Accounting Standards Board of Japan (ASBJ)
Fukoku Seimei Building 20F, 2-2, Uchisaiwaicho 2-chome, Chiyoda-ku, Tokyo 100-0011, Japan
Phone +81-3-5510-2737 Facsimile +81-3-5510-2717 URL http://www.asb.or.jp/
ASBJ FASF

September 6, 2010

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sir or Madame,

Comments on the Exposure Draft "Defined Benefit Plans"

We appreciate the efforts of the International Accounting Standards Board (IASB) on the post-employment benefits project and welcome the opportunity to comment on the Exposure Draft "Defined Benefit Plans" (hereinafter referred to as the "ED").

Recognition

Question 1
The exposure draft proposes that entities should recognise all changes in the present value of the defined benefit obligation and in the fair value of plan assets when they occur. (Paragraphs 54, 61 and BC9–BC12) Do you agree? Why or why not?

1. We broadly agree with the proposal that entities should recognise all changes in the present value of the defined benefit obligation and in the fair value of plan assets when they occur.

2. However, we disagree with some aspects of the proposals in the ED for the reason mentioned in paragraphs 4-6. Instead, we suggest an alternative described in paragraphs 7-12.

3. Our comments to Question 1 and Question 6 are combined because they are interrelated with each other.

The aspects of the proposal with which we disagree and the reasons for our opposition

4. We disagree with the following proposals:

   (a) not to recycle remeasurements of the net defined benefit liability (asset) , which are to be recognised in other comprehensive income.

(b) to transfer those remeasurements immediately to retained earnings.

5. We disagree with non-recycling of remeasurements of the net defined benefit liability (asset), because we consider it necessary to recognise all gains or losses in profit or loss once in some period. If remeasurements of the net defined benefit liability (asset) are to be recognised in other comprehensive income in the period in which they occur, they should be recycled to profit or loss in subsequent periods, in our view[1].

6. In particular, actuarial gains and losses on the defined benefit obligation should be recognised in profit or loss once in some period, for the following reasons:

   (a) For actuarial gains and losses on the defined benefit obligation, considering they are changes in estimates of the service cost (which is an operating expense item) recognised in prior periods, they should be included in operating expenses once in some period.

   (b) Actuarial gains and losses arising from changes in discount rates should also be recognised in profit or loss once in some period, considering they are changes in estimates of the interest cost recognised in prior periods. This aspect of the ED's proposal is inconsistent with the accounting treatment in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets,* which requires recognition of change in non-financial liabilities arising from changes in the discount rate in profit or loss.

An alternative we suggest and its rationales

7. We suggest that actuarial gains and losses should be recognised immediately in the statement of financial position and in other comprehensive income in the period when they occur and be recognised in profit or loss over subsequent periods (ie be recycled)[2].

   (Reason 1: The improvements in financial reporting intended by the IASB can be achieved by our suggestion.)

8. The first reason for our suggestion is that it would also achieve all of the following improvements intended by the proposal in the ED (as described in paragraph BC10 of the ED):

   (a) the resulting amounts from immediate recognition in the statements of financial position and comprehensive income are relevant to users of financial statements and easier for them to understand. In contrast, deferred recognition can produce misleading amounts, for example:

[1] There already exist gains or losses items which are never recognised in profit or loss under IFRS, all of which are items of difference from US GAAP.

[2] This is the same approach as that adopted in FASB ASC Topic 715.

    (i) an asset may be recognised in the statement of financial position, even when a plan is in deficit; or

    (ii) the statement of comprehensive income may include gains and losses that arise from economic events that occurred in past periods.

  (b) it improves comparability across entities by eliminating the options allowed by IAS 19.

9. We would like to add the explanation of why our suggestion (deferred recognition in profit or loss with recycling) can eliminate the problem described in paragraph 8(a)(ii). Net gains and losses presented in comprehensive income under our suggestion would reflect only economic events occurring during the current period, because the amount recognised in profit or loss through deferred recognition would be entirely offset by the amount recognised in other comprehensive income as reclassification adjustment.

10. There may be a criticism that profit or loss under our suggestion would include gains and losses arising from economic events that occurred in prior periods. However, we believe that the non-recycling proposed in the ED would be more problematic because it would result in those gains and losses never being recognised in profit or loss (see paragraph 6).

(Reason 2: There would be only minor amendments to the existing practice.)

11. Second, our suggestion has a practical advantage that it would not affect the amounts of profit or loss recognised under existing IAS 19 for entities currently applying deferred recognition; that is, it requires only minor amendments of those entities.

(Reason 3: Divergences with US GAAP can be avoided.)

12. Because US GAAP requires recycling like our suggestion, adopting our suggestion would avoid divergences with US GAAP and improve international comparability.

Possible arguments against our suggestion

13. We acknowledge that the views similar to our suggestion in paragraph 7 were not accepted in the ED as a result of consideration described separately as follows:

  (a) maintaining deferred recognition (paragraphs BC9-BC12 of the ED)

  (b) recycling (paragraph BC45 of the ED)

14. However, the reason for not accepting (a) is related to deferred recognition in the statement of financial position and it is irrelevant to our suggestion (see paragraphs 8-10). In regard to the arguments on (b) above that there is no conceptual basis for recycling (paragraph BC45 of the

ED), we are in favour of the alternative view that "There is no conceptual basis for the decision that have been made about which items should be presented in profit or loss and which items should later be reclassified into profit or loss. A review of performance presentation should be made with the aim of bringing more of the items currently presented in other comprehensive income into profit or loss and thereby maintaining profit or loss as a central concept for performance reporting"[3]. Accordingly, arguments in the ED against our suggestion are not persuasive enough.

Transfer to retained earnings immediately after recognition in other comprehensive income

15. We disagree with the ED's proposal described in paragraph 4(b) because it would be inconsistent with IFRS 9 *Financial Instruments*, which does not provide specific requirements related to the transfer of the cumulative gain or loss within equity, in the light of jurisdiction-specific restrictions on components of equity. A fundamental problem with this proposal is that it lacks adequate consideration about the objective of presenting retained earnings and accumulated other comprehensive income separately within equity from a viewpoint of their respective accounting characteristics.

Question 2 Should entities recognise unvested past service cost when the related plan amendment occurs? (Paragraphs 54, 61 and BC13) Why or why not?

16. We disagree with the proposal. Attributing unvested past service cost arising from plan amendments to future service from employees would be consistent with IFRS 2 *Share-based Payment*, as mentioned in paragraphs 2.19 and 2.20 of the discussion paper. We believe that unvested past service cost should be attributed to future service over the vesting period through the recycling mechanism.

[3] Paragraphs AV3 and AV6 of alternative view of Jan Engstrom in the exposure draft *Presentation of Items in Other Comprehensive Income*

Disaggregation

Question 3
Should entities disaggregate defined benefit cost into three components: service cost, finance cost and remeasurements? (Paragraphs 119A and BC14–BC18) Why or why not?

17. We understand the intention of the proposal in the ED, which would require entities to disaggregate defined benefit cost into three components, based on the view that the components of defined benefit cost have different predictive values and disaggregating information about the components increases usefulness of financial reporting (see paragraph BC14 of the ED). However, as described in the comments to Question 5, we are of the view that the definition of finance cost needs reconsideration and that in amending the existing treatment (paragraph 119 of IAS 19) and deciding how to present these components further consideration is needed about the nature of the components, as described in paragraphs 18-20.

Necessity to consider which components are labor cost

18. The ED seems to lack consideration about which components of defined benefit cost are labor cost.

19. In Japan GAAP and US GAAP, all components including actuarial gains and losses and past service cost are recognised in profit or loss and they appear to be regarded as labor cost as a whole. On the other hand, the ED does not seem to regard the remeasurement component as labor cost, given that it would never be presented in profit or loss.

20. We suggest the IASB should consider which components of defined benefit cost are labor cost, because this issue may affect which components of defined benefit cost should be presented in operating income and how to treat those components in capitalisation of inventories (see our comment to Question 15).

Defining the service cost component

Question 4
Should the service cost component exclude changes in the defined benefit obligation resulting from changes in demographic assumptions? (Paragraphs 7 and BC19–BC23) Why or why not?

21. We agree with the proposal that the service cost component should exclude changes in the

defined benefit obligation resulting from changes in demographic assumptions, because "the predictive value of service cost differs from the predictive value of changes in the estimate of service cost"(paragraph BC22 of the ED).

22. See also paragraph 6(a) for our comment on the treatment of changes in the defined benefit obligation arising from changes in demographic assumptions, which would be included in actuarial gains and losses under the proposal of the ED.

Defining the finance cost component

Question 5

The exposure draft proposes that the finance cost component should comprise net interest on the net defined benefit liability (asset) determined by applying the discount rate specified in paragraph 78 to the net defined benefit liability (asset).

As a consequence, it eliminates from IAS 19 the requirement to present an expected return on plan assets in profit or loss.

Should net interest on the net defined benefit liability (asset) be determined by applying the discount rate specified in paragraph 78 to the net defined benefit liability (asset)? Why or why not? If not, how would you define the finance cost component and why? (Paragraphs 7, 119B, 119C and BC23–BC32)

23. We disagree with the proposal in the ED. Net interest on the net defined benefit liability (asset) should be determined using the expected rate of return on plan assets and the discount rate on the defined benefit obligation for the following reasons:

    (a) It is conceptually wrong to see a net defined benefit liability as "a financing amount owed by the reporting entity to the plan or to the employees" (paragraph BC29 of the ED), because a defined benefit obligation and plan assets have different economic drivers and are measured on different bases (paragraph BC31 of the ED).

    (b) Accounting treatment in accordance with the proposal in the ED would result in a less faithful representation. For example, even if plan assets were made up with cash, which generates no income, or in contrast, even if aggressive investment were made, the return on plan assets that is to be deducted from financial cost would be de determined using a high quality corporate bond rate.

    (c) Although the ED criticises the subjectivity inherent in determining the expected rate of return (paragraph BC41 of the ED), subjectivity is an inevitable factor in accounting estimates, not only expected return on plan assets. On the contrary, some have the view

that an expected return on plan assets reduces asymmetry of information and is useful information (paragraph 2.14 of the discussion paper).

Presentation

Question 6

Should entities present:

(a) service cost in profit or loss?

(b) net interest on the net defined benefit liability (asset) as part of finance costs in profit or loss?

(c) remeasurements in other comprehensive income?

(Paragraphs 119A and BC35–BC45) Why or why not?

See our comments to Question 1.

Settlements and curtailments

Question 7

(a) Do you agree that gains and losses on routine and non-routine settlement are actuarial gains and losses and should therefore be included in the remeasurement component? (Paragraphs 119D and BC47) Why or why not?

(b) Do you agree that curtailments should be treated in the same way as plan amendments, with gains and losses presented in profit or loss? (Paragraphs 98A, 119A(a) and BC48)

(c) Should entities disclose (i) a narrative description of any plan amendments, curtailments and non-routine settlements, and (ii) their effect on the statement of comprehensive income? (Paragraphs 125C(c), 125E, BC49 and BC78) Why or why not?

24. We disagree with the proposal in the ED, because we believe that the treatment of gains and losses on non-routine settlement should differ from that of actuarial gains and losses. We suppose that the proposal in the ED is based on the view that it is no longer necessary to treat gains and losses on settlement differently given that actuarial gains and losses would be immediately recognised. However, in our view, gains and losses on non-routine settlement should be immediately presented in profit or loss, whereas deferred recognition of actuarial gains and losses in profit or loss should be retained.

Disclosures

Question 9

To achieve the disclosure objectives, the exposure draft proposes new disclosure requirements, including:

(a) information about risk, including sensitivity analyses (paragraphs 125C(b), 125I, BC60(a), BC62(a) and BC63–BC66);

(b) information about the process used to determine demographic actuarial assumptions (paragraphs 125G(b) and BC60(d) and (e));

(c) the present value of the defined benefit obligation, modified to exclude the effect of projected salary growth (paragraphs 125H and BC60(f));

(d) information about asset-liability matching strategies (paragraphs 125J and BC62(b)); and

(e) information about factors that could cause contributions to differ from service cost (paragraphs 125K and BC62(c)).

Are the proposed new disclosure requirements appropriate? Why or why not?

If not, what disclosures do you propose to achieve the disclosure objectives?

25. In regard to the item (a), where to disclose the sensitivity analyses (eg in management commentaries as non-financial information) should be considered, because they are forward-looking information.

26. We disagree with requiring the item (c) because its usefulness is questionable. In many jurisdictions, the present value of the defined benefit obligation excluding projected growth in salaries, which is ABO, would not approximate the entity's obligation on termination of the plan, in the cases of lump-sum retirement benefit plans.

Other issues

Question 13

The exposure draft also proposes to amend IAS 19 as summarised below:

(a) The requirements in IFRIC 14 *IAS 19—The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*, as amended in November 2009, are incorporated without substantive change. (Paragraphs 115A–115K and BC73)

(b) 'Minimum funding requirement' is defined as any enforceable requirement for the entity to make contributions to fund a post-employment or other long-term defined benefit plan. (Paragraphs 7 and BC80)

(c) Tax payable by the plan shall be included in the return on plan assets or in the measurement of the defined benefit obligation, depending on the nature of the tax. (Paragraphs 7, 73(b), BC82 and BC83)

(d) The return on plan assets shall be reduced by administration costs only if those costs relate to managing plan assets. (Paragraphs 7, 73(b), BC82 and BC84–BC86)

(e) Expected future salary increases shall be considered in determining whether a benefit formula expressed in terms of current salary allocates a materially higher level of benefits in later years. (Paragraphs 71A and BC87–BC90)

(f) The mortality assumptions used to determine the defined benefit obligation are current estimates of the expected mortality rates of plan members, both during and after employment. (Paragraphs 73(a)(i) and BC91)

(g) Risk-sharing and conditional indexation features shall be considered in determining the best estimate of the defined benefit obligation.(Paragraphs 64A, 85(c) and BC92–BC96)

Do you agree with the proposed amendments? Why or why not? If not, what alternative(s) do you propose and why?

27. We disagree with the item (b) because it is unclear whether the resulting expansion of the scope of the provisions relating to minimum funding requirement would be an improvement, although we understand it aims at clarification.

Transition

Question 15

Should entities apply the proposed amendments retrospectively? (Paragraphs 162 and BC97–BC101) Why or why not?

28. We disagree with the retrospective application because it would be burdensome for entities, sometimes necessitating retrospective recalculation of the carrying amount of inventories at the beginning of the periods.

29. Entities applying deferred recognition of actuarial gains and losses permitted under the existing IAS 19 often include their amortization in cost of inventories. On the other hand, under the proposal in the ED, entities would usually exclude actuarial gains and losses (to be recognised in other comprehensive income) from cost of inventories[4], although the ED does not specify

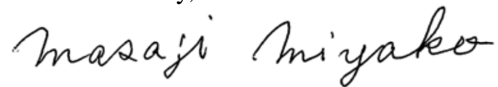
[4] The reason is that if items recognised in other comprehensive income are included in cost of inventories, it could result in burdensome treatment of allocation of the items to other comprehensive income, rather than cost of goods sold (otherwise, it would be necessary to regard the nature of the items as having changed from other comprehensive income to cost of goods sold because of inclusion in cost).

whether they should be included in cost of inventories (it appears it would depend on the entity's accounting policy). Accordingly, it is expected that many entities would need a change in the treatment in cost accounting.

* * * * *

We hope that our comments will contribute to the forthcoming deliberations in the project.

Yours sincerely,



Masaji Miyako
Board Member of the Accounting Standards Board of Japan and
Chairman of the Retirement Benefits Accounting Technical Committee