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The financial reporting of pensions – A P(roactive)A(ccounting)A(activities)inE(urope) Discussion Paper

Dear Sirs,

To the discussion paper mentioned above we would like to make the following comments:

Chapter 1: Introduction
We think that the distinction between defined benefit plans and defined contribution plans is not useful anymore as forms of pension plans have been developed which carry characteristics of both. The pension liability should reflect the obligation of the entity's individual pension plan. Therefore the distinction between the two forms would be redundant.

Chapter 2: Liabilities to pay benefits
We concur with the opinion that only benefits which the entity is presently committed to pay should be reflected in the pension liability. Only increases in pensions or its calculation basis that an entity has a constructive or legal obligation to provide should be included.

The reported pension liability should not reflect changes to the entity's or the plan's financial position. This would mean a deteriorating financial position causing individual interest rises which in turn would lead to a lower liability. We believe that this would not fulfil the requirement of prudent representation of liabilities.

We think that establishing a linkage between expected future salary increases to the pension liability would prove to be unreliable and prone to error. An individual career and salary path is unforeseeable and should not be included in the pension liability. Therefore the pension expense for each period should be based on the benefits the employer is presently committed to provide. This would include increases in benefits or salaries that are required by law or contract or which are based on a constructive obligation.

We see a pension liability as an obligation towards an individual employee. Therefore we think financial reporting of pension liabilities should reflect this and should not be based on the premise that the liability is owed to the workforce as a whole.

Chapter 3: Assets and Liabilities – Reporting Entity considerations
We agree that that the consolidation of pension plans should be subject to the same principles regulating all other matters of consolidation.

We think that in cases in which the entity has set aside specific plan assets to cover the pension liability (IAS 19.54 and IAS 19.102 – 104) the offset is appropriate. The offset demonstrates clearly to the users that all requirements of the IAS regarding designation of plan assets and putting them beyond the entity's and its creditors reach have been met.

Chapter 4: Recognition of pension assets and liabilities
We agree that changes in assets and liabilities should be recognised immediately. It should be for the reporting entity to decide under the rule of consistency of presentation whether the changes are shown in the profit or loss account or directly in equity.

Chapter 5: Measurements of liabilities to pay benefits
We agree that the discount rate should be a risk free rate.
Information about the risk that the amount of pension benefits will differ from today's expectations should be conveyed by disclosure.
We agree that if alternative means of settling a liability are available it should be reported at the lowest amount of the cash outflows or other transfer of economic benefits needed to discharge the liability.
The liability should not be reduced to reflect the reporting entity's credit risk. We think that reporting a lower liability as the credit risk and the interest rate have increased would not meet the requirement of prudent reporting.
Expenses of administering the plan's assets and benefits should be deducted either from investment income or should be shown in the profit or loss account.

These expenses are incurred to make sure that pension benefit will be honoured by the entity. So they should not increase the liability or decrease the plan assets.

Chapter 6: Measurement of assets held to pay benefits

Following the purpose of the IAS we agree that assets held to pay benefits should be reported at current values.

Chapter 7: Measurement of employee interest in trusts or similar entities

We agree that a net asset or liability of a trust should be measured as if they were held directly.

Chapter 8: Presentation in the financial statements

In principle we agree that different components of changes in liabilities or assets should be presented separately. But in order to present accurately the financial position and performance of the entity in accordance with the specifics of its business model and environment the presentation of changes in assets and liabilities should be left to the entity's discretion. This means that the decision whether to present the changes in the profit or loss account or directly in equity should be left with the entity. The various changes in assets and liabilities should be allocated to positions of the profit and loss account with the clear purpose to represent accurately the financial performance of the entity. Achieving this goal is served best at the discretion of the entity. This would also simplify the task of presenting the changes in accordance with domestic accounting rules still relevant. A mandatory presentation in the profit and loss account could also lead to variations in the financial performance which could only be explained to the users as the result of a stiff regime of financial presentation standards.

The above said also applies to the question whether the effects of changes in the discount rate should be presented under actuarial gains and losses in the profit or loss account or directly in equity.

We concur with the proposal that the financial statements should only report actual return on plan assets. Usefulness of the reporting of expected returns notwithstanding we believe there is no room for them in financial statements which are meant to present the financial performance based on past decisions and developments. The expected returns should be presented in a note to the financial statements.

Chapter 9: Disclosure in the employer's financial statements

We agree with the objectives of disclosure.

Chapter 10: Accounting for multi employer plans
We agree that the principles of reflection of a single employer plan in the financial statements should also apply to multi employer plans.

Chapter 11: Financial reporting by pension plans
We agree that an entity's liability to pay benefits in the future should be included in the measurement of the pension liability. The measurement should be based only on general accounting principles.
We also agree that an employer's covenant in respect to the pension liability should be included in a the plan's statement of financial position.

Should you have any questions about our comments please do not hesitate to contact us.

Yours faithfully,

DZ BANK AG

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