SAC Meeting	Agenda reference	3b
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Topic **Principle-Based Disclosure Framework – Illustration of Application to Pension**

Working Draft memorandum follows.

Working
Draft

MEMORANDUM

To: IASB Staff

From: Neri Bukspan and Dane Mott

Date: 6 April 2009

Re: Principle-Based Disclosure Framework – Illustration of Application to Pension

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Overview

The ITAC has recently proposed to the FASB a "principles-based" disclosure framework that can be applied to all financial statement accounts[1]. The use of this framework is intended to eliminate the need to specify separate disclosure requirements with each new or revised accounting standard issued: It will vastly enhance the readability and understanding of financial statement footnotes, improve transparency and consistency of financial reports and at the same time introduce efficiencies to the standard-setting process.

We were requested by the IASB Staff to provide an outline of a potential application of this framework to pension accounting[2]. This document summarizes our recommendation. It does not reflect the views of the ITAC whose members were not consulted in the preparation.

Proposal

Our outline follows the "three category" approach proposed by the ITAC. Under this approach, disclosures will be specified broadly but will apply solely to material items in a general sense. Materiality should be evaluated from an earnings, cash flow, and balance sheet perspective. That is, entities will be making an assessment, pursuant to which they would consider whether pension constitutes material enterprise obligation or treasury activity in the first place, and if so, consider within that activity what elements would be considered material. For those considered material, providing information (in a "scalable" fashion depending on applicable elements) to investors would be warranted. For example, providing information on potential near-term cash outlays or mortality rates assumptions would be warranted when inter-period movements can materially alter the amount of the obligation or future cash flows.

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[1] See "Unsolicited agenda request for a principles-based disclosure framework," 11 December, 2007, available at http://www.fasb.org/investors_technical_advisory_committee/itac_comment_letters.shtml

[2] We believe this disclosure example provided herein can accommodate not only pensions. Its requirements can apply to all sorts of deferred compensation arrangements containing 'variable elements' including post retirement medical and life benefits and other deferred compensation arrangements.

I. General

Outlines the basis of presentation for that particular account/financial statement line item (e.g., in a manner similar to information presented currently under "significant accounting policies" – this will serve to replace or substitute the information currently presented in that caption)[3]

In this section entities will disclose the nature of their pension and other post-retirement benefit arrangements in broader terms. It will cover pertinent and material items including (but not limited to):

- The objective of the arrangement/s (i.e., benefits provided);
- Who is covered (e.g., current employees, family members, pensioners, directors, , etc.);
- The legal structure of the arrangement/s (e.g., single employer defined benefit or defined contribution-based promise, defined benefit pension and/or health & welfare multi-employer plans (including the amount of plans contributed into), SERPs, annuity funded, trust, etc.);
- Manner of funding (e.g., funded, pay-as-you-go, unfunded, others assets – cash, investments, life insurance cash values --specifically set aside to meet obligations, employer match, etc.);
- Risk management strategies related to the plan (e.g., asset allocation strategies employed, hedging within or outside the plan);
- Pertinent contractual terms of the arrangement/s (e.g., active/frozen). This will also include the general provisions and requirements for participation and achieving benefits (e.g., years of service, vesting, contingent payouts, etc.); and
- Any other issues that could be triggered by pension and other post-retirement benefit arrangement funding levels (e.g., regulatory -- such as ERISA -- reportable events in credit agreements, funding level-based provisions in credit agreements or other debt agreements)

The objective is to provide "general information" type disclosure similar to those currently presented and not to create an exhaustive list of new requirements. Disclosure for companies with multiple arrangements and activities will clearly be more extensive than those provided by entities with limited activities.

[3] Excerpted from the ITAC's framework

II. Composition

Outlines what is included in the account/line item (e.g., item breakdown and netting – such as loans net of provisions) and also providing a roll-forward when appropriate (including amounts attributed to increases or decreases arising from changes in estimates).

In this section/s entities will disclose the account/s composition as follows:

- Total obligation itemized by main arrangement category;

- When assets are set to offset the liability (e.g., as part of a trust) -- the amounts should be displayed on a gross and net basis;

- Other assets set aside on the balance sheet to meet funding obligations; annuities, etc.

- When obligations are material, this section will also provide roll-forwards for liabilities in a manner similar to that required by FASB Statements 87, 106, and 132(R) . It will schedule movements during the period by main categories (e.g., beginning balance, employer contributions, employee contributions, payouts, current period increase in liability due to service cost, interest accrual, effect on changes in discount rates, other experience related gains/losses such as mortality rates, and effects of law changes and plan modifications);

- For funded plans and when assets amounts are material (without reference to the net unfunded amount), this section will also itemize the assets by main asset and investments categories (e.g., fixed income securities, equity securities, real estate, annuities purchased, alternative investments, etc.);

- When pension-related assets are material, this section will also provide roll-forwards for assets. It will schedule movements during the period by main categories (e.g., beginning balance, employer and employee contributions, gains/losses by principal investment categories, and payments made to beneficiaries);

- For profit & loss accounts, the composition of pension and post retirement expense and its location on the income statement (e.g., operating cost, financing income, financing expense, etc.);

- Composition of pension related cash flows during the period if are not otherwise evident by the roll forward schedules (e.g., for companies with a defined contribution or a pay as you go program); and

- Amounts not yet recognized (e.g., deferred in comprehensive income) including roll forward (e.g., beginning balance, gains/losses deferred during the period, amounts amortized and recognized in earnings, effects of changes in estimates or re-measurements, and ending balance).

III. Assumptions, Estimates and Uncertainties

Outlines principal assumptions, estimates, sensitivity analyses, and a qualitative discussion regarding risks and uncertainties and the potential of the amounts to change over time

In this section/s entities will disclose the principal estimates and assumptions inherent in the measurements included in the accounts, the potential for future variability and rationale thereof. Assumptions would be disclosed when plausible changes to them (individually or in the aggregate) may have a meaningful effect on the account balance. This section will include, as applicable:

For Liabilities:

- Principal assumptions underpinning the measurement of the liabilities (e.g., discount rates, retirement expectation, vesting, mortality rates, etc.);

- Estimated cash requirements for the next 1-5 years for the firm (including for funding the plan, and for unfunded plans, the direct payments to beneficiaries); and

Potential impact of possible changes in estimates (including impact of contingencies such as benefits that may be dependant on future profits or vesting). These may be expressed as a sensitivity analyses or a range. For example, sensitivities to changes in discount rates given a plausible change (e.g., +/-100 bps).

For Assets:

Valuation assumptions and categories (for consistency, entities would provide disclosures similar to those provided for similar assets that are not related to pensions). Entities will provide disclosures similar to those required by FASB Statement 157 addressing the manner in which investments are valued;

- Potential impact of possible changes in estimates – may be expressed as a sensitivity analyses or a range; and

- Other disclosures that may include, as applicable, counterparty risk (e.g., for annuities), concentrations (e.g., currencies/industries), effects of hedging, etc.

For Cash Flows:

- Potential impact of possible changes in estimates – may be expressed as a sensitivity analyses or a range.

- Voluntary contributions and amounts and use of any credit balances that may off-set regulatory funding requirements.

For P&L:

- Disclosures as to whether the company is using a market-related value or fair value of asset amount for the computation of pension expense – return on assets. Also sensitivities around use of expected returns would be helpful.

To the extent, market-related values and other smoothing mechanisms are maintained, the following assumptions would also need to be disclosed:

- The amount of the market-related value of plan assets;
- The number of years smoothing for the market-related value of plan assets;
- The remaining service life of employees; and
- Any other major assumptions that an analyst would need to know to model impacts on earnings.

Other Uncertainties:

- Disclosure of any potential triggers in debt or credit agreements that are connected to funding.
- Regulatory funding levels by geographic regions would also be helpful (e.g., in the US, the PPA of 2006 modified ERISA requirements and called for certain minimum funding levels to be reached over a set period of time).

Appendix

Illustration of the application of the framework to:

- Entities with minor pension activity/obligations,
- Entities with moderate pension activity/obligations,
- Companies with extensive pension activity/obligations

To be developed – by or together with IASB Staff?

- Entities with minor pension activity/obligations,
  Only items highlighted in green
- Entities with moderate pension activity/obligations,
  Only items highlighted in green and blue
- Companies with extensive pension activity/obligations
  All items (yellow, blue and green).