The Actuarial Profession
making financial sense of the future

discussion paper response

International Accounting Standards Board

Preliminary Views on Financial Statement Presentation

April 2009

www.iasb.org

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Dear Sir/Madam

IASB Discussion Paper *Preliminary Views on Financial Statement Presentation*

Thank you for offering The Actuarial Profession the opportunity to comment on this Discussion Paper. Our detailed comments follow.

We note that under current accounting standards, the performance statements incorporate a mix of approaches: some items are marked to market through P&L; some are marked to market but through the statement of comprehensive income, and others – which for many companies are just as large and as volatile – are not marked to market at all. It is clear that investors are receiving information that presents those items which are marked to market as much more risky than those which are not. This impacts management behaviour which in turn cycle back to investor pressures. There is clear risk that decisions made are as a result sub-optimal. In relation to pensions in particular, the treatment and resulting behaviour seems somewhat counter intuitive as pension liabilities are in general much more flexible in terms of payment renegotiation than some other liabilities that are not marked to market such as lease or bank debt commitments.

The Discussion Paper proposes that most re-measurement gains/losses will be included in the proposed single performance statement, mixed in with profits not derived from re-measurements, with nothing in that primary statement to distinguish them. This is likely to reinforce the sub-optimal decision making already seen. Whilst splitting out the re-measurement gains in a Note to the accounts (in the proposed Reconciliation Schedule) provides some clarity, it is unlikely in itself to mitigate this behaviour.

We suggest that it will only be appropriate to extend the inclusion of re-measurement gains within the primary performance statement once all aspects of accounting are on a consistent basis, with all assets and liabilities marked to market (or such other approach as will be specified in the conceptual framework). Even then, re-measurement gains should be clearly distinguished on the face of the performance statement.

In our view it is arbitrary and inappropriate to include some re-measurement gains/losses above the net profit line (e.g. gains/losses on pension assets/liabilities – which we note are unrealised) whilst including others below the line in Other Comprehensive Income (e.g. unrealised gains on hedges).

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We also note that there is a stated intention to include all aspects relating to a particular activity in a single line item, and therefore wholly within (say) Operating or Financing, rather than split between them. For example, it is suggested that all costs relating to pensions will be included in Operating. However, in relation to pensions in particular, we see the provision of remuneration (service cost) as clearly distinguishable from the decision to provide that remuneration on a deferred basis, with the interest cost, return on assets and re-measurement gains/losses that result. Remuneration belongs in Operating.

On the other hand, the impact of “borrowing” from employees (by deferring payment), and therefore the interest cost, is indistinguishable in nature from borrowing through the issue of corporate debt and should be accounted for in the same way and presented in the same part of the performance statement, i.e. in Financing. With the decline in provision of defined benefit pension arrangements many companies only have legacy defined benefit pension arrangements with no current benefit accrual (ie zero service cost). We don’t see how it can be appropriate for interest cost, return on assets and re-measurement gains/losses for companies with no service cost to be included in Operating. Even for companies with continuing accrual of defined benefit pensions, service cost is small compared to the other items for most companies, and the logic for inclusion in Operating is in our view flawed.

Finally, we question why in the examples in the Discussion Paper pension cost incurred in the year is charged twice to profit (within both "cost of goods sold" and "general and administrative expenses"). Does this indicate some deeper thinking around the IASB’s attitude to the provision of pensions to employees?

If you have any questions or would like to discuss any of these matters further, please do not hesitate to contact us. Should you wish to do so, please contact Martin Hewitt, Pensions Practice Manager on 0207 632 2185 or via Martin.Hewitt@actuaries.org.uk.

Yours sincerely,

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About The Actuarial Profession

The Actuarial Profession is governed jointly by the Faculty of Actuaries in Edinburgh and the Institute of Actuaries in London, the two professional bodies for actuaries in the United Kingdom. A rigorous examination system is supported by a programme of continuing professional development and a professional code of conduct supports high standards reflecting the significant role of the Profession in society.

Actuaries' training is founded on mathematical and statistical techniques used in insurance, pension fund management and investment and then builds the management skills associated with the application of these techniques. The training includes the derivation and application of 'mortality tables' used to assess probabilities of death or survival. It also includes the financial mathematics of interest and risk associated with different investment vehicles – from simple deposits through to complex stock market derivatives.

Actuaries provide commercial, financial and prudential advice on the management of a business's assets and liabilities, especially where long term management and planning are critical to the success of any business venture. A majority of actuaries work for insurance companies or pension funds – either as their direct employees or in firms which undertake work on a consultancy basis – but they also advise individuals, and advise on social and public interest issues. Members of the Profession have a statutory role in the supervision of pension funds and life insurance companies as well as a statutory role to provide actuarial opinions for managing agents at Lloyd's.

The Profession also has an obligation to serve the public interest and one method by which it seeks to do so is by making informed contributions to debates on matters of public interest.