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Sir David Tweedie
Chairman of the
International Accounting Standards Board
30 Cannon Street
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United Kingdom

Düsseldorf, 18 September 2008
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Dear Sir David

Re.: Discussion Paper: Preliminary Views on Amendments to IAS 19 Employee Benefits

We appreciate to be given the opportunity to comment on the above mentioned Discussion Paper issued by the IASB in March 2008.

General Remarks

As announced, the IASB will undertake a fundamental and comprehensive revision of IAS 19 in cooperation with the FASB in order to develop a common standard on post-employment benefit promises. In principle, we appreciate the Board's intention to remedy some deficiencies in limited areas of the current IAS 19 already before entering into this project. In particular, IAS 19 would be improved through the proposed elimination of the existing alternatives for recognising changes in the defined benefit obligation and in the value of any plan assets prompted by actuarial gains and losses in favour of a uniform recognition of all changes in value in the statement of financial position for the period in which the changes occur. However, with regard to the presentation of the changes in value in comprehensive income we recommend not to decide on this issue before completing the financial statement presentation project.

Furthermore, considering its far-reaching consequences for financial reporting in practice, we doubt the benefits of developing a new, but presumably only temporary concept for parts of IAS 19. Such measures should be the subject matter of the common phase of the project to be performed in cooperation with the

FASB. Preparers and users of financial statements should not unnecessarily be burdened with the effort required for potentially changing the accounting concept for post-employment benefit promises twice within a relatively short period of time. Moreover, proceeding stepwise in the fundamental revision of IAS 19 involves the risk of an unintended pre-commitment in parts of the standard.

Instead of introducing a new category for post-employment benefit promises (i.e. contribution-based promises) which are to be measured by using a new kind of measurement basis ("fair value assuming the terms of the benefit promise do not change"), we believe that the promises which have been identified as being troublesome should be accounted for following the concept underlying IFRIC D9.

Comments on the 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?

Given our general remarks, in our opinion the scope of this short-/medium-term revision of IAS 19 should rather be limited than extended. Therefore, no additional issues should be addressed as part of this project.

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?

From our point of view, there are no other factors that the Board should have considered in this respect.

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?*

With regard to defined benefit promises, we principally support the Board's proposition to eliminate the options in IAS 19 for recognising changes in the defined benefit obligation and any plan assets resulting from actuarial gains and losses (particularly the complete and immediate recognition in profit or loss, the complete recognition in other comprehensive income and the 'corridor'-approach) in favour of a compulsory complete and immediate recognition in the statement of financial position in order to achieve better comparability and to ensure recognition of all liabilities.

Although we fundamentally support the proposed elimination of the 'corridor'-approach, we recommend not to decide on the accompanying issues of presentation in comprehensive income concerning defined benefit promises before completing the financial statement presentation project (cf. paras. 1.17-22). In this context, we further suggest not to exclude the recycling issue from this project.

In any case, it has to be ensured that the supported complete and immediate recognition of any changes in value in the statement of financial position does not lead to an inappropriate increase in volatility of earnings. Since the effects resulting from changes in the valuation parameters often reverse in the long run they are not relevant for users who are interested in assessing future earnings and cash flows.

Recognising the changes in value entirely and immediately in profit or loss would imply the risk of systematically distorting financial performance: If an economic unit has a liability from a defined benefit promise measured at the present value of the obligation as well as non-financial assets measured according to the cost model of IAS 16, the amount of the liability would rise in the event of a decrease in the interest rate. The non-financial assets whose economic value is estimated by using a discounted cash flow model would benefit from the decrease in the interest rate. However, this increase in economic value would not be reflected in the financial statements, as the measurement is limited by the historical costs of the non-financial assets.

Among the three approaches put up by the Board for discussion, we favour the 'remeasurement'-approach (without recycling). According to this proposal income and expenses prompted by changes in the discount rate and in the value of any plan assets are recognised in other comprehensive income. All other costs (e.g. the costs of service, interest cost and interest income) are recognised in profit or loss (paras. 3.15 et seq.). Concerning the required method of determining interest income on plan assets we prefer using market yields at the reporting date on high quality corporate bonds (para. 3.29, third alternative) in order to preserve within the concept of 'net accounting' the equivalence of the interest rate that has to be used to measure the defined benefit obligation (paras. 3.30 and 1.11, third bullet). Furthermore, this method is appropriate to objectify the difficult determination of interest income on plan assets.

A decision in favour of the 'remeasurement'-approach would be consistent with the treatment of revaluations of property, plant and equipment according to IAS 16 and of intangible assets according to IAS 38 (para. 3.18). Furthermore, choosing this approach would lead to income and expenses having a higher assigned predictive value being recognised in profit or loss, whereas income and expenses with a lower assigned predictive value being presented in other comprehensive income (paras. 3.18 and 20 et seqq.).

We reject the 'all through profit or loss'-approach (para. 3.11), because it would result in a sharp but not relevant rise in volatility of earnings. Moreover, applying this approach would lead to combining items with different predictive values in the income statement. The 'financing'-approach (paras. 3.12-14) is unconvincing, because interest income and expenses resulting from post-employment benefits promises and from any related plan assets would be recognised in other comprehensive income, whilst interest income and expenses are recognised in profit or loss in other cases.

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?

With regard to the method required to determine interest income on any plan assets when using the 'remeasurement'-approach we would like to propose a method worth being considered as an alternative to the method we identified as preferable in our answer to question 3. According to this alternative method the interest income of any plan assets would be determined by applying the respective interest rate for fixed-interest financial assets and applying a fixed interest rate derived from a financial asset with similar risk for variable-interest financial assets or investments in equity instruments.

A decision in favour of the 'remeasurement'-approach would contribute to avoid an inappropriate increase in earnings' volatility. Such an end could alternatively be achieved by determining the discount rate as a long-term average of interest rates from the past instead of using the interest rate as of the reporting date. We proposed this approach already in our comment letter dated October 2nd, 2007 on the Exposure Draft for an IFRS for SMEs (now Private Entities). Applying the measurement basis 'amortised cost using the effective interest method', as stipulated in IAS 39.47 (for the measurement of 'other financial liabilities'), to the measurement of obligations from post-employment benefit promises, implies, in theory, that the total amount of the obligations would have to be divided into partial obligations incurred at different points in time. These partial obligations would then have to be discounted (and unwinded) using the respective market interest rate that was valid at the time of incurrence. Since such a procedure would require complex calculations, it seems justifiable to use instead one historical long-term average interest rate for high quality corporate bonds to determine the present value of the total obligation from post-employment benefit promises. Altogether, this would result in short-term variations in the market interest rate that have a major impact on the amount of the obligation having only a minor/alleviated effect on profit or loss.

Regarding the choice of the appropriate discount rate, the Board should carefully and comprehensively consider all arguments in favour and in disfavour for using the market yield at the reporting date on high quality corporate bonds or rather a long-term average of market yields from the past on deciding the question which approach provides more useful information to users.

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 this project, and why?

In the Discussion Paper not only those promises are addressed whose accounting is troublesome in practice but also those promises which can be measured appropriately on the basis of the current IAS 19 (q.v. our comments to questions 8, 9 and 10).

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?

According to our assessment, in Germany many plans that have so far to be accounted for as defined benefit promises would, under the Board's proposals, have to be reclassified as contribution-based promises (in particular newly awarded promises), because only a minority of promises are typical final salary promises. Whereas up to now, far more than 50 % of all post-employment benefit promises are classified as defined benefit, under the new concept a vast majority of all promises would be contribution-based.

In case of a retrospective application of the proposed new categorisation practical problems would arise from having to reclassify many promises from defined benefit to contribution-based.

With regard to other conceptual und practical problems resulting from the new categorisation, we refer to our answers to the following questions.

Contribution-based promises, as defined in the Discussion 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.

Question 7 – Do the proposals achieve that goal? If not, why not?

According to our assessment, the proposals would achieve the goal described above. Albeit, we do not support the proposals.

Recognition issues related to contribution-based promises

Chapter 6 of the Discussion Paper discusses recognition issues related to contribution-based promises. The Board's preliminary views are summarised in paragraphs PV9-PV11.

Question 8 – Do you have any comments on those preliminary views? If so, what are they?

Measurement of contribution-based promises

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?

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?

The proposed introduction of contribution-based promises as a new category of post-employment benefit promises which is to be measured at fair value (assuming the terms of the benefit promise do not change) is strictly rejected by the IDW because this step would have a far-reaching impact insofar as, henceforth, most promises would fall into this new category and, consequently, this would mean a fundamental amendment to the current practice in this area of accounting for post-employment benefit promises. At the same time, it may be presumed that given the Board's long-term joint project with the FASB the new rules would only be effective temporarily. Moreover, the proposed accounting for contribution-based promises is not convincing.

The current distinction between defined contribution and defined benefit plans adequately reflects the different economic substance of the two kind of plans.

- With regard to defined contribution plans, the reporting entity's obligation for each period is limited to the amounts to be contributed to the fund for that period. Actuarial risk and investment risk fall on the employee (IAS 19.25).
- With regard to defined benefit plans, the reporting entity is obligated to provide the agreed benefits to the employee. The actuarial risk and the investment risk remain with the reporting entity (IAS 19.27).

Whereas the current classification appropriately reflects the obligation and the risk exposure of the reporting entity, the proposed new categorisation would result in a distinction of post-employment benefit promises not taking suitably into account the different kinds of obligation and risk exposure. The new category of contribution-based promises would encompass today's defined contribution plans as well as certain plans that so far have to be classified as defined benefit. Due to the proposed new definition it would be unclear to what extent these promises contribute to the indebtedness of the reporting entity and to which risks it is exposed to. Some contribution-based promises would result in liabilities to be recognised, others would not. Therefore, the new classification would diminish the decision-usefulness of the financial statements. Albeit, we agree with the Board's view that an amendment of the standard is needed for the plans which were identified as being troublesome in practice.

Aside from the fact that, on a conceptual level, it appears to be disputable whether the proposed measurement basis "fair value assuming the terms of the benefit promise do not change" is – in view of the qualifying annex – actually a fair value in its literal meaning, in practice many problems will evolve when measuring contribution-based promises with the "fair value" of the obligation:

- Since for obligations from post-employment benefit promises, values derived from active markets are currently not available and presumably also will not be available in the foreseeable future, the fair value would have to be established by using a valuation technique.
- Using a valuation technique normally requires an assumption about the size of the default risk of the promises to be measured. The default risk is deter-

mined by the degree to which the promises are protected in the event of default. Estimating the default risk, it would have to be considered whether or to what extent the promises are actually protected against the case of insolvency of the reporting entity. Protection could either be obtained by means of an external institution (e.g. a pension assurance association, in Germany the Pensions-Sicherungs-Verein aG, Cologne), assets in an external retirement benefit plan (e.g. a CTA or a pension fund) or another third party. The applied interest rate has to reflect the level of risk of the (un-)protected promise. Subject to the kind of (non-)protection, the appropriate interest rate could either be the common credit risk of the employer, the risk-free interest rate, an interest rate adjusted to the (average) risk of the external assets or a combination of the aforementioned.

The distinction necessary therefore would lead to a substantial increase in complexity, even for the measurement of promises with a fixed return which in the past could already be measured without any difficulties. In practice, these promises which so far are classified as defined benefit are discounted using an interest rate for high quality corporate bonds at the reporting date, i.e. an interest rate that is not influenced by the employer's own credit risk and the other factors mentioned above. It should remain allowed to use this procedure until the Board commits itself to a long-term and conceptually persuasive accounting for post-employment benefit promises.

- In the context of fair value measurement, we again alert to the problems arising from a recognition (in profit or loss) of the effects resulting from a change in the credit risk of an reporting entity's own liabilities. For example, if the employer's own credit risk is to be considered, a decrease in the degree of creditworthiness will lead to a lowering of the employer's obligations from contribution-based promises which would be both paradoxical and counterintuitive.
- Furthermore, measurement at fair value could lead to the following problem provided the fair value is regarded as an exit value (which is not consistently the case within the current set of IFRS): The fair value would be the same as the cost incurred by the employer for the purchase of an annuity contract in order to hypothetically settle the liability. Since the assumptions by insurance companies about mortality are often more conservative compared to the respective assumptions by pension funds and the yields of annuity contracts only seldom are as high as the yields of high quality corporate bonds, the value attributed to a certain promise would be higher if this promise would be classified as contribution-based instead of defined benefit, as it is

the case now. It is doubtful whether such a higher value is appropriate because the employer typically does not intend to actually settle the obligation early. Therefore, the exit value is, in principle, unsuitable. Moreover, it appears to be paradoxical that liabilities which expose the employer to a lower risk than final salary promises do, would conceptually tend to be measured with a higher value than final salary promises. In addition, it has to be considered that the outflow of liquidity resulting from the settlement of the liability will itself have an impact on the credit risk of the employer.

- If IAS 19 henceforth would stipulate that contribution-based promises have to be measured at the fair value of the liability, whereas an obligation from a defined benefit promise would still have to be measured according to the projected unit credit method (PUCM), IAS 19 would contain two different measurement bases for obligations which, from its economic substance, are often essentially the same and only differ in their legal arrangement. This may result in an obligation being accounted for with different amounts even though the promises comprise benefits which may not only be the same in terms of economic substance but also in terms of amount. In addition, this would provide the reporting entity with an undesired structuring opportunity.

Instead of introducing a new category of post-employment benefit promises and a new measurement concept, for the time being the Board should only address the forms of promises which are really troublesome. To this end, it could, for example, amend or clarify IAS 19 based on the proposals submitted by IFRIC already in July 2004 with IFRIC D9: “Employee Benefit Plans with a Promised Return on Contributions or Notional Contributions”. The proposals are, to a large extent, in conformity with the present measurement concept. Indeed, D9 was withdrawn by IFRIC in November 2006 as it then appeared to be more appropriate that the issues in question are regulated in IAS 19 rather than in an Interpretation. Nevertheless, we notice that the approach proposed in D9 for measuring the troublesome promises are already applied in practice.

D9 distinguished between those promises for which the employer – apart from effecting the contributions – guaranteed a fixed return on those contributions (promises with a fixed return) and those promises for which the employer – again apart from effecting the contributions – promised a return on those contributions that is linked to the future return from an asset, group of assets or an index (promises with a variable return). So far, both forms of promises are classified as defined benefit and, according to the Board’s proposals, would be classified henceforth as contribution-based.

- According to D9 *promises with a fixed return* would still be measured as defined benefit promises using the PUCM, i.e. calculating the benefits to be paid to the employee in the future by projecting forward the (notional) contributions at the guaranteed fixed rate of return, subsequently allocating the benefits to periods of service under the plan's benefit formula and finally discounting the benefits allocated to the periods to the present value using a market yield at the reporting date on high quality corporate bonds. Any plan assets are conventionally deducted from the gross obligation. Until a new and final concept is not in place, it seems both reasonable and practicable to continue applying this method (cf. also para. 5.31).
- Measuring *promises with a variable return* according to the PUCM using the expected return on plan assets has also been regarded as problematic under D9 since the determination of the expected future benefits rendered to the employee would have to be done on the basis of the asset- or index-specific yield of the plan assets, whereas the discounting would have to be effected using a market yield at the reporting date on high quality corporate bonds. Mostly, these two yields will differ leading to inappropriate accounting. Consequently, D9 proposed to measure the obligation from promises with a variable return with the fair value of those assets the promise is based on. From our point of view, this approach is appropriate because it takes into account the economic substance of those promises. Some sources in literature note that the legitimacy of such a measurement may already be derived from the present IAS 19.85(b). A congruent measurement of plan assets and obligations from post-employment benefit promises is – in the opposite direction – also implemented in IAS 19.104 and IAS 19.104D for insurance policies.

In para. 5.32 the Board argues that there is no conceptual basis to separate promises with a fixed return from promises with a variable return. From our point of view, there actually is a conceptual difference between these two kinds of promises: Whereas promises with a fixed return can be expressed in terms of a fixed nominal amount from the date that it is granted, such a determination is not possible for promises with a variable return.

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?

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?

As already explained in our answer to questions 8, 9 and 10, we strictly object to the introduction of contribution-based promises as a new category for the above-mentioned reasons. Albeit, we support the proposed elimination of the deferred recognition model in favour of a complete and immediate recognition of changes in obligations and in plan assets in the statement of financial position.

In our answer to questions 8, 9 and 10, we argued for a measurement of certain plans according to the concept underlying IFRIC D9. Since promises with a fixed return would, in principle, still be measured using the projected unit credit method, the disaggregation and presentation of the different components of post-employment benefit cost in comprehensive income should consequently be made in accordance with the 'remeasurement'-approach. Two alternatives should be considered concerning promises with a variable return which would be measured with the fair value of the assets upon which they are based: First, the changes in the obligation and in the value of any plan assets could be disaggregated and presented in comprehensive income in the same manner as for promises with a fixed return, i.e. according to the 'remeasurement'-approach. Alternatively and following IFRIC D9, all components of the changes in value could be presented in profit or loss without any disaggregation.

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?

Regarding the Board's proposal on measuring benefit promises with a 'higher of' option, it has to be critically noted that two different measurement bases have to be applied for measuring one promise that is seperated into a host defined benefit promise and a 'higher of' option (on the one hand measurement according to the PUCM, on the other hand fair value assuming the terms of the benefit promise do not change). In particular the use of fair value leads to an increase in complexity for the preparer as well as for the user of the financial statements.

Measuring the option shall – according to the Board – incorporate both the intrinsic value and the time value of the option (para. 10.12). In spite of the Board's concerns (paras. 10.10 et seq.), it should be considered to measure the 'higher of' option only at its intrinsic value as a pragmatic approach within the scope of this project. This simplification should also apply if the Board decides to implement our alternative measurement proposal outlined below.

If a reporting entity awards its employees a promise to pay the higher amount of a defined benefit final salary host promise on the one hand and a promise with a fixed or variable return on (notional) contributions on the other hand, the total liability (assuming a debit balance with regard to plan assets) should be recognised as follows:

Since the host promise is a defined benefit promise, it has to be measured according to the method of IAS 19 modified as mentioned above (i.e. with a complete and immediate recognition of all changes in value in the statement of financial position) using the PUCM. Disaggregation and presentation of the changes in value in the statement of comprehensive income should be done in conformity with the 'remeasurement'-approach. To account for the chance for the (former) employee to receive a higher benefit when entering the payment phase, the reporting entity has to recognise an additional liability amounting to the difference between the defined benefit host promise and the promise with a fixed or variable return, provided that the amount of the latter exceeds the amount of the former as of the reporting date. The promise with a fixed or variable return should be measured – as already explained in our answer to questions 8, 9 and 10 – based on the concept underlying IFRIC D9. Regarding disaggregation and presentation of changes in value of this additional liability in the statement of comprehensive income, we refer to our answer to the questions 11 and 12. Therefore, disaggregation and presentation should be subject to an additional liability resulting from a promise with a fixed or a variable return.

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.

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

We do not have any comments on this matter.

Question 15 – Do you have any other comments on this paper? If so, what are they?

We do not have any further comments on this Discussion Paper.

We would be pleased to answer any questions that you may have or discuss any aspect of this letter.

Yours sincerely

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