a higher interest expense, but the reported profit would not reflect the economic benefit of the pension fund having more pension assets thereby earning a higher return.

Approach 3: we do not support this proposal over the existing IAS19 approach, but see it as preferable to approaches 1 and 2.

- We can see some merit in the argument that experience gains and losses on pension liabilities are reported in profit.
- We support inclusion of the impacts of changes in financial assumptions in other comprehensive income, but see no grounds for treating the impacts of changes in demographic assumptions differently. The impacts of changes in all financial assumptions (discount rate, price inflation, salary growth, pension increases etc) should be treated in the same way.
- The impacts of changes in demographic assumptions should also be reflected in other comprehensive income.
- We see no grounds for replacing the expected return on assets with a meaningless "interest income" amount which bears no relation to the asset classes in which the pension assets are invested. If the Board believes that companies are making over-optimistic assumptions on asset returns, then we believe that it would be better to be more prescriptive in setting out how companies should select these assumptions for each asset class.
- On balance we see no strong grounds for preferring this approach to IAS19 as it currently stands.

Question 4 - Recognition and presentation of defined benefit promises

(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?

We see no grounds for changing the framework that is currently set out in IAS19 other than elimination of the corridor/deferral option.

As discussed in our response to Question 2 above, we believe that expected return on assets, as required for under current IAS 19, provides useful information to the user about management's expectations about long-term trends.

Question 5 - Definition of contribution-based promises
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?

Currently, pensions benefits are either classified as defined benefit or defined contribution. We see no benefit to users or producers of accounts by introducing a third arrangement, "contribution based promises".

Defined contribution plans with a guaranteed return are accounted for satisfactorily under the provisions of existing IAS 19 as defined benefit plans, and we believe no change is required at present. However, we think that it might be helpful to users to enhance this accounting with a description of the nature of such plans as disclosure.

The current classification of such plans as DB works satisfactorily at present, and where those plans have a different risk profile to final salary DB plans, this is reflected at present into the sensitivities. We believe that this aspect works reasonably well at present, and we see no grounds for change.

PV6 sets out that "post-employment benefit promises are formal or informal arrangements under which an entity is obliged to provide employee benefits (other than termination benefits) payable after the completion of employment". Our view is that both IAS19 and this discussion paper lack clarity on whether bridging pension or pension augmentation benefits granted as part of a termination benefit should be included as part of pensions liabilities and costs. Our view is that such a benefit does form part of pensions liabilities and costs, and that the accounting standard should say this.

Question 6 - Definition of contribution-based promises
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?

See our answer to question 5 above.

Question 7 - Definition of contribution-based promises
Contribution-based promises, as defined in this paper, include promises that IAS 19 classifies as defined contribution plans. The Board does not intend this proposal to lead to significant changes in the accounting for most promises that meet the definition of defined contribution plans in IAS 19. Do the proposals achieve that goal? If not, why not?

See our answer to question 5 above.

Question 8 - Recognition issues related to contribution-based promises
Chapter 6 discusses recognition issues related to contribution-based promises. The Board's preliminary views are summarised in paragraphs PV9–PV11. Do you have any comments on those preliminary views? If so, what are they?

We accept the principal that unvested contribution-based promises should generally be recognised.

Question 9- Measurement of contribution-based promises
(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) See our answer to question 5 above.

b) We support the existing "level playing field" approach under IAS19 whereby liabilities are discounted at a rate equivalent to the yield on a high quality corporate bond, regardless of the credit strength of the sponsor. Reflecting changes in a sponsor's credit strength in the measurement of the pension liability would create unnecessary complexity which would not help the user of the accounts. In addition, using a discount rate that reflected the credit strength of the sponsor could be seen as being misleading, as the weaker the company is financially, the lower the pension liability appears to be.

Question 10 - Measurement of contribution-based promises

(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?

a) We agree that liabilities should be measured in the same way in the payout, deferment and accumulation phases. For a member who is in retirement or deferment, the way in which the benefit originally arose is not relevant to the basis of measurement.

b) We do not agree that the new definition of contribution-based promises should be introduced at this stage, and we do not agree that fair value is an appropriate measure for pension liabilities which will be extinguished by settlement rather than transfer. Having said that, other than the question of what discount rate to use (a question which applies to all pension benefits), we see no practical difficulties in measuring liabilities in the payout phase.

Question 11 - Disaggregation, presentation and disclosure of contribution-based promises

(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?

See our answer to question 5 above. We support the current IAS19 approach to report plans with DB elements as DB plans, and do not support introduction of a third arrangement, "contribution based promises".

Question 12 - Disaggregation, presentation and disclosure of contribution-based promises

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?

See our answer to question 3 above: currently, pensions benefits are either classified as defined benefit or defined contribution. We see no benefit to users or producers of accounts by introducing a third arrangement, "contribution based promises".

Question 13 - Benefit promises with a 'higher of' option

(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?

We support measuring such liabilities as the higher of a defined benefit or contribution based promise. The proposal to disaggregate the "higher of option" from the host defined benefit strikes us as being complex, an unnecessary burden on companies, and of little value to the user of the accounts.

Question 14 – Other matters

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 postemployment 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?

i. We support introduction of an explicit requirement to disclose mortality rates, and propose that the requirement is in line with the current disclosure of most UK-listed companies: the accounting standards should explicitly require companies to report average number of years' survival in each major country for males and females from retirement age and average number of years' survival from retirement age assumed for someone who is currently 20 years' from retirement.

ii. We support more explicit requirements to disclose sensitivity of pension plans to changes in financial markets (where material), with explicit requirement to disclose impact of changes in discount rates, inflation rates, and asset values on the pension balances and costs.

iii. We support introduction of an explicit requirement for international companies to split their pension balances and assumptions between the countries in which they provide pension benefits for the two or three countries where they have their largest pension plans (where providing this split is material to the overall pension figures).

iv. We support retention of the requirement to show both an expected return on assets and the difference between expected and actual return on assets.

v. Disclosure of total expected contribution to the Group's pension funds over the next year or two would make sense where the sponsor has already committed to make these payments.

vi. We do not support introduction of more than one measure of pension liabilities

Question 15 – Other matters

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

We have no additional comments.