

May 2010
Volume 18, No.1

THE PENSION FORUM

published by the Pension Section of the Society of Actuaries

SOCIETY OF ACTUARIES

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Comments on any of the papers in this Forum are welcomed. Please submit them to the editor of the *Pension Forum* at kelley.mckeating@sympatico.ca. They will be published in a future issue of *Pension Section News*.

Printed in the United States of America

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Editors' Introduction

Welcome to the 2010 *Pension Forum*!

International Financial Reporting Standards are already impacting aspects of retirement program financing, management, and disclosure in many parts of the world. IFRS will soon lead to a fundamental shift in North American actuarial thinking as we all become accustomed to operating under a principles-based paradigm instead of the rules-based regulatory world in which most of us have been operating for close to a quarter century.

This *Forum* opens with two articles that, we believe, offer an excellent introduction to the “what” and the “why” of IFRS. We are grateful to the accounting firm of McGladrey & Pullen (RSM International) for giving us permission to reprint the material that was originally published in their *Insights* newsletter and also to the *Journal of Applied Research in Accounting and Finance* for allowing us to reprint a 2007 paper authored by Sir David Tweedie, Chair of the International Accounting Standards Board.

For the first time ever, we used a Call for Papers approach to solicit papers for the *Pension Forum*. We hope you enjoy the insights, analysis, and inspiration offered by the papers we've selected for publication.

This publication is the result of a collaborative effort between the Pension Section's Communications and Research Teams. Many thanks to those who served on the Project Oversight Group, reviewed abstracts, and decided which papers to accept for publication: Mike Archer, Art Conat, Eric Fredén, Ian Genno, Andy Peterson (SOA), and Steve Siegel (SOA).

We welcome your feedback on the material presented in this issue and your suggestions for future *Pension Forum* themes.

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An IFRS Primer

By McGladrey & Pullen LLP

Editors' Note: The following is a compilation of excerpts from selected 2008 and 2009 issues of two publications—Insights and IFRS Bulletin—produced by the accounting firm McGladrey & Pullen LLP. We believe that this provides a clear and helpful introduction to the IFRS concept.

This material is reprinted with permission. We thank McGladrey & Pullen for having granted that permission.

1. Principles vs. Rules: The heart of the difference between US GAAP and IFRS

Convergence between US GAAP and IFRS is no longer a question of if, but rather of when. One of the first steps that US companies preparing for convergence need to take is to grasp the difference between the rules-based approach of US GAAP and the principles-based approach of IFRS. To better understand the debate between a principles-based set of standards and a rules-based set of standards, it might be useful to first analyze what are commonly identified as some of the benefits of each of these approaches:

Principles-based Set of Standards	Rules-based Set of Standards
Better able to cope with speed of change of business environment	More workable in large, complex economies and countries
Less voluminous	Less room for interpretation
Encourages use of professional judgment with a focus on what is right	Provides more guidance for practical implementation
Seen as possibly discouraging financial engineering	Less need for explanation in financial statements

In the United States, many people believe that US GAAP has ably served the most successful, dynamic and growing economy of the modern era, and wonder why it should be replaced. Many who support a rules-based set of standards believe that a large and complex economy like that of the United States needs rules, whereas principles are workable only in smaller countries. They think that with so many cultures and business environments, it is a real challenge to develop principles that are robust and workable in all jurisdictions. Their view is that a rules-based system where there is less room for interpretation could actually result in less complex and more transparent financial statements, as there would be less need for explanation. With the United States characterized by a pervasive litigious environment dominated by a prescriptive and very legalistic regulatory framework, moving toward a more principle-based approach for accounting standards might represent a leap with difficult-to-predict consequences.

In general it appears that, at least outside the United States, a strong consensus has emerged in favor of principles and the use of judgment versus rules. Supporters of a principles-based set of standards believe that principles are about common sense and what is right. They think that, by definition, business decisions are judgmental and such a judgmental component cannot be eliminated. In their view, the purpose of accounting should be to fairly depict economic reality and the judgmental component is an integral part of the economic reality. Those who support a principles-based approach believe that failing to emphasize and appropriately bring to the surface the judgmental component of financial reporting can result in misleading information for the users of financial information. In a principles-based context, the tenacious desire for “bright lines” tends to be seen as a search for artificial borders that might result in an illusionary one-size-fits-all answer to the inherent economic uncertainty.

We would like to point out that possibly the debate is not about whether we should have principles only or rules only. IFRS include guidance and in some cases are closer to a set of rules than a set of principles. Also, it might not be entirely accurate to refer to US GAAP as a rules-based set of standards. After all, the “P” in “GAAP” stands for “principles.” US GAAP was born as a set of principles. However, over the years, a rules-driven approach has prevailed and as a result, it fairly depicts where US GAAP stands along the principles vs. rules continuum. Hence, in practice, when visualizing the principles vs. rules continuum, it might be more appropriate to focus the discussion on how close to the “pure principles approach” extreme IFRS should be positioned.

2. How Judgment Is Applied in Practice

The exercise of judgment is not the result of obscure decisions but rather is intended to be the result of a thoughtful process that combines two major ingredients: knowledge of principles-based IFRS, and sound and professional business and accounting knowledge.

Perhaps the first thing that crosses one’s mind when comparing the word “principle” with the word “rule” is that a rule offers a higher degree of certainty, provided it is well-formulated and detailed. A principle might initially be perceived as less prescriptive and subject to a higher degree of interpretation. In other words, when we move from an environment characterized by rules to an environment characterized by principles, we could say that we enter a sort of unknown territory dominated by a not-well-defined process called “exercising judgment.”

The Oxford English Dictionary defines “judgment” as: “The ability to make sensible decisions after carefully considering the best thing to do.” Interestingly, that dictionary gives the following exemplification, among others, for how the word “judgment” can be used: “It is not something I can give you rules for; you’ll have to use your judgment.” This example describes very well the idea behind a set of principles: principles extend where rules, by definition, cannot reach.

Contrary to popular belief, the exercise of judgment is not the result of an uncontrollable obscure process. In fact, using the words of the Oxford English Dictionary, the exercise of judgment is more like a “sensible” and “careful” journey that can be undertaken only after carefully considering “the best thing to do”—i.e., by having a good knowledge and understanding of the core principles underpinning IFRS. The following steps might constitute some milestones along the journey of exercising judgment.

Preliminary Considerations

- Focus on the substance of the transaction from a business standpoint. Understanding the economic rationale of the transaction is a fundamental prerequisite.
- Forget about IFRS and US generally accepted accounting principles. As an experienced accountant basing your analysis on the principle of substance over form, what would you consider to be the proper accounting treatment to be applied?

Analysis of IFRS

- Identify the possible accounting alternatives that can be used under IFRS.
- Consider all relevant IFRS literature, including IASB staff discussion papers that resulted in the issuance of the IFRS.
- Analyze what peers and competitors did in similar situations. What is the industry practice?
- Verify whether there are applicable regulatory enforcement decisions.

Build a Case

- Document the process that led to a final decision, explaining the reasons for the decision. That is, reply to the following questions: Why is alternative A preferable to alternative B? According to what IFRS literature does this make sense?
- Consult other views and share your opinion.

It is likely that at the end of this journey the exercise of judgment is not as obscure as we thought. However, this process takes time and effort, and there are no miraculous shortcuts that can be taken. Ultimately, there's no better recipe than explaining why alternative A is preferred over alternative B and what the consequences are.

Readers of financial statements will have all the information they need to make informed decisions. Sometimes artificially reducing inherent uncertainty to a black and white situation does not add very much to transparency. In certain cases it is not a question of right vs. wrong, but rather a question of transparent information vs. lack of information. Possibly in such cases, what is meaningful is explaining why a certain decision has been made, rather than simply saying what the decision was.

3. Learning from the EU: Common Pitfalls in the IFRS Conversion Process

The conversion to IFRS is not simply an accounting exercise, but rather a project embracing the company as a whole. Whether a large multinational company or a small single-location company, European experience has shown that underestimating the complexity of an IFRS conversion project can result in unnecessary efforts, unexpected costs and missed opportunities. Following is a summary of the most common pitfalls Europeans experienced when converting to IFRS in 2005:

- IFRS projects were started too late generally due to preparers not having a proper grasp of IFRS and thinking it would be a “journal entry” exercise focused on differences between previous generally accepted accounting principles and IFRS. The conversion process is much more than that.

- Not enough time was dedicated to the preliminary stage. Early identification of difficult issues to be faced and judgment calls to be made is an indispensable preliminary step for proper set-up of the conversion project.
- Expecting to find solutions overnight. The solution to a complex issue is the result of a process. Entities need to start researching early and share information throughout the process with consultants and auditors.
- Unexpected issues arise. The conversion to IFRS is comparable to a home remodeling project—you always end up spending more time and money than expected. Be prepared for the unexpected by allowing plenty of time, and budgeting accordingly.
- Underestimating the time needed to develop the financial statement footnotes. Companies should not be so absorbed in the preparation of the financial statements that they fail to notice the extensive disclosures required by IFRS.
- Focusing on the short-term impact of IFRS on the financial statements. Management should realize that some accounting choices made at the time of conversion to IFRS will bear consequences for a long time in the future.
- System changes require lots of time. The conversion to IFRS impacts the entire IT system. It is not a simple spreadsheet.
- Lack of knowledge made some companies dependent on external consultants. External consultants can be helpful, but ultimately the company should possess the internal knowledge and resources necessary to convert to IFRS.

With 20/20 hindsight, many European companies likely would have approached the conversion to IFRS differently. Hopefully, their experience will be used by U.S. companies to avoid the common mistakes and pitfalls described above.

Can Global Standards Be Principle Based?

By Sir David Tweedie

Editors' Note: This paper was originally published in Volume 1, Issue 2 of The Journal of Applied Research in Accounting and Finance. It is reprinted here with permission.

Abstract

This paper examines issues pertaining to standard setting in an increasingly interconnected world. It is argued that many present day accounting standards are flawed, generally because of inherent compromises welded into their structure, yielding needless complexity and sometimes absurd results. Using examples drawn from contemporary practice, including pension accounting, financial instruments and lease accounting, an argument for a move towards more simplified, principles based accounting is made. Some of the potential gains from such a project are discussed, as well as potential barriers and how these might be avoided in the quest for better accounting.

Introduction

The focus of this paper lies on the future direction of accounting, in particular whether it is possible to create and implement a set of common international accounting standards that are principles-based and eliminate the need for 'bright lines' and unnecessary rules.

When contemplating this topic it is not difficult to be struck by a growing sense that accounting is becoming too complex, that an audit partner must increasingly rely on the expertise of specialists to conduct an audit, and that financial statements are becoming ever more difficult for even the sophisticated investor to use. Of course, some of the complexity of today's accounting is a reflection of a marketplace where transactions are also complex. However, an element of these concerns is justified. Some of today's accounting standards are needlessly complex.

My goal at the IASB is to make accounting more understandable, while providing transparency to transactions where current rules obscure rather than highlight economic reality. Many in the readership may be sceptical of our ability to achieve that aim and arguably the trends more generally are not encouraging. The Lord's Prayer has 56 words, the Ten Commandments 297 words, the U.S. Declaration of Independence (mistake though that was) 300, and the European Commission Directive on the Importation of Caramel Products 26,911 words.

Clearly, it will be a challenge to reverse this trend. However, the cause of principles-based accounting standards is a worthy cause. If we succeed in developing a principles-based system used internationally, we will have served a future generation, preparers, and investors well and probably saved the accounting profession from itself.

A Growing Consensus on Global Standards

The IASB is well-positioned to take the lead in the effort to develop principles-based standards with the great majority of the world's economies moving towards IFRSs. Broad acceptance exists over the logic

of adopting a single set of high-quality accounting standards relevant to the world's capital markets. "The life blood" of capital markets is financial information that is:

1. Comparable from company to company;
2. Relevant to investment financing decisions;
3. A faithful depiction of economic reality; and
4. Neutral, favouring neither supplier nor user of capital, neither buyer nor seller of securities.

At the same time, national borders have less meaning as barriers to international capital flows disappear, and investors seek higher returns and diversification opportunities. Companies are increasingly operating in multiple jurisdictions, and the cost of consolidating different national accounts is costly and prone to error. In this environment, it makes sense to have a single set of high-quality financial reporting standards used throughout the world's capital markets. The creation of such a set of standards is the IASB's mission.

As a country dependent on trade and with sophisticated capital markets of its own, Australia, at the initiative of the FRC, recognized the benefit of IFRSs at a very early stage in the IASB's existence. Australia's decision to adopt IFRSs in 2005 served as a catalyst for others to adopt the standards in the Asia-Oceania region. Indeed, it is significant that all of the region's major economies—including China, India, Korea, and Japan—all are moving in the direction of IFRSs.

Outside of the Asia-Oceania region, Australia is in good company as well. In 2005, the countries of the European Union joined Australia in adopting IFRSs. Deloitte estimates that 102 countries either permit or require the use of IFRSs for listed companies, while a large number of other countries have formal policies of convergence towards IFRSs. Two hundred companies in the Fortune Global 500 are using IFRSs, and IFRS preparers account for US\$11 trillion of the world's equity market capitalisation of US\$36 trillion. By the end of 2011 it is expected that some 150 countries (including China, Canada, India, Israel and Korea) to be using IFRS and US GAAP and IFRS to be giving virtually the same results.

The Situation Today

Despite the advance of IFRSs, it is not appropriate to draw a conclusion on the IASB's commitment to a principles-based approach on the basis of the existing set of IFRS standards. Until now, the primary focus of the IASB has been on preparing the set of standards for use by countries, like Australia, for their adoption in 2005.

The IASB's existence and shape owes much to a major restructuring initiative taken by Michael Sharpe in his role as Chairman of the former IASC (our predecessor body)—the result of his vision being the formation of the IASB in 2001. From the IASC we inherited a suite of 34 standards. While most of these standards were principle-based there were, due to US influence, some that could be described as overlaid with additional guidance and rules. Of these 34 standards, 14 had been heavily criticised by the International Organisation of Securities Regulators (IOSCO). It was quickly realised that if IFRSs were to be accepted on capital markets throughout the world, these 14 standards had to be improved as soon as possible.

The Board's work, therefore, for the first five years was to try to get the 34 standards ready for 2005—given the request to have a year's breathing space this meant that most of the improvements (to 17 standards) had to be, and was, completed within three years—by 31st March 2004. There was no time for major revisions. Even for the new IFRSs adopted for business combinations, share-based payments, and extractive industries, it was necessary to borrow from other literature or grandfather existing national practice.

During its first few years, the IASB was also presented with an opportunity. The US Securities and Exchange Commission (SEC) and the FASB have always been consistent supporters of international standards. However, following the collapse of Enron and other financial scandals in the US, the willingness to accept international approaches to accounting standards grew. It was this changing mood that led the FASB and the IASB to capture what was a small window of opportunity. The Norwalk Agreement was the result.

The aim was to merge two internationally used forms of accounting into one by choosing “the gold standard” i.e., where the Boards' standards differed, by choosing the better of the two or, if neither was of appropriate quality, writing a new standard. The boards agreed to remove the differences between their standards as quickly as possible; to align their agendas to avoid future differences; and to interpret all the standards in the same way. The aim was to reach a position where the requirement for companies listed on the US financial markets using IFRSs to reconcile to US GAAP would be removed as the standards would be virtually the same.

Some of the differences between IFRSs and US GAAP have now been eliminated, and we are beginning to see the light of the end of the tunnel regarding the potential elimination of US reconciliation requirement. The SEC has set a target for the elimination of the reconciliation requirement for IFRS accounts by 2009.

Admittedly, the IASB may have reached different conclusions and drafted standards differently if it had inherited a clean sheet of paper. However, events did not present us that opportunity, and we adapted to a rapidly emerging market place. This was largely to enable countries like Australia to adopt a workable platform of standards in 2005.

The Future of Accounting is Now

Today, the pressure to repair the inherited standards or focus on short-term convergence projects is over. The IASB can now do some real standard-setting with our objective in mind—to produce one set of high quality global standards. It is from this point forward that observers should judge our commitment to principles-based accounting standards and to the elimination of unnecessary complexity in accounting.

I often hear that the effort to write principles-based standards is doomed to failure, because of our partnership with the US FASB. This view unjustly states that our work programme is focused too narrowly on the removing the reconciliation requirement and will lead us to adopt an overly complex and prescriptive approach used in the United States. I do not believe that is the case, because the fundamental nature of the convergence programme has changed.

An agreement (known as the Memorandum of Understanding) between the FASB and the IASB and involving the SEC and the European Commission was completed in February 2006 setting out a

roadmap for the removal of the need for the reconciliation requirement. The focus has evolved from the elimination of differences of existing standards to a new emphasis on a joint effort to develop new standards where current accounting is deficient.

The approach adopted in the Memorandum of Understanding enables us to adopt a clean sheet approach to new accounting standards. For these new proposals, the IASB is determined to write standards based upon clearly articulated principles. Arguably, a good principles-based standard must pass four tests:

- i. Is the standard written in plain English? (This is also important to enable easy translation of our standards.)
- ii. Can the standard be explained simply in a matter of a minute or so? If not, why does it take longer? (i.e., can only specialists understand it or can most accountants use it?)
- iii. Does it make intuitive sense?
- iv. Does management believe it helps them to understand and describe the underlying economic activity?

Today, it would be an understatement to say that some of the standards on the books cannot meet these tests. Accounting can be both primitive and a closed book to outsiders. The blame is shared. Many standards are difficult to understand because the main principles are submerged under a series of exceptions and detailed guidance. This does not have to be the case. Furthermore, in many cases, by popular demand the basics of transactions are frequently disguised to avoid volatility in income or to disguise the real levels of debt of a company.

It is possible all too frequently to despair of accounting. Frankly, accounting is not rocket science. It is often said of the professions that they try to surround their activities with mystique to confuse the layman. Accounting standards can do more than that—they frequently baffle many accountants so much so that few audit partners can complete an audit without relying on the advice of experts within the firm. A useful retort when confronted by many supporters of complicated accounting policies is: “Explain that to your granny.”

The next section of the paper explores this approach to the contemplation of accounting rules by examining three of the most egregious cases where exceptions in accounting rules to accommodate different interests have added complexity, while reducing transparency. All three are now under review.

Pension Accounting

Contemplate the application of the “granny” test to the existing pensions standard. Suppose a pension fund is in equilibrium, having liabilities of A\$40 million matched by assets of a similar amount. If the value of the assets was to fall to A\$30 million and liabilities remained the same, the fund would have a deficit of A\$10 million. Under what is the most commonly used option of IAS 19,¹ the deficit is reduced:

¹ See “Post Retirement Benefits, Outside the Corridor” *Company Reporting*, No 199, January 2007, p 3.

- a) by a reduction of 10 percent of whatever is the higher of assets or liabilities—in this case liabilities, leading to a reduction of A\$4 million
- b) by ‘spreading’ the remaining deficit of A\$6 million (A\$10 million minus the \$4 million) over the expected working lives of the employees—say 10 years for this example.

The result is that deficit shown in the financial statements becomes A\$600,000. The incomplete nature of such an amount recognised in income and expense and the balance sheet obscures the impact of the loss in value of the fund assets on the entity. While information about the total deficit is shown in the notes, standard-setters know that disclosure is no substitute for good accounting. Moreover, there is a growing body of academic research indicating that market participants do not incorporate the disclosures in decision making. This does not make any sense. I know that I couldn't explain that to my granny.

Furthermore, not only is the change in the value of a pension fund not reflected in the financial statements correctly but the annual cost of pensions charged against annual income is offset by the estimated long term return on the assets in the fund. Some of these estimated returns have been heroic! In the United States from 2000–2004, the income statements of the top 500 companies, recorded these estimated returns at US\$498bn. The actual return amounted to US\$197bn.² In other words, US\$301bn of phoney profits flowed through the profit and loss accounts of the top 500 American companies over a period of five years.

Leasing

On leasing, there is some good news—the standards internationally are harmonised. The bad news is that they are absolutely useless! One of my great ambitions before I die is to fly in an aircraft that is on an airline's balance sheet. Why does this not occur? Because most aircraft are leased and the standards divide leasing into two types: operating leases and capital/finance leases in which (broadly speaking) the asset is owned for almost its entire life. For operating leases the only amount shown in the financial statements is the annual lease payments which are charged to the profit and loss account.

For finance leases, the present value of the future payments under the lease is shown as a liability and on the other side of the balance sheet the right to the asset. Why aren't aircraft shown? This is because aircraft are not leased for their entire life. They are usually leased for only seven years; therefore, they fall into the operating lease category. But ask the airline the following questions:

- Q: Can the airline escape from the lease? A: No, it is committed to annual payments over the next seven years.
- Q: Can the airline measure the amounts it has to pay over seven years? A: Yes, it is written into the lease contract.

The definition of a liability is met. The airline has an obligation from which it cannot escape and which can be measured reliably. It should, therefore, show as a liability the present value of the payments that have to be made and on the other side the rights to the aircraft for the same period. These would not be

² 'Pondering Pensions: How They Affected the S&P500 in 2004'

The Analyst's Accounting Observer May 27, 2005 (Revised June 27, 2005)

trivial figures. The leasing volume for the year of 2005 amounted to US\$582bn³— and this was for only one year. Most of it was off balance sheet.

Financial Instruments

Finally let's turn to financial instruments (especially IAS 32 and IAS 39) because they are the poster children of 'rules-based' accounting. However, the 500 pages of IASB guidance or nearly 1200 pages in US GAAP are not the result of a standard-setter's whim—they reflect the two boards' desire to address their constituents' desire to account for specific transactions, to reduce reported earnings volatility, and to have more certainty through guidance.

It could be argued that those who claim to understand IAS 32 and IAS 39 haven't read these standards carefully enough. Here's why. IAS 32 requires an asset or liability to be recognised when an entity uses its own equity instruments as 'currency' in a contract to receive or deliver a variable number of shares whose value equals a fixed amount, which is inconsistent with the conceptual framework. The treatment of impairment is different depending whether it is for goodwill or a tangible asset, or (separately) whether it is an equity instrument or a debt instrument held as available for sale.

While these inconsistencies can be overcome, some would argue that the business world is complex and accounting standards that would overtly simplify a complex world, would do a disservice to the financial community. No-one could argue that IAS 39 does not attempt to deal with complexity. It is also true that there are clearly articulated principles in IAS 39. The standard applies to cash and contracts for cash. From a measurement perspective:

- all financial assets and liabilities are measured at fair value on initial recognition.
- subsequent measurement should reflect the nature of the instrument and purpose for which it is held
- all derivatives are measured at fair value

It is in the application and in the exceptions to the principles that the problems occur. For example, paragraph 9 of IAS 39 defines a derivative instrument. The definitions are discussed further in Application Guidance paragraphs AG9 to AG12A. The definition is further elaborated on in paragraph 38 and AG53 to AG56 dealing with regular way contracts. These paragraphs are then supplemented in the implementation guidance to IAS by nine issues dealing with the definition of the derivative and five issues dealing with regular way contracts.

Similarly, financial instruments are defined in four categories in paragraph 9 which is then expanded upon in AG14 to AG26. Another 13 issues dealing with these definitions appear in the implementation guidance. Paragraphs 10 and 11 describe an embedded derivative and illustrate the appropriate accounting treatment. Such derivatives should be separated from the host contract and accounted for as a derivative unless the embedded derivative is closely related to the economic characteristics of the host contract (there are also a couple of other conditions in paragraph 11 relating to separation of embedded derivatives from a host contract).

³ Source: [World Leasing Yearbook 2007](#), p1

However, an entity may elect, in certain situations, to measure the entire hybrid instrument at fair value through profit or loss under paragraph 11A. If the embedded derivative cannot be measured separately a further exception is given in paragraph 12. Eleven further issues involving embedded derivatives are dealt with in the implementation guidance.

Similarly, IAS39 allows optional hedge accounting. Gains and losses on derivatives can be held back (breaking all the normal rules) if cash flow hedge accounting is used. If it is not, these gains and losses will be recognised as they arrive. The timing of these gains and losses is essentially a management choice. I have long given up asking my colleagues to explain this one to their granny.

A Better Way

The sections above discussed three clear cut cases where accounting is needlessly complex or fails to reflect the economic facts, but there are certainly other examples. The question is as to possibilities in the future. Can standards be written differently? Can the standard-setter deal with the main issues related to a particular type of transaction (what is known as an 80% standard) leaving the other problems to be dealt with by reference to the standard's main principles and the use of professional judgement?

Returning to the four tests set out earlier, the answer lies partly in developing standards that make intuitive sense, partly in the drafting, and finally in the way financial statements are presented and explained.

A Principles-Based Standard⁴

If principle-based standards are to be introduced then lessons must be learned from the problems arising from existing standards. If complexity is to be avoided the exceptions to the scope and to treatments will have to be eliminated. Similarly, application guidance will have to be limited to only what is absolutely necessary to operationalise the principle.

It would not, however, be enough simply for a standard setter to make the above a desirable objective. A process would have to be introduced to ensure that principles-based standards are delivered. All exceptions should be questioned and re-debated before a final standard is issued. Applications of exceptions by analogy would have to be prohibited—thereby eliminating a major source of interpretations.

The core principles would have to be clearly stated. Other sub-principles should be related to these in a tree-like structure. Inconsistencies with other standards should be dealt with. Despite the potential delay consequential amendments should be made if by doing so collectively standards now use the same principles.

Principles should be tied to the conceptual framework. The basis for conclusion of the standards should have specific discussion of the how the principles in the standards compare with the framework. Any departure would have to be explained. It may be necessary to depart from the framework if emerging transactions indicate that the framework is out of date. Any exception to the framework, however, should provide a basis for elimination of the exception by later changes to the framework itself.

⁴ I am indebted to my Board colleagues and in particular to Mary Barth, Jim Leisenring, Trish O'Malley, Warren McGregor, John Smith and the Directors, Liz Hickey and Wayne Upton, for their observations on this issue.

See also, *Principles-Based Approach to US Standard Setting* FASB, 2002; Katherine Schipper; 'Principles-Based Accounting Standards' *Accounting Horizons*, March 2003, and *Principles Not Rules: A Question of Judgement*; Institute of Chartered Accountants of Scotland, 2006.

The use of principles should eliminate the need for anti-abuse provisions. It is harder to defeat a well crafted principle than a specific rule which financial engineers can by-pass. A principle followed by an example can defeat the 'tell me where it says I can't do this mentality'. If the example is a rule then the financial engineers can soon structure a way round it. For example, if the rule is that, if A, B and C happens, the answer is X, the experts would restructure the transaction so that it involved events B, C and D and would then claim that the transaction was not covered by the standard.

A principle based standard relies on judgements. Disclosure of the choices made and the rationale for these choices would be essential. If in doubt about how to deal with a particular issue, preparers and auditors should relate back to the core principles. The basis for conclusions should also include, in particular, the question of whether there is only a single view to tackle the economics of the situation. Often there are competing views - is one deemed to be more relevant. If so, reasons for choosing that particular view should be explained in the basis for conclusion and reasons for rejecting the others clearly outlined.

All application guidance and examples to understand the principles have to be questioned. Would anything be missed if they were deleted? If guidance is necessary, is the principle sufficiently clearly stated? Does the standard include bright lines and arbitrary limits? Why are these necessary? Does the transition follow the normal pattern? If not, why is a change proposed?

How could this be put into practice? Taking the leasing example from earlier, the core principle in a new leasing standard could be expressed as:

"The entity is required to show the liability it has incurred by signing the lease contract and the rights to the asset obtained thereby."

That is the thrust of the standard. How much more would be required? It would possibly be necessary to define sub-principles related to the core principle in a tree-like structure dealing with:

1. the definition of the particular liability incurred and the rights obtained;
2. the treatment of renewal options or cancellation features; and
3. residual guarantees.

Telling It As It Is

The result of such an emphasis on principles, and a reluctance to provide detailed guidance, will necessarily lead to what might be called 'tell it as it is' accounting. Now, the application of this approach could lead to increased volatility in financial statements. For this reason, it is necessary to focus on presentation and management commentary as well.

Presentation should show where volatility will have an effect in the short term and where it relates to long term matters. Users would have to understand the differences between gains and losses in the short term as part of the opening cycle reflecting nearness to cash and those resulting from long term investment portfolios, revaluation of buildings and changes in pension fund surpluses and deficits. The

financial statements should reflect these differences in the timing and uncertainty of the realisation of the gains and losses—and enable management to explain their company's performance appropriately.

In this new world, management commentary takes on added significance. Make the company tell its shareholders what it tells the analysts. For example, in the UK, while many companies were upset at having to show their pension fund deficits they soon learned how to deal with the problem. Companies were saying things such as:

“We have a pension deficit of A\$40m, we expect to put an extra A\$5m per annum into the fund over the next few years. We assume the assets in the fund will grow at 4% per annum and we will change the scheme slightly. We therefore expect that by 2011 the scheme will be back in equilibrium. The effects on profits, assuming they stay at today's levels, will be 1.3%.”

All we standard-setters have to do is provide the vehicle in the form of the management commentary. As in many cases standard-setters know what has to be done—but can we make it understandable.

A Shared Challenge

A principle based system will only work if preparers, auditors, users and regulators wish to make it work. Use of judgement will require preparers and auditors to exercise courage and to defend their judgements. Users would have to accept that companies would not always adopt exactly the same treatment for dealing with particular situations but over time it is likely that the better treatment would emerge as being favoured. If an inappropriate treatment emerged then clearly the standard setter would have to step in to correct the situation by amending the principle or by dealing with the issue specifically (another rule?).

The training of accountants would have to change. The basic concepts of accounting would have to be emphasised at degree and at professional training level. Preparers and auditors would have to accept that a principle-based system would tend to ban the treatments designed to smooth earnings.

Greater user sophistication is necessary. Investors will need to rely on the variety of information that corporations are giving to explain financial results and be able to recognise the different sources of performance and volatility. Regulators should not be able to second guess preparers who have made honest and reasonable judgements and which meet the objective of a principle. If two or more methods are appropriate to achieve the result the principle desires then these have to be accepted. If the regulator insists on one method he is in effect inventing the rule and moving away from a principle based system. Regulation can be the enemy of principles—a danger that has to be watched by securities and prudential regulators world wide.

Similarly, we cannot deal with high volumes of requests for interpretations—whether as formal International Financial Reporting Interpretations Committee (IFRIC) pronouncements or explanations of decisions not to offer an IFRIC interpretation. Every interpretation is a rule. For example, in several issues brought to IFRS recently, it is often difficult to choose between two competing treatments. The question that has to be asked is: does it matter if management select one policy and disclose the effect

of selecting another? The information will be in the market place and adjustments can be made if necessary. If the effect is material and the issue occurs frequently a case may arise for a few paragraphs being added to the standard to ensure greater comparability.

Finally, the legal situation. It will be much more difficult in the United States to introduce a principle based system given the litigious nature of that society. This must be acknowledged as a risk to IFRSs as the goal of convergence is pursued. However, it is arguable that the risk has been overstated in some quarters. The risk can be mitigated however by the careful generation, collection and retention of documentation and the seeking of expert advice and the views of professional colleagues throughout the life cycle of transactions. Above all, those who make such judgements, document them and who have made an honest and fair attempt to meet the principle should be defended.

If the United States cannot accept the degree of judgement deemed appropriate elsewhere then the FASB may have to issue requirements additional to those of the IASB. The IASB would then have to consider ways of ring-fencing the additional US guidance to prevent such guidance associated with a jointly written standard from being deemed compulsory by IASB's current requirements to look to the standards of other standard setters if an IFRS does not deal with a particular situation.

The Last, Best Chance

We are at an important juncture in accounting. The integration of the world's capital has led to the emergence of IFRSs as a broadly accepted set of accounting standards. This development has also provided us with a unique opportunity to write standards that focus on clearly articulated principles, making financial reporting more accessible to a broader range of users again.

Ultimately, the financial reporting world will get the standards which it deserves. A rules-based system is inevitable:

- If those involved with financial reporting do not act with integrity,
- if in court accountants attack reasonable judgements which have turned out to be, with hindsight, incorrect,
- if auditors and preparers ask for voluminous interpretations or additional guidance,
- if raw economic facts are unpalatable and exceptions to the principles sought,
- if the regulators insist on particular ways of dealing with a situation.

This is probably the standard-setters' last chance to move the clock back to try to write shorter, less complex standards, to remove the cottage industry of the expert and return accounting to the profession. We have to move away from the position where only the technical partner understands (or thinks he or she understands) the standards. Accounting is not rocket science—we have to try to write standards for the bulk of the profession. The IASB is going to try this, but it will then be over to the profession.

IFRS Conversion: The Role of the Global Actuary

By Tim Geddes, FSA, FCA, EA, MAAA and Marcus Rafee, FSA, EA, MAAA

1. Introduction: Basic Business Case

A large multinational corporation will likely expend significant effort changing the organization's accounting methodologies from U.S. Generally Accepted Accounting Principles (US GAAP) to International Financial Reporting Standards (IFRS). The scope of work will likely encompass much more than changes to specific debits or credits—demanding significant planning, strategizing and coordinating across the organization's global network. A strategically positioned global actuary who is well-integrated into the conversion process has the opportunity to add significant value to the organization in this important endeavor. This paper provides background on a typical conversion process and describes the important roles that a global actuary could play in support of a large multinational client.

2. Background: The IFRS Conversion Imperative

Throughout the past decade, the U.S. Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) have participated in a difficult back-and-forth exchange regarding the mutual goal of unifying the world's two most prevalent accounting standards. The two boards have entered into a Memorandum of Understanding, which sets forth the objective and plan to move toward a convergence of standards. These efforts toward convergence have, to date, brought limited successes and, in many areas, US GAAP as promulgated by FASB and IFRS as set forth by the IASB remain quite different.

While the FASB and IASB have been working to make the two sets of standards more compatible, the U.S. Securities and Exchange Commission (SEC) has been gradually moving toward permitting companies that historically reported under US GAAP to begin utilizing IFRS. The SEC's first excursion into the IFRS jungle permitted foreign filers to submit unreconciled IFRS financial statements with the Commission beginning in late 2007. In 2008, the SEC progressed further when it offered an invitation (perhaps more appropriately characterized as a "save the date" message) to U.S. companies proposing that certain U.S. filers might be able to file IFRS statements with the Commission as early as fiscal 2009.

However, the proposal for early use of IFRS by U.S.-domiciled enterprises is limited. The SEC's offer for IFRS reporting requires that a company be very large—one of the 20 largest globally in its industry as measured by market capitalization. Furthermore, the company must be able to demonstrate that its 20-company peer group uses IFRS more often than any other set of accounting standards. Because the SEC's invitation applies only to a select few, the marketplace response thus far has been tepid and the RSVP list remains fairly short. The SEC was expected to meet in the fourth quarter of 2009 to further discuss its proposal. Although the current terms are likely to change, some form of early option to use IFRS will probably still exist in the near future—for certain companies.

The SEC proposal also contains a roadmap for the mandatory conversion of all U.S. filers to IFRS. Among a number of other things, the roadmap provides milestones which, if achieved, would result in mandatory conversion for SEC filers to IFRS for fiscal years ending as early as 2014. The conversion requirements would progress in stages, with large accelerated filers being required to report under IFRS in 2014 and all filers being required to do so by 2016.

As consulting actuaries have begun to position themselves more broadly as business advisors, an understanding of a company's industry and business situation has become increasingly more important. The preparation an organization may be undertaking to change its entire accounting foundation is clearly one of the considerations that should be top-of-mind in the course of an actuary delivering business advisory services. While an external global actuary can significantly assist in the IFRS conversion process in many ways, a sound understanding of the organization's timing and motivations for such a conversion is a prerequisite for effective and meaningful advice.

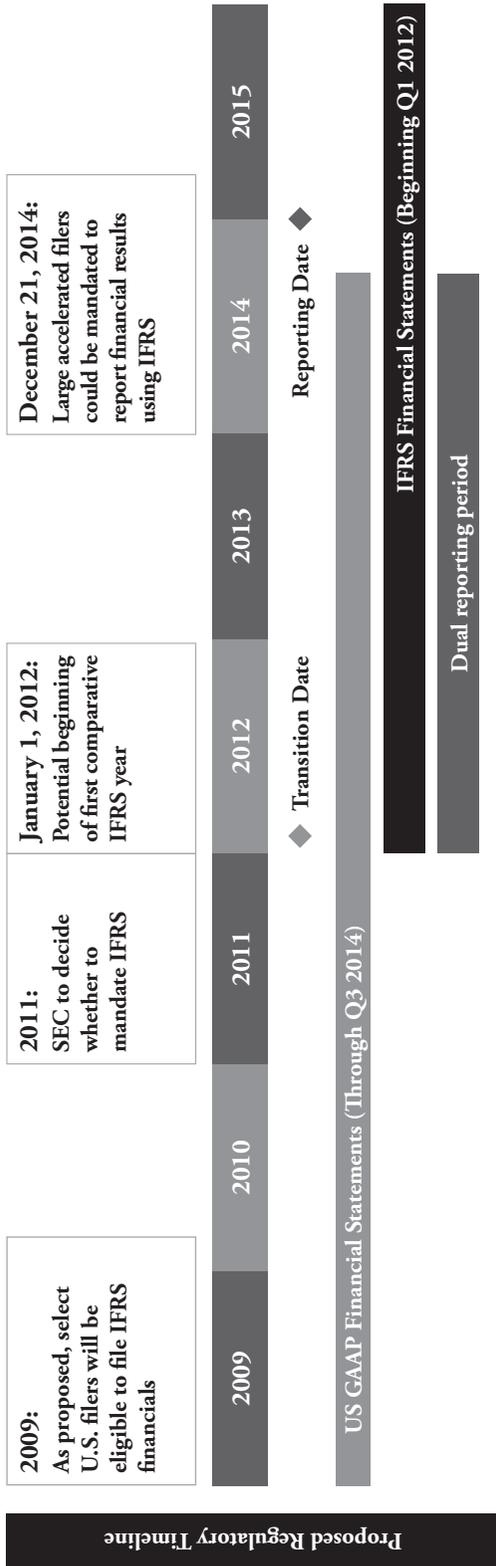
3. Getting from Here (US GAAP) to There (IFRS)

At the most basic level, one might question why companies are thinking about IFRS now when conversion may not be required for another five or more years. Companies are evaluating the potential impact of an IFRS conversion for a number of reasons, but nearly all should lead to being prepared well before the actual conversion deadline. First and foremost, the most immediate push toward IFRS is occurring for organizations whose parent companies are located in Brazil, Canada and India where IFRS conversion is expected within the next one to three years. In many cases, these companies are under the gun for an immediate conversion. In these high-pressure situations, organizations are increasingly likely to look to well-informed outside advisors to assist in all areas of the conversion.

Additional companies will begin to qualify for the SEC's early adoption election as more countries adopt IFRS. According to a 2007 Deloitte & Touche LLP survey, over 40 percent of the Fortune Global 500 was reporting under IFRS at that time and it was expected that the percentage would increase in the next couple of years as Canada and Brazil moved to IFRS. With the further addition of India—as well as the likelihood that Japan will soon follow suit—that percentage will likely increase even more significantly and, with it, the likelihood that IFRS will become the dominant reporting standard for a company's industry peer group.

For organizations that primarily conduct business in the United States and would not qualify for early adoption if the SEC finalizes its roadmap as it stands, the timetable for mandated conversion may seem very long. However, a more detailed examination of what is involved in an all-encompassing conversion has helped us understand why many companies are beginning assessment projects now. To wit, conversion to IFRS reporting in 2014 will likely require one or two comparative year(s) of income statement presentation. Thus, the "transition date" may be as early as Jan. 1, 2012 so that income for 2012 and 2013 can be shown on an IFRS basis in conjunction with the first official IFRS reporting for 2014 (see Figure 1 on page 18).

Figure 1. Proposed Regulatory IFRS Timeline



One might also question why a company would voluntarily elect to change accounting standards early if it could. While the answer will certainly vary from company to company, some key business case considerations include:

- Analysts/shareholders may begin to expect reporting under IFRS as a larger percentage of the global business community begins to report under international standards.
- Utilizing accounting standards that are mandated across much of the rest of the world can facilitate easier access to non-U.S. capital markets.
- Unifying accounting standards can streamline the global statutory reporting process, resulting in both reduced costs and increased internal control (e.g., elimination of manual adjustments to produce local statutory accounting results).

To be effective when asked to be involved in an IFRS effort, a global actuary should first ground itself¹ in the broad strategy and timing of the IFRS conversion. It should then develop a deep understanding of the structure and process for executing such a significant change across the organization.

An undertaking as large as a complete change in accounting/reporting standards will demand significant attention and active participation from many areas of the organization. A typical company will establish a steering committee with representation from upper management within the tax, accounting, finance, human resources, information technology and internal audit functions. Regional and/or business line leaders will be appointed to spearhead various work streams of the project within their responsibility areas. Finally, an outside IFRS conversion advisor (which will typically be a large accounting firm, but may or may not be the independent public accountant of record) may also be retained to assist in the process.

The company will likely establish a project management office (PMO) to develop timelines, manage execution against those timelines, and coordinate issues that cross multiple jurisdictions and/or work streams (see Figure 2 on page 20). The PMO would have responsibility for advising the steering committee on the progress of the project and for ensuring that issues are elevated to the appropriate levels as necessary. The PMO may be comprised of internal company resources or, very often, a combination of internal resources and outside advisors. A global actuary participating in the conversion effort should interact effectively with the PMO so that the benefit aspects of the conversion are not inappropriately separated from the remainder of the conversion project.

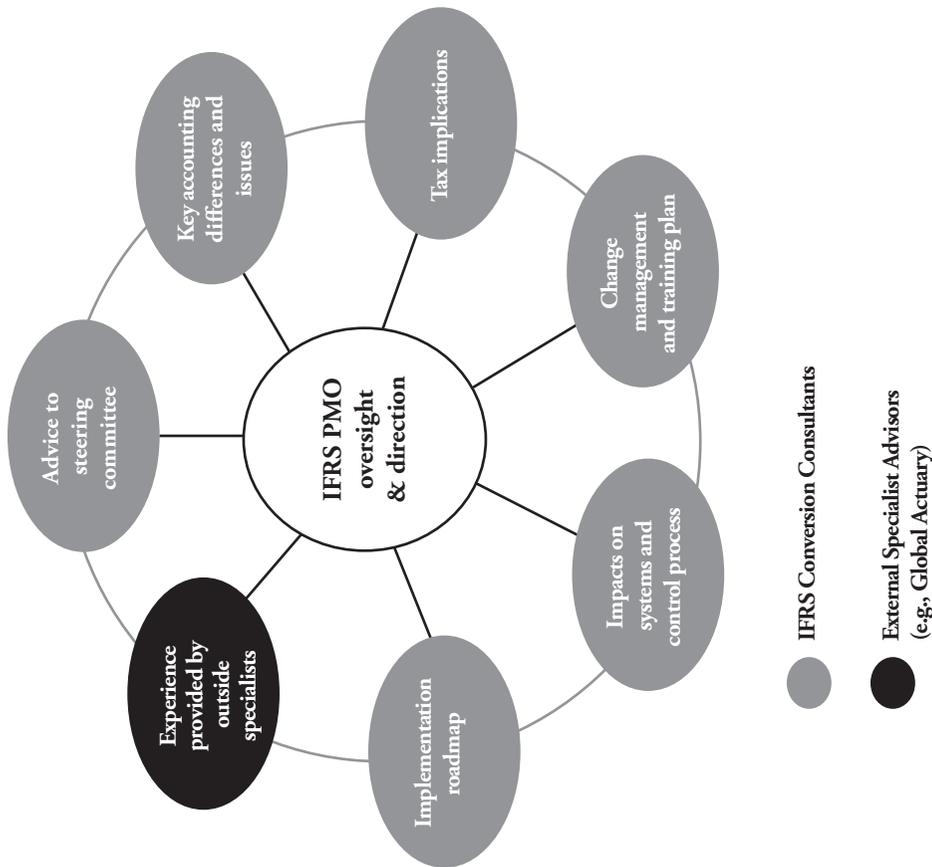
In general, the PMO will separate the IFRS project into three distinct segments: assessment, conversion and sustainment. The global actuary should proactively approach the finance function prior to the kick-off of the assessment phase to discuss the value that it can bring to the process. Much of the incremental value that a strategically minded global actuary can deliver is achieved in the early stages of the assessment.

3.1 Assessment Phase

During the assessment phase, the organization evaluates the business case for conversion and determines the best methods/technique to execute the conversion across the organization. Key activities during this phase include identifying the most significant differences in accounting treatment, reviewing existing

¹ To avoid gender bias, the authors have elected to use the neutral pronoun when referring to the global actuary.

Figure 2. PMO Responsibilities and Functions



global reporting requirements under IFRS and other GAAP, determining tax and systems implications of the conversion, evaluating training needs within the organization and appraising the organization's readiness to accept the change. A typical outcome of the assessment phase is a comprehensive work plan detailing what needs to change, where those changes need to be executed, how to implement the changes, and when the changes need to be completed. This document is frequently referred to as an implementation roadmap.

While each of the above activities requires attention during the assessment phase, the identification of significant accounting differences is generally viewed as the foundation of the IFRS assessment. In general, an evaluation of accounting differences begins with an understanding of the accounting methods, policies and procedures that a company currently applies in its principal locations across the globe. To develop this inventory, most companies utilize an elaborate series of questionnaires (or an integrated technology solution that accomplishes largely the same goal). Much of the effort during the assessment phase of a conversion is focused on issuing, completing, reviewing and summarizing questionnaire responses. In the authors' experience, a more decentralized decision-making process and/or a limited coordinating influence will increase the effort and expand the time required to complete the questionnaire assessment process.

While not really part of the conversion process, it should be noted that this inventory and assessment of global accounting policies will frequently unearth areas in which US GAAP has not been consistently or correctly applied in the past. In this regard, the conversion project becomes a catalyst for correcting prior (hopefully minor) accounting deficiencies and improving the control process.

3.2 Conversion Phase

The second phase of the IFRS conversion process is where the proverbial rubber meets the roadmap. During this phase, the organization will make elections with respect to IFRS accounting policies (and there are many elections to be made). A strategic conversion process should involve a strong business analysis of the relative preferability of the various allowable accounting method elections. In many cases, the inclination will be to make IFRS elections that most closely align with current US GAAP policies. However, doing so can put the company in a precarious position if its competitors make new elections under IFRS which, while initially producing a change in policy, better reflect the underlying substance and economics of the company's business. Anecdotal evidence suggests that the majority of European conversions were done in a way to minimize changes to policy. These decisions may or may not have been the optimal strategic elections with respect to future business performance.

The elections made during the conversion phase will be documented within newly developed accounting procedures. In many cases, the initial conversion to IFRS will occur at the local statutory level. This statutory conversion may be done in advance of the required conversion date for corporate IFRS reporting and can be implemented in various countries on a staggered schedule. Such a tiered conversion process has the advantage of balancing resource demand, recognizing statutory cost savings earlier, and allowing the organization to gradually become more knowledgeable about IFRS.

The culmination of the conversion phase is the issuance of IFRS financial statements for the consolidated organization. In complex global organizations, this conversion may extend over multiple years and require the implementation of additional tracking systems. For example, in the arena of pension benefits and other postemployment benefits (OPEB), new processes may be required to track the potential application of the pension asset ceiling or additional liabilities under International Financial

Reporting Interpretations Committee (IFRIC) Interpretation Number 14. In addition, reporting under both US GAAP and IFRS will likely be required for some transitional period. Once the conversion is complete, however, the organization will begin to recognize the efficiency and control advantages of operating with a single set of accounting principles worldwide.

3.3 Sustainment Phase

The goal of the third phase of the project is to transform the organization into one which thinks, evaluates and performs on an IFRS basis. For example, a key goal during this phase involves the elimination of consolidation adjustments to achieve IFRS compliance. This process improvement will likely require further technology enhancements, organizational change management and additional ongoing training. New monitoring will need to be introduced to achieve compliance with statutory and tax reporting procedures. Furthermore, companies will want to maintain a focus on streamlining processes to take full advantage of the efficiencies available under unified IFRS reporting.

4. The Role of the Global Actuary

Based upon a general understanding of the IFRS conversion process, a strategically minded global actuary should be able to provide significant value across all phases of the conversion process. For example, it could help a company with the coordination/centralization of information during the assessment phase, with the modeling and analysis of election choices during the conversion phase, and with the improvement of the processes and technology used for global benefits reporting during the sustainment phase.

4.1 General Importance of Pension/OPEB Accounting

The business case for global actuarial involvement is further supported by the unique position of pension/OPEB accounting within the conversion process. Benefits accounting nearly universally produces differences in accounting results after conversion. According to a recent survey of US GAAP to IFRS conversions, 99 of 131 respondents (over 75 percent) reported significant differences with respect to pension/OPEB the highest incidence of differences over all major accounting areas.²

Not only do pension/OPEB plans frequently produce changes to a company's financials, but often these liabilities are some of the largest on the organization's statement of financial position. Similarly, in the authors' experience, the resulting impact of an IFRS conversion on the accounting results for these benefit programs tends to be quite large. Consequently, pension/OPEB accounting frequently has the dubious distinction of producing the largest technical accounting differences in the IFRS conversion process.

In addition to frequency and severity (to borrow actuarial terminology), significant choices exist with respect to pension/OPEB accounting policies. Certainly, an organization needs to understand its plans' current financial position. However, the organization must also be well-informed of the potential effects of upside and downside pension performance and the impact of accounting elections on the reflection of that performance. Many factors will affect a company's decision on these elections, including the specific plan situation at the time of conversion, the type of risk that the organization is taking with its investment

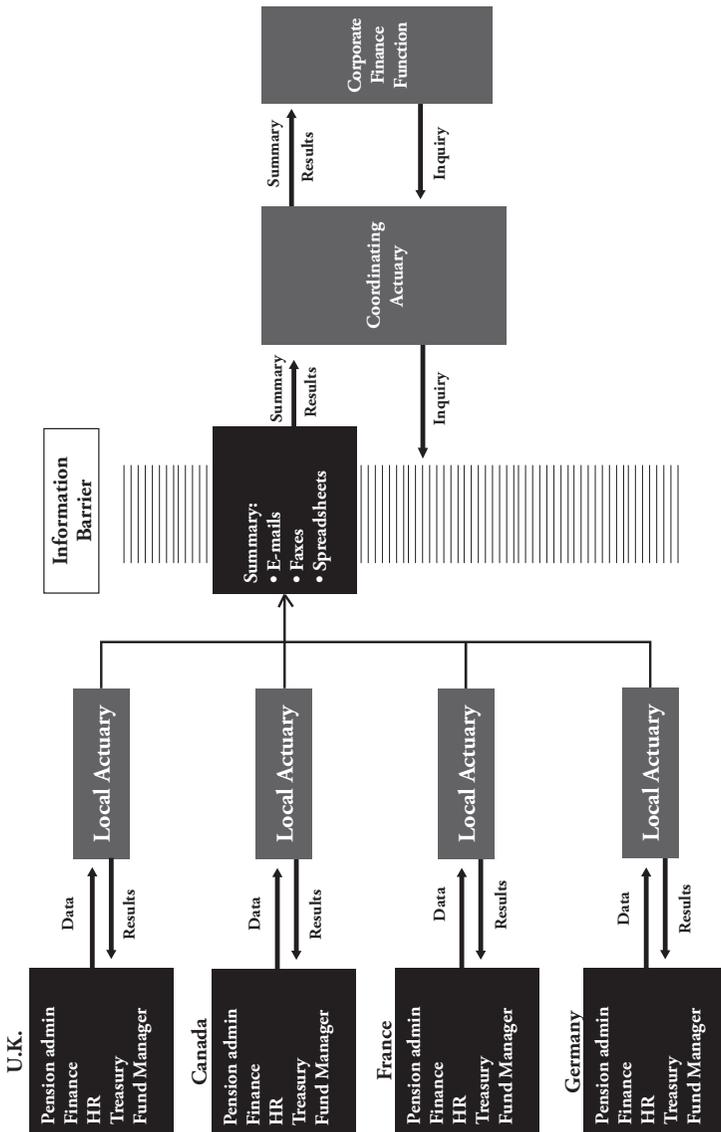
² *The Analyst's Accounting Observer*, Volume 17, No. 4, dated March 28, 2008. "IFRS & GAAP: The Urge to Converge."

allocation, and strategic decisions about downside risk versus upside opportunity. In addition, certain IFRS elections can only be utilized if they are uniformly adopted across all plans in all jurisdictions. This requirement for uniformity increases the need for centralized control over the decision-making process—further enforcing the need for a strong, strategic global actuarial role.

4.2 Limitations of the Traditional Approach

The process currently used by many companies to manage their benefits plan accounting does not optimally support an IFRS conversion. In many cases, management has decentralized the oversight of benefits accounting to regions, countries or even plan/plant level accounting personnel (see Figure 3). Very often, this dispersion of oversight leads to differences in selecting actuarial methods, policies, assumptions and control frameworks across different plans.

Figure 3. Example of Traditional Approach to the Global Actuarial Role



The decentralization of accounting oversight tends to support the traditional actuarial relationship structure in which representatives from local offices (generally within the human resources function) maintain the strongest relationship with the actuarial vendors. This local-based ownership of the actuarial relationship results in the sequestering of knowledge around global benefit plans within the local offices—with a combination of the local actuarial vendor and the local office employees.

The local actuaries have great knowledge of regulatory, funding and statutory (pre-IFRS) accounting requirements. Under the traditional actuarial model, these local actuaries would likely also provide the US GAAP reporting as a by-product of their local work, and this information ultimately flows upstream to the current consolidated US GAAP financials. Unfortunately, US GAAP reporting may not be a core competency of the local actuary. If there is no strong centralized oversight under the traditional model, many important choices are made based on dialogue between local management and their local actuaries. As such, heavy reliance is frequently placed on the local actuary for decision making that may be more appropriately owned within the corporate accounting departments.

Absent a change in process, a similar approach will continue after the IFRS conversion, which can make the implementation and monitoring of important IFRS election decisions difficult. Furthermore, because the local actuary retains much of the important benefit plan understanding with respect to the accounting impact of these plans, information must be pulled from the local vendor through local office personnel and filtered up to corporate. This type of multitiered process limits corporate insight into benefit plan accounting information and increases wait-times when corporate decisions require this level of detail.

The traditional approach to providing actuarial services through disjoint local vendors can be a significant impediment to all phases of an IFRS conversion project. The lack of centralized information can encumber the assessment phase. The lack of a strong benefits accounting structure can hamper the implementation of uniform policies during conversion, and the number and dispersion of the responsible parties can make the training and technology improvements more challenging during sustainment.

Specifically, the assessment is made more difficult because the lack of centralized information increases the number of questionnaires that must be distributed. This number, as well as their geographic dispersion across numerous regions/countries/business units, can result in a slower response time (and thus slow the assessment process). In addition, verification of the responses can become nearly impossible as, oftentimes, no one has specific knowledge of the current policy elections other than the local office personnel who completed the questionnaire. Conducting a high level review of likely differences and effects can also become more challenging because, under the traditional model, a number of actuarial analyses must be conducted by a variety of local actuaries and individually routed through local office personnel.

The conversion phase can also be inhibited by the decentralization as project leadership struggles to obtain strong documentation of specific existing policies because many of these policies are currently undocumented, and knowledge of the procedures may only reside with the local external actuarial vendor. Furthermore, achieving consistency in application of the new standards is more complicated because controls are more difficult to evaluate.

The lack of a centralized structure can make achieving efficiencies and identifying further opportunities more difficult during sustainment as well. Procedures giving rise to incongruities with US GAAP that are discovered during the assessment and conversion phases may be perpetuated. Any thought of implementation of a strong global process or efficiency-enhancing technology suffers under the model where limited centralized oversight exists.

4.3 Increased Case for a Global Actuarial Role

Substantial opportunities exist for a strategically minded global actuary to bring value to complex global enterprises. In general, the marketplace has shown increasing demand for improved internal controls, enhanced corporate visibility and better overall governance of the cost center created by the operation of pension/OPEB plans. The looming IFRS conversion could represent the single best opportunity to date to demonstrate the strong global actuary's value to a complicated international organization.

The advent of Sarbanes-Oxley requirements for internal controls encouraged many large multinational companies to reassess the structure of the traditional actuarial relationship. That re-evaluation led to a significant increase in the number of organizations who were interested in retaining the services of a global coordinating actuary. The implementation of a global actuarial function has generally followed one of two paths: addition of an internal coordinating actuary within the organization (internal option) or selection of a single actuarial firm network to provide coordination and actuarial valuation services across the globe (external option).

Under the internal option, the traditional structure of locally appointed actuaries serving local client contacts remains largely unchanged. The internal global actuary is then responsible for collecting and consolidating relevant data, summarizing that data, and providing footnote information to the corporate controller. Under the external approach, a common vendor is selected to provide actuarial valuations around the world through their network of firms in various countries. Under either approach, the global actuary provides a single point of contact for questions/concerns and creates an avenue for an actuarially informed discussion between the corporate controller and local actuaries in the various countries.

However, by simply adding a global coordinating actuary, an effective connection is not automatically made with local corporate contacts. Under either of the typical global coordination approaches, the centralization of knowledge is generally limited to high level understanding. The global actuary's role is usually restricted to compiling results while the local actuaries continue to perform the bulk of valuation activities (either with a variety of firms under the internal option or within the global actuarial firm's network under the external option).

The local actuaries do not generally provide details as to what is happening in a given plan at any given time beyond what is disclosed in annual summary information. The dispersion of the actual valuation work amongst the component firms within the network may compromise the true centralization of knowledge and, consequently the accessibility of that knowledge to corporate managers. The primary communication points continue to be between the local actuary and the local corporate contacts. The global actuary may emerge as a gatekeeper who actually inhibits a meaningful exchange of information and slows the global communication process.

4.4 Increasing the Role of the Global Actuary

Should the SEC's roadmap proposing a transition to IFRS by 2014-2016 be approved, executing an IFRS conversion would be required for all SEC filers. As discussed above, the traditional model to providing services around pension/OPEB financials will significantly detract from the conversion process. A proactive, strategically minded consulting actuary should be able to demonstrate that movement to the global actuarial model will substantially improve execution of the IFRS conversion (across all phases) within the benefits area. Furthermore, the enhanced structure of the actuarial relationship should continue to facilitate improvements to the other areas cited above in the context of the enterprise's corporate finance strategy.

The specific design of the enhanced global actuarial role could vary in how much it differs from the typical coordination role. In the simplest sense, the new role could take the form of *coordination plus* in which the global actuary performs much the same function as in the typical consolidation role, but takes a more active role in understanding the details of the calculations that the local actuaries are performing. In particular, the global actuary would be familiar with the plan provisions, selection of actuarial assumptions, accounting implications, internal control processes and information system requirements in every locality. The global actuary could also engage in ongoing dialogue with local management and the local actuaries.

Such a connection between someone familiar with corporate desires/actuarial nuances (the global actuary) and someone familiar with local corporate/plan developments (the local managers) can help dramatically improve the alignment of decision making with corporate objectives. Within the IFRS conversion context, such a connection could facilitate more timely responses to documentation of existing policies (assessment), more effective review of proposed standards (conversion) and better execution of process improvements (sustainment).

More specifically, in the assessment phase of the IFRS conversion, the global coordinating actuary can emerge as the primary person helping the company complete the informational questionnaires. The global coordinating actuary can also facilitate communication between the local actuaries to provide an opportunity for the actuarially informed parties to discuss the relevant pension/OPEB plan features and identify potential accounting differences. The increased centralization can also provide easier access to information, which can help simplify the validation and review process for data collected on plans across the globe.

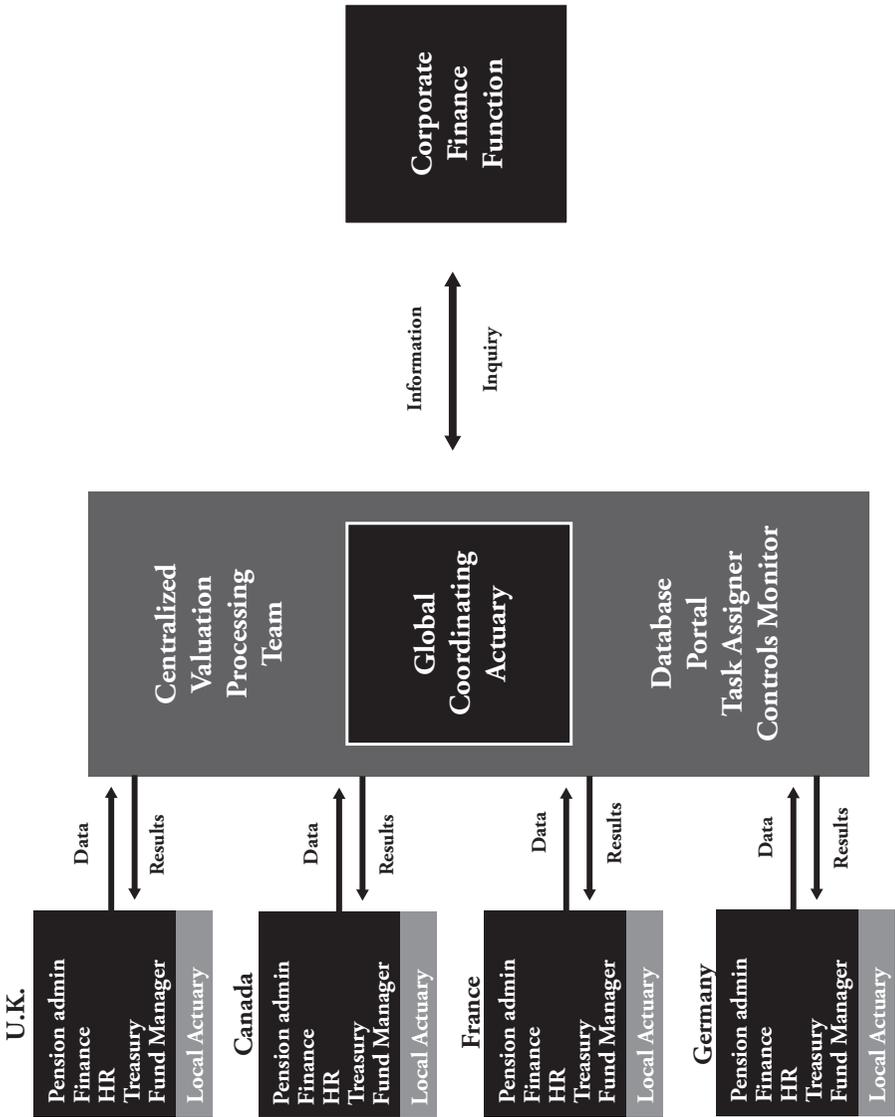
Many global actuaries may already be executing on a coordination plus basis. The unification of policies/procedures under IFRS makes a stronger case for expanding this model to other companies or to more plans within existing clients.

In some limited cases, the role of the global actuary could be filled internally rather than externally. However, it is likely that such an internal actuarial role would be restricted to very large companies with extremely large benefit obligations. The existence of such an internal resource can greatly improve the organization's conversion efforts. Similarly, organizations can benefit from the external global actuary where circumstances are not conducive to maintaining such experience, knowledge and skills internally.

Taking a quantum leap forward, the global actuarial role could be completely redefined to include helping companies perform corporate accounting valuations for significant global plans. This *global*

valuation actuary role would necessitate a detailed understanding of the actuarial and plan details—as well as the accounting implications and system/process controls—at the global level. Implementation of a global valuation actuary model would do the most to change the location of knowledge and increase transparency to corporate users (see Figure 4). Such a role could facilitate an efficient collection of information on current policies during the assessment phase and would support a well-informed benefits accounting management thereby easing the review process.

Figure 4. Enhanced Global Valuation Actuary Role



The global valuation actuary could also facilitate the financial modeling of the impact of IFRS implementation both at a high level during the assessment phase and at a more detailed forecasting level during the conversion phase. The communication of the new procedures and the adherence to those policies would be more easily monitored, as the corporate accounting management would have direct contact with the actuaries responsible for implementing those changes. Finally, the sustainment phase would be clearly enhanced by the streamlining of coordination with corporate management and the support provided by the global valuation actuary.

The business case for such an increased role, whether modest or dramatic, could be described as an emerging need for a well-informed, central resource possessing significant experience with the company's global benefits footprint. Moreover, the existence of such a person could help significantly reduce the amount of effort necessary for an IFRS conversion in the benefits area and dramatically improve the overall execution of the pension/OPEB financial reporting process. The director of global benefits could attempt to perform this duty. However, the professional in that role might lack the necessary accounting background to be of substantial assistance in the details of an IFRS conversion. The role could be given to the finance professional responsible for global pension/OPEB accounting, but this individual would likely not have access to detailed benefit plan information nor possess knowledge of plans that are not currently being consolidated under US GAAP but may require valuation under IFRS.

A global actuary should be uniquely positioned to have access to both sets of information. The global actuary who takes a more active role in understanding the details of the global benefits plans would understand the accounting positions that have been taken historically. This professional would be knowledgeable about existing plan provisions, having had active involvement in preparing the actuarial valuation results. The global actuary would already be aware of any pending plan design changes, having been an integral part of the costing analysis related to any potential redesign. Finally, the global actuary would be able to comment on actuarial details that drive IFRS differences and which would likely not be apparent to non-actuaries.

5. Effective Execution of the Role of Strategic Global Actuary in an IFRS Conversion

As described earlier, an IFRS conversion is an extensive corporate-wide endeavor. The execution of such a wholesale change in an organization is generally managed by an experienced PMO staff fully dedicated to scoping, tracking, overseeing and ultimately executing the project. While consulting actuaries generally have experience managing large actuarial consulting engagements and their staff is expected to deliver results according to established timelines, participation in an organization-wide engagement such as an IFRS conversion is not commonplace for the typical actuarial consultant. Therefore, the actuary must fully assimilate itself into the overall project structure in order to be effective within the broader IFRS conversion effort.

Of course, the global actuary for an organization may not be from the same firm that has been retained to assist in the overall IFRS conversion effort. Moreover, the conversion effort demands integration of a number of threads that are as large as (or larger than) the pension/OPEB work stream that the global actuary is supporting. As a result, the actuary should attempt to participate regularly in the project management meetings even though those meetings may be led by the lead IFRS conversion

consultant rather than company representatives. Such coordination between the actuarial firm and the IFRS conversion consultant can help reduce the possibility that the actuary's role becomes disjoint from the remainder of the project.

5.1 Advantages to the Enterprise of Involving the Global Actuary

If integrated properly and executed effectively, the global actuary's role in the IFRS conversion will enhance the employee benefits thread of the project significantly. As discussed above, the global actuary has a singular perspective on the global accounting for benefits plans—likely being uniquely positioned to understand the actuarial, accounting and human resources dynamics.

The actuary can play the lead role in helping the organization coordinate the questionnaire responses necessary for documenting existing global US GAAP benefits accounting policies. Such coordination will involve discussions with local country accounting management, local country actuaries, accountants within the corporate controller's office and the professionals (internal and external) responsible for project management activities. This interaction will naturally involve an expanded role beyond the traditional global actuarial model and speaks to a need for a more involved global actuary as posited earlier.

5.2 Advantages to the Global Actuary of Involvement in the IFRS Conversion

The global actuary will also gain from helping the organization in their benefits-related IFRS conversion efforts. Specifically, involvement in such a process should further develop its knowledge of the plan details in each of the affected countries. Such increased knowledge should enable the actuary to be a more effective advisor on a variety of benefits matters in the future.

In addition to the direct benefit of gaining more insight into benefits happenings worldwide, the global actuary's participation in a strategically imperative project, which the IFRS conversion represents, should offer opportunities for the actuary to demonstrate value at the highest levels of the finance organization. The necessity throughout the conversion process for frequent discussions with global benefits leaders within the human resources and finance functions should help cement stronger relationships for the global actuary, reaching beyond the traditionally strong relationships with corporate leaders.

6. Beyond IFRS: Leveraging the Conversion Investment

Once the conversion has been completed (no small feat by itself), the global actuary should be ideally positioned to leverage the insights gained and advise on a variety of other areas related to the operation of the benefits programs. The global actuary's role in the conversion process should have laid the groundwork for a more efficient, better-controlled benefits reporting process. A well-executed conversion will have generated improved documentation around the overall actuarial valuation process, including major cost drivers such as principal plan provisions and key actuarial assumptions/methods. The documentation should also enhance corporate insight into the roles and responsibilities of all parties involved in the process.

As an example, an organization could utilize information gained from the IFRS conversion to review the overall process for its actuarial valuation activities. The increased visibility resulting from the conversion will have highlighted the decentralized activities prevalent under the traditional actuarial model. The

additional insight may readily demonstrate the advantages of consolidating actuarial vendors and implementing a global actuarial model. Furthermore, the conversion will likely have highlighted the lack of corporate governance of the current benefits accounting process. Such a perceived weakness may very well lead to a formal codification of corporate accounting policy with respect to pension/OPEB plans under IFRS, something with which a global actuary could clearly assist greatly.

Moreover, many companies, and their independent auditors, will further recognize the complexity of the benefits valuation process and desire more complete documentation of the various participants' roles and responsibilities. Companies frequently are surprised by the degree to which the accuracy of the actuarial valuation process depends upon their own employees' execution of responsibilities across many countries. As a result, once a better understanding of the overall process is gained, corporate sponsors often exhibit a desire for more traditional project planning, such as explicit work plans for IFRS valuations in each applicable country.

Enhanced documentation might also include a global responsibility matrix delineating ownership of processes such as collection of census data for each plan. In addition, internal processes may be established to formally assign responsibility to review the actuary's work product to ensure the final valuation was completed utilizing data consistent with the information provided. Documentation of other phases of the valuation cycle can also be frequently improved, including an enhanced structure for assumption setting and better controls around the process of recording results to the general ledger.

Another likely consequence of the conversion effort is a desire for more centralization of the benefits management process within the human resources function. As stated previously, it is very common for local benefits management to be the responsibility of local and regional human resources leaders. This dispersion of benefits management to regional leadership makes achieving a holistic benefits vision considerably more complicated. Much in the way that limitations in the decentralized actuarial process will have been highlighted by the conversion, the lack of deep understanding of plan structure will ultimately have been uncovered as well.

A currently emerging trend within global human resources departments is the concept of a *global benefits organization*. Under such a design, the local country human resource personnel who are responsible for strategic benefits decisions report through a benefits specialist organization rather than through regional human resources leadership. This functional design can help create better linkage with the global enterprise's talent and rewards strategy. The chain of accountability also often produces a more effective control of benefits spend and eases the means by which corporate-wide solutions—such as global asset pooling and economies of scale in benefits administration—can be implemented.

Lastly, the lack of effective technology being used to manage the global benefits accounting/valuation process will likely have been underscored by any difficulty encountered in obtaining the necessary information to execute the conversion. In many cases, companies consolidate much of their benefits accounting information by using spreadsheets and e-mail. Most global actuarial firms have technology solutions to capture global benefits data, but these systems are not in use as widely as one might expect.

These systems can improve the process in a number of ways. They represent an important part of the company's controls framework by serving as a means to document the key sub-processes in the valuation—data collection, assumptions setting, plan provision confirmation, and plan inventory

certification. The systems can also be a means by which the results are effectively communicated to global users within the company. By storing these results in an accessible database, the results entered centrally can be reviewed against booking entries input by the local country personnel. Furthermore, the storage of results in an accessible database helps to create the transparency highlighted in previous sections of this paper.

7. Conclusion

An IFRS conversion represents a substantial undertaking that is likely to affect nearly every area of an organization. Much more than simply how the beans are counted, the far-reaching impacts of such a conversion include how employees (from executives to the sales force) are rewarded, how information systems need to be structured, and, yes, how benefit plans are managed. The global actuary has a unique opportunity with an IFRS conversion to deliver substantial value to a company, gain a better understanding of the organization's benefit structure, and ultimately to help to leverage the activities used for conversion to enhance the company's overall benefits reporting/valuation/management process.

Note:

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“IFRS Conversion: The Role of the Global Actuary”

by Emrys Trusler, FIA, and Francis Ratna, FIAA, MAAA

We have been working in the international practice of Mercer for a number of years. Accordingly, the role of the global actuary is of particular interest.

The paper by Geddes and Rafiee summarized their view of the role of a global actuary in the following key areas:

- The opportunity for a consulting actuary to provide value to an enterprise transitioning from US GAAP to IFRS
- How appointing a global actuary can be beneficial to a multinational enterprise in areas beyond the conversion to IFRS.

The paper discusses the convergence of US GAAP and IFRS and the potential roadmap for US GAAP filers to adopt IFRS in the future. It also discusses the role a global actuary could take in this process.

1. Summary

Overall, the adoption of IFRS and/or IFRS harmonization will present many challenges to US GAAP filers over the next few years. The analysis and arguments presented in the paper are comprehensive and well-developed. Geddes and Rafiee make a compelling case for consulting pension actuaries to take a greater role in assisting an enterprise with its conversion to, and future reporting under, IFRS.

However, some of the roles proposed for the global actuary in the paper may not be practical or even possible. For example, the paper suggests that a global actuary may be able to take an enhanced global actuary role, performing valuations for all benefit plans globally and presenting results to both headquarters and the local entities. There are a number of potential issues with such an approach:

- Data protection—Many countries have legislation that protects employee data and could prohibit transfer of employee data overseas.
- Local knowledge—While a global actuary might be expected to have a reasonable knowledge of the benefit environment in each country, it may not be practical for the global actuary to have the level of local knowledge required to be able to certify valuation results in each country.

A more realistic approach may be for the enterprise to appoint a single actuarial firm globally to perform the enhanced global actuary role. Using this approach, a single coordinating actuary in the enterprise’s home country would work closely with headquarters. Local actuaries from the same firm based in each country would work with their local counterparts. The local actuaries would take instructions from the coordinating actuary, work with the local operations, and report results to the coordinating actuary.

This approach combines the strategic advantages of the enhanced global actuary with the practical and logistical advantage of having local advisors with deep local expertise.

2. Detailed Comments

As noted above, the paper addresses two key themes:

- Opportunities for consulting actuaries in the transition to IFRS, and
- The benefits of appointing a global actuary beyond the IFRS conversion.

The arguments supporting both ideas are well-expressed and compelling, but the link between the two is not immediately apparent. The paper suggests that conversion to IFRS might be the catalyst for appointing a global actuary. However, it could be argued that there are many other compelling reasons for appointing a global actuary. These include:

- Improvements to global governance
- Consistency of pension accounting policy
- Establishment of internal controls.

Experience also suggests that the value of a global actuary to an enterprise required to report long-term employee benefit liabilities is not materially different under IFRS than under US GAAP.

In summary, the arguments supporting both themes are compelling but need not necessarily be linked. To explore the full scope of the arguments presented, a more independent presentation may have been appropriate.

2.1 IFRS Conversion

The paper provides a good overview of the many challenges and potential benefits that an enterprise faces when either early-adopting IFRS or preparing for adoption at a future date.

In particular, the warning against automatically choosing the path of least resistance (i.e., the policy decisions that result in the least changes from US GAAP) was an excellent point.

However, the paper could have provided greater detail on the specific challenges of moving from US GAAP reporting under ASC 715 to IFRS reporting under IAS 19. Experience suggests that the key changes that enterprises have faced are:

- Discount rate basis (possibly moving to government bond rates for IAS 19 in some countries)

- Method of recognition of actuarial losses (immediate statement of recognized income and expense (SORIE), immediate Profit & Loss or 10 percent corridor)
- Use of the fair value of assets instead of the market-related value of assets
- Application of the asset ceiling under IFRS.

Practicing pension actuaries, particularly those based in the United States, may have an interest in seeing a more detailed discussion of these issues, the differences between ASC 715 and IAS 19, and how an enterprise may choose to address the issues and the differences. We also note that these challenges are relatively small and straightforward in the context of an overall transition to IFRS and are often dwarfed by the challenges faced by other parts of the enterprise.

2.2 Enhanced Global Valuation Actuary Role

The model for the enhanced global actuary role presented in Figure 4 of the paper may overstate the potential role of the global actuary. The diagram suggests that employee and plan data would be sent to the global actuary, who would then prepare the valuations for all countries in a central location.

Such a model would face significant challenges in practice due to:

- The difficulty of understanding the plan provisions and correctly valuing plans in different jurisdictions without detailed local knowledge
- Plan documents being available only in local language(s) and/or local contacts who only speak local language(s)
- Privacy issues related to the transfer of employee data across borders

In relation to the last bullet, privacy laws may make it impractical to transfer the valuation data across borders to a central valuation location (for example, sending employee data from an EU country to outside the EU). Hence, we do not believe that this level of detailed involvement in the valuations by the global actuary would be workable in practice.

However, the broader argument made for an enhanced role for the global actuary is sound. Global governance policies, pension accounting policy, establishment of internal controls and assumption setting are only a few of the areas where a global actuary can assist an enterprise beyond simply aggregating local valuation results.

Global actuaries at many of the larger consulting firms are already providing assistance in these areas, working closely with local actuaries and other employee benefits consultants. Typically, these consultants work for the same consulting firm and with the same resources and standards as the global actuary, although this is not a requirement. A discussion of this approach could form the basis for another paper exploring the benefits of this model, as they are different to those arising from consolidation of accounting results, and extend beyond pensions to all employee benefits.

2.3 New Developments

Subsequent to the completion of the paper, there have been a number of key developments:

- In February of 2010, the SEC voted unanimously in support of the move toward adopting IFRS for U.S. public companies (after support for the roadmap had somewhat cooled in 2009).
- The SEC vote on whether to mandate adoption is now expected in 2011.
- The earliest that IFRS would be required is now 2015 (delayed from 2014, which was proposed in the original 2008 roadmap).
- The SEC has withdrawn the proposed rules that would have allowed some U.S. issuers to adopt IFRS early.
- In April of 2010, the IASB issued an Exposure Draft (Defined Benefit Plans—Proposed Amendments to IAS 19, ED/2010/3) which, if adopted as proposed, would substantially amend IAS 19.

3. Conclusions

Overall, Geddes and Rafiee present a comprehensive and well-argued case for consulting pension actuaries to take a greater role in assisting a client with its conversion to, and future reporting under, IFRS.

However, some of the roles proposed for the global actuary in the paper may not be practical or even possible. The paper suggests that a global actuary may be able to take an enhanced global actuary role, performing valuations for all benefit plans globally, and presenting results to both headquarters and the local entities. A more realistic approach may be for the enterprise to appoint a single actuarial firm globally to perform the enhanced global actuary role. Using this approach, a single coordinating actuary in the home country would work closely with headquarters and would be supported by the firm's local actuaries who would work with the local operations of the enterprise.

“IFRS Conversion: The Role of the Global Actuary”

by Stephen N. Eisenstein, FSA, EA, FCA, MAAA

1. Introduction

Tim Geddes’ and Marcus Rafiee’s paper on International Financial Reporting Standards (IFRS) conversion and the expanding role of the global actuary raises many good points for consideration. The general information they discuss includes:

- SEC Proposed Roadmap for US GAAP to IFRS conversion,
- Why companies may want to convert to IFRS,
- Company process for converting to IFRS,
- Different roles for the global actuary and
- Expanding the global actuary role.

This commentary intends to provide additional information on the SEC’s position, the resultant impact on the IFRS conversion timeline and other thoughts on the global actuary’s role.

2. SEC Proposed Roadmap

Subsequent to Geddes and Rafiee completing their paper, the SEC issued a reiteration of its support for IFRS as the single set of global standards.

The SEC issued its statement of support of convergence and global accounting standards on Feb. 24, 2010. In its document, the SEC provided an update regarding its consideration of global accounting standards. The SEC continues to believe in a single set of high-quality, globally accepted accounting standards that will benefit U.S. investors.

The SEC directed its staff to develop and execute a work plan (the Work Plan) to enhance both understanding of the SEC’s purpose and public transparency. Execution of the Work Plan, combined with the completion of the convergence projects of the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB), will position the SEC to make a determination regarding incorporating IFRS into the financial reporting system for U.S. issuers in 2011. The first progress report on the Work Plan is expected no later than October 2010.

Comments received on the Proposed Roadmap expressed a view that U.S. issuers would need approximately four to five years to successfully implement a change in their financial reporting systems to incorporate IFRS. Assuming that the SEC determines in 2011 to incorporate IFRS into the U.S. domestic

reporting system, it is likely that the first time U.S. issuers would report under IFRS would be approximately 2015 or 2016. This is a deferral of at least one to two years from the 2014 reporting discussed in the Proposed Roadmap. Furthermore, the SEC withdrew the proposed rules for limited early use of IFRS by certain U.S. issuers.

3. Conversion to IFRS

Deferring the implementation of the change to IFRS under the Work Plan provides additional preparation time for companies. However, it does not change the likelihood that conversion to IFRS will occur.

Geddes' and Rafiee's proposed regulatory timeline discussion identifies that initial IFRS reporting will likely require one or two years of comparative income statement information, which is consistent with IFRS 1—First-time Adoption of International Financial Reporting Standards. A different way to view the comparative information requirement is that if a company's first IFRS financial statements include at least three statements of financial position, then a first-time IFRS reporting date of Dec. 31, 20XX would require an IFRS transition date of Jan. 1, 20XX-2 (or, the close of business on Dec. 31, 20XX-3).

Geddes and Rafiee identify a three-phase approach to IFRS conversion, including key activities, a potential team structure and implications. Two of these key activities involve identifying differences between US GAAP and IFRS, and developing a company's accounting policy elections, which should be consistent across the reporting entity. Acceleration of these activities may occur if the parent company operates in countries in which IFRS conversion is expected earlier than in the United States. For example, the target date for IFRS conversion is the end of 2010 for Brazil and for fiscal years ending on or after March 31, 2010 for certain voluntary adopting qualifying domestic companies in Japan (with a 2012 target for mandatory use of IFRS).

4. Global Actuary

Geddes and Rafiee comment on the size and volatility of pension/other postemployment benefit (OPEB) obligations on the company's balance sheet. For some companies, the pension/OPEB obligations are one of the largest financial statement liabilities. They also tend to be not well understood by the company or its auditors. The global actuary can fill the gap by bringing clarity and understanding to other parties.

The authors discuss the global actuary role from a traditional approach as the aggregator of information to a more expanded strategic role as either an internal or external actuary. In this more expanded role, the authors appear to focus most on the centralization of the traditional approach with a more active role due to the regulatory emphasis on internal controls and corporate governance.

The strategically minded global actuary can go much further than the centralization role. The global actuary can use both human resource and finance skills to become the bridge between the two functions. The global actuary can also utilize his or her understanding of actuarial valuations and the potential involvement of different functional areas within the company (human resources, information technology, legal, treasury, accounting, finance, SEC reporting, etc.) related to pensions/OPEBs to assess, improve and monitor the company's financial reporting processes. Furthermore, the global actuary can go beyond the aggregator/coordinator plus role to:

- become more deeply involved in financial statement internal controls,
- help the company use actuarial information for business purposes such as the allocation of pension/OPEB expense across business units, divisions, subsidiaries and corporate functions,
- identify the various constituencies and how they might use actuarial results (e.g., accounting, finance, lenders, auditors, etc) and
- if an internal actuary, manage the vendor relationship with the external actuaries.

Geddes and Rafiee identify how IFRS conversion can further expand the global actuary role. Other avenues to expanding the global actuary role may include involvement in global benefit strategy, global compliance, and global mergers, acquisitions and divestiture support. There are numerous opportunities.

The global actuary may be either an internal or an external role. The authors suggest that the internal role would be restricted to very large companies with extremely large benefit plans. Although this makes logical sense, the complexities of a global organization with several plans across many countries may also provide good opportunities for an internal global actuary regardless of the size of the obligations. It is possible that the complexities may be just as, if not more, important as the size of the obligations.

5. Summary

Geddes and Rafiee present many good ideas and thoughts about IFRS conversion and the internal or external global actuary. Their observations can serve as the beginning of a long conversation about how actuaries can expand beyond their traditional roles of today through their involvement in IFRS conversion, participation across a company's functional areas, and knowledge of pension/OPEB compliance, financial and operational interrelationships.

Authors' Response to Comments by Emrys Trusler, Francis Ratna and Stephen Eisenstein

By Tim Geddes and Marcus Rafiee

We thank Emrys Trusler, Francis Ratna and Stephen Eisenstein for their thoughtful comments. We appreciate their support of the role of the global actuary with activities related to a client organization's International Financial Reporting Standards (IFRS) conversion (and beyond).

We acknowledge that there have been many developments subsequent to our writing. As indicated in the discussants' comments, the SEC has issued a statement in support of convergence and has updated its considerations of timetables. The International Accounting Standards Board (IASB) has also issued proposed technical changes to the mechanics of accounting for pension/other postemployment benefits (OPEB), and some of these changes support the continuing convergence of the two accounting standards.

We appreciate Eisenstein's observation on the value of an internal, strategically minded global actuary for a smaller multinational organization. Indeed, mid-sized enterprises may have fewer staff dedicated to global benefits management and/or benefits finance functions. Under those circumstances, the advisory role of an internal strategic actuary might, in fact, be even more critical.

We absolutely agree with the comments of Trusler and Ratna that the broader role of a strategic global actuary is valuable under both US GAAP and IFRS. We believe, however, that there are often discrete pivotal opportunities for professional advisors of any kind to advance their role within a client organization. Frequently, these opportunities arise in conjunction with some form of transformational change within the enterprise. We suggest that the conversion of the financial reporting platform is exactly such a transformational change and, consequently, a unique opportunity for the strategic global actuary to advance its position.

We recognize the challenges for a global actuary as outlined by Trusler and Ratna with respect to data privacy and language barriers. However, we continue to believe that these challenges are not insurmountable with the correct structure of the client service team (including both the centralized global team and the local support resources).

Finally, we readily acknowledge that there are a number of critically important technical differences between US GAAP and IFRS with respect to pension/OPEB accounting. It was not our intention to describe those accounting differences in this paper. Rather, we focused our discussion on the implications for the actuarial professionals serving a client organization.

Transition to IFRS in Canada from a Pension/Benefit Perspective— Including a Look at the Big 5 Banks

By Geoffrey Melbourne, FSA, FCIA

1. Introduction

Following a proposal made in January 2006 and rigorous review of Canada's readiness for changeover, including consultations with the public regulatory authorities and the independent Accounting Standards Oversight Council, the Canadian Accounting Standards Board (AcSB) confirmed in February 2008 that use of International Financial Reporting Standards (IFRS) will be required in 2011 for publicly accountable profit-oriented enterprises.¹

The transition to IFRS will have significant impacts on financial reporting by affected entities and broader business implications as well. A 2008 executive research report prepared by the Canadian Financial Executives Research Foundation (CFERF) provides good background in the form of survey results on the preparedness of Canadian industry for the transition.²

This paper highlights the differences between IFRS and the other major financial reporting standards used by entities in Canada (namely Canadian Institute of Chartered Accountants Handbook—Accounting {CICA} and Financial Accounting Standards³ {FAS}) from a pension/benefit plan perspective. It seeks to ground academic differences between the standards in the realities of the “Big 5”⁴ Canadian commercial banks based on their publicly available annual reports. All of these five banks are publicly listed, have a consistent October 31 year-end, sponsor relatively large pension/benefit plans in Canada, and have operations in other parts of the world. These institutions represent a manageable, somewhat homogeneous data set, and are of great importance to the Canadian economy.

In addition to issues associated with compliance with the new financial reporting, it is possible that the transition may lead to behavioral changes on the part of affected plan sponsors. In this regard, the immediate funded status recognition in income statements, which the International Accounting Standards Board (IASB) had initially proposed for 2013,⁵ and the impact of IFRIC 14 would be of particular concern. On the one hand, a mark-to-market-type approach would introduce a level of volatility and disrupt the level of comfort to which some plan sponsors have become accustomed with

¹ Media Release Communiqué—Canadian Accounting Standards Board Confirms Changeover Date To IFRS [<http://www.acsbcanada.org/media-releases/item18391.pdf>].

² IFRS Readiness in Canada, CFERF Executive Research Report, ISBN# 978-0-9809715-0-7 [<http://www.feicanada.org/files/CFERF%20IFRS%20FINAL%20REPORT.pdf>].

³ The Accounting Standards Codification under FAS has been ignored for purposes of this paper.

⁴ Royal Bank of Canada (RBC); The Toronto-Dominion Bank (TD); The Bank of Nova Scotia (BNS); Bank of Montreal (BMO); Canadian Imperial Bank of Commerce (CIBC).

⁵ At the time this paper was initially prepared, such recognition had been a tentative decision of the IASB. However, the IASB released its long-awaited Exposure Draft on Proposed Changes to IAS 19 (Defined Benefit Plans) in April of 2010 [<http://www.iasb.org/NR/rdonlyres/C6F8EF54-ADE4-4C9C-B23A-AEFAE9BFE815/0/EDIAS19DefinedBenefit0410.pdf>]. The Exposure Draft proposes that the re-measurement component of the change in funded status be recognized in Other Comprehensive Income (OCI) rather than in the income statement as had been tentatively decided. This approach would greatly mitigate volatility on the income statement (though not on the balance sheet).

the smoothing mechanisms now available. On the other hand, it is arguable that bringing the funded status onto the balance sheet through the income statement would no longer distort the economic decisions sponsors are often called upon to make regarding their plans (such as changing their designs or even settling them), or the investment decisions they have to make regarding plan assets (which are not always considered in an ERM framework).

In core areas of their business, some affected multinational entities may see some appeal in a consistent financial reporting standard for all their operations. However, for a non-core area like sponsorship of defined benefit (DB) pension and other benefit plans, already under pressure from cost escalation and volatility, financial market collapse and increased regulatory requirements, the transition to IFRS may well force boards and managements to reassess their appetite for the increasing complexity imposed by these plans, having regard to competitiveness considerations and the interests of employees, shareholders and other stakeholders.

2. Key Differences

This section of the paper highlights the main differences between current IFRS and the other major financial reporting standards used by entities in Canada from a pension/benefit plan perspective.

IAS 19 is the accounting standard under IFRS that prescribes the accounting and disclosure for pensions, other post-employment benefits (OPEB) and other employee benefits. Sponsors of DB pension/OPEB plans might expect to encounter key differences in the financial reporting for such plans under IAS 19 versus CICA (3461) and FAS (87, 106 and others) in the areas discussed below.

2.1 Transition Impact

IFRS generally incorporates a full retrospective⁶ principle, with IFRS 1 being the accounting standard dealing with first-time adoption. Many sponsors of DB pension/OPEB plans would have been accustomed to deferring the recognition of actuarial gains and losses in income whilst reporting under CICA or FAS. This would be generally unwieldy to apply retrospectively to the inception of each plan. So, as an alternative, IFRS 1 permits (for all plans or none) a first-time adopter to recognize (in retained earnings) all cumulative actuarial gains and losses at the date of transition to IFRS (thus creating a “fresh start” under IFRS), even if it uses deferred recognition for later actuarial gains and losses.

Other unrecognized balances that an entity previously reporting under CICA or FAS might be carrying are a transitional asset/obligation and past service costs. On transition to IFRS, a reporting entity would recognize (in retained earnings) any remaining transitional asset/obligation⁷ and all vested past service costs.⁸ There is no similar exemption for treatment of past service costs as there is for actuarial gains and losses. Thus, subject perhaps to materiality considerations, a first-time adopter would have to determine the extent of any unvested past service costs retrospective to the inception of each plan, with such amounts remaining unrecognized on the balance sheet upon transition. This could be somewhat tedious for OPEB plans if the amortization policy under CICA or FAS had been different, but again, any adjustments would be through retained earnings.

⁶ Full retrospective means that a reporting entity uses the same accounting policies in its opening IFRS statement of financial position and throughout all periods presented in its first IFRS financial statements.

⁷ Plan funded status upon adoption of the standard, adjusted for any balance sheet asset or liability being held in respect of the plan at that time—generally subject to amortization over the average remaining service period of employees expected to receive benefits under the plan.

⁸ Costs of plan amendments.

2.2 Gain or Loss Amortization

Reporting entities currently have three main options for the recognition of actuarial gains and losses under IAS 19:

1. Spread over average future working lifetime of participating employees outside an optional 10 percent corridor⁹—this is similar to the common approach under CICA or FAS. However, unlike CICA and FAS, spreading is not possible if there are no active members.
2. Recognize immediately in income—this is also possible under CICA or FAS, but is currently unpopular under all three accounting standards.
3. Recognize immediately on the balance sheet via *SORIE/OCI*,¹⁰ without hitting the income statement—this is not an option under CICA or FAS. Unlike FAS, there is no recycling from OCI to the income statement.¹¹

Options 2 and 3 above mitigate issues arising from the full retrospection principle under IFRS since, under either of these options, there is no issue of any gains or losses remaining unrecognized on the balance sheet on transition.

2.3 Past Service Cost Amortization

Past service costs under IFRS are amortized over the period until benefits become vested. For pension plans, given that vesting in Canada is between zero and two years, this results in much faster recognition than the amortization over the average future working lifetime typically used under CICA or FAS. This would be of concern to plan sponsors in unionized environments or otherwise where benefit upgrades are negotiated or granted periodically.

2.4 Asset Smoothing for Income or Expense Purposes

IFRS does not allow the asset smoothing for expense purposes that is allowed under CICA or FAS, whereby a market-related value (MRV) of assets (which recognizes changes in fair value in a systematic and rational manner over not more than five years) may be used in place of the fair value of assets to determine:

- the expected return on plan assets to be recognized in income, and
- the gain or loss to be amortized in income, and the 10 percent corridor if applicable.

2.5 Early Measurement Date

IFRS does not allow the use of an early measurement date of up to three months prior to the valuation

⁹ Ten percent of the greater of the defined benefit obligation and the fair value of plan assets.

¹⁰ *SORIE*—Statement of Recognized Income and Expense (terminology being replaced by “OCI”); *OCI*—Other Comprehensive Income.

¹¹ Gains or losses, past service costs and transitional amounts not yet recognized in the pension/benefit expense under FAS are recognized under OCI (net of tax), with such balances being adjusted as they are subsequently recognized in the pension/benefit expense pursuant to the relevant amortization/recognition provisions.

date as is allowed under CICA. Subsequent to the introduction of FAS 158, this is also not allowed under FAS for fiscal years ending after Dec. 15, 2008.

2.6 Different Settlement/Curtailment Treatment

Under CICA or FAS:

- Settlements are concerned with gains and losses only. Gains or losses arising on the settlement are combined with other unrecognized gains or losses before pro rata recognition.
- Curtailments are concerned mainly with past service costs (pro rata based on future years of service eliminated) and also with changes in obligation under some circumstances.¹²

Under IAS:

- For both settlements and curtailments, there is full recognition of the changes in assets and obligations due to the event, plus some recognition of unrecognized gains or losses and past service costs.

2.7 Balance Sheet Limitation

FAS does not include the concept of a limitation on the carrying value of the balance sheet asset in respect of a DB plan.

CICA does include this concept in the form of a valuation allowance, which is any excess of the adjusted benefit asset over the expected future benefit, where:

- The adjusted benefit asset is the minimum of the accrued benefit asset and the plan surplus (in other words, the accrued benefit asset less the excess, if any, of the aggregate of unamortized past service costs, losses and transitional obligation over the aggregate of unamortized actuarial gains and transitional asset).
- The expected future benefit (to the plan sponsor) is the amount of surplus the sponsor can withdraw from the plan plus the present value (using the expected return on plan assets) of contribution holidays available to the sponsor.

Under CICA, the accrued benefit asset is presented net of any valuation allowance on the balance sheet and changes in the valuation allowance are recognized in the income statement for the relevant period.

IFRS includes a concept that is similar to the valuation allowance, with the main difference being that discounting for purposes of determining the expected future benefit is done using the discount rate rather than the expected return on plan assets. IFRS also includes special provisions (with no equivalents under CICA) such that a gain would not be recognized solely as a result of an actuarial loss or a past service cost in the current period, or a loss would not be recognized solely as a result of an actuarial gain in the current period.

¹² If the obligation decreases, the resulting gain is fully recognized in income if there existed unrecognized gains before the curtailment, or is recognized in income to the extent that it exceeds prior unrecognized losses. The converse is true if the obligation increases.

As a result of IFRIC 14, which came into effect for annual periods beginning on or after Jan. 1, 2008, plan sponsors now also have to consider the extent to which there is a requirement to make minimum funding contributions to cover a past service shortfall which would then give rise to surplus or additional surplus under the plan. If the sponsor cannot recover such surplus, then the defined benefit asset must be reduced or the defined benefit liability must be increased. Currently there is considerable debate regarding the application of IFRIC 14 in Canada especially given the current environment of high solvency deficits and minimum funding contributions. Affected sponsors might expect to bring at least a portion of funding deficits (generally determined on a more conservative basis than for accounting purposes) onto their corporate balance sheets.

3. Proposed Revisions to IAS 19

In addition to differences that transitioning DB sponsors might face given current IFRS, changes to IAS 19 are in the works. Concerns about adopting IFRS may be exacerbated depending on the final changes implemented.

The IASB is working on a project to issue, within four years, a standard that would significantly improve pension accounting,¹³ pending a fundamental review of all aspects of post-employment benefit accounting. This project forms part of the Memorandum of Understanding between the IASB and the U.S. Financial Accounting Standards Board (FASB), which sets out a Roadmap of Convergence between IFRS and US GAAP. This paper analyzes the impact of the aspects of Part 1 of the proposed changes that seeks to address recognition and presentation of changes in the defined benefit obligation and in plan assets, disclosures and other issues that can be addressed expeditiously.

At the time this paper was initially prepared, the IASB had made the tentative Part 1 decisions listed on the left below, which would be of significance to sponsors of DB pension/OPEB plans in Canada. However, the IASB released its long-awaited Exposure Draft on Proposed Part 1 Changes in April of 2010. The Exposure Draft contained some major differences from the tentative decisions. These are summarized on the next page.

¹³ This is an objective of the project. Some stakeholders might have misgivings on the extent to which it will be met.

2009 Tentative Decisions	2010 Exposure Draft
<ul style="list-style-type: none"> Reporting entities would be required to recognize the full change in plan funded status in the period in which it occurs (eliminating deferred recognition, as well as recognition under SORIE/OCI). 	<ul style="list-style-type: none"> The re-measurement component would be recognized in OCI rather than in the income statement, greatly mitigating volatility on the income statement (though not on the balance sheet).
<ul style="list-style-type: none"> Changes in the plan funded status (net defined benefit asset or liability) would be disaggregated into service cost, interest cost and re-measurement components for presentation. The interest cost would be presented in the same way as other finance costs. The service cost and interest cost would be disclosed either in the income statement or the notes. The re-measurement component would be presented net of tax effects. 	<ul style="list-style-type: none"> The interest cost would be determined based on the net defined benefit liability or asset, rather than just the defined benefit obligation, reducing the expense for funded plans relative to the tentative decision.
<ul style="list-style-type: none"> Reporting entities would recognize unvested past service costs in the period of the related plan amendment, thereby resulting in immediate recognition of all plan amendments. 	<ul style="list-style-type: none"> No major differences
<ul style="list-style-type: none"> Reporting entities would consider future salary increases when assessing whether a benefit formula attributes a materially higher level of benefits to future years (requiring a “project and prorate” approach for career average plans, for example, leading to higher liabilities than accrued liabilities, and reversing a proposal regarding such plans in a 2008 discussion paper issued by the IASB). 	<ul style="list-style-type: none"> No major differences
<ul style="list-style-type: none"> Reporting entities would include administration costs in the defined benefit obligation (to the extent they relate to past service). Investment management costs would continue to be allowed for in the return on assets. The defined benefit obligation might therefore be expected to increase somewhat as a result of this requirement. 	<ul style="list-style-type: none"> No major differences
<ul style="list-style-type: none"> References to curtailments and settlements, becoming redundant, would be eliminated. 	<ul style="list-style-type: none"> No major differences
<ul style="list-style-type: none"> Additional risk disclosures would be required, aligned with IFRS 4 and IFRS 7. Given the market fallout in 2008, recent market conditions, and concerns that the nature and extent of liquidity risk disclosure requirements were unclear and difficult to apply, CICA (section 3862) and FAS (132(R)-1) have also introduced additional risk disclosure rules around plan assets. 	<ul style="list-style-type: none"> No major differences

3.1 Summary of Differences on and Following Transition

Considering the tentative decisions made by the IASB regarding proposed revisions to IAS 19, sponsors of DB pension/OPEB plans would be affected by the transition to IFRS in the following areas, among others:

- Unrecognized balances (gains and losses, transitional asset/obligation and past service costs) will be recognized in retained earnings without hitting the income statement.
- Considerable income statement volatility (depending on the relative sizes of the plans and the corporations, and relative to the status quo) would be introduced by the immediate recognition requirement, compared to the various dampening mechanisms previously available (including amortization, using a corridor and asset smoothing). This paper illustrates the extent of such potential volatility. Many plan sponsors might be greatly relieved that the Exposure Draft has recanted on what may have been widely perceived as an extreme proposal for calculating the DB expense.
- The elimination of early measurement dates for affected entities currently reporting under CICA will exacerbate all the time pressures and logistical issues typically associated with corporate financial statement production.
- Some entities might expect to bring a portion of funding deficits onto their corporate balance sheets.

4. A Look at the Big 5 Banks

This section of the paper takes a look at the Big 5 Canadian commercial banks and how they might be affected by the transition to IFRS from a pension/benefit plan perspective. It also presents a pictorial look at the impact for a broader group of plan sponsors. The analysis in this section is based on the IASB tentative decisions before the 2010 Exposure Draft. As noted earlier, plan sponsors may have “dodged a bullet” given the more lenient DB expense calculation proposed in the Exposure Draft.

In the context of the Canadian economy (see gross domestic product statistics in Table 1), the Big 5 commercial banks are major contributors (see Table 2¹⁴), and sponsor relatively large pension/benefit plans in Canada. Each of these banks also has operations in various other parts of the world.

¹⁴ All information in Table 2 was extracted directly from the FY2008 annual reports of the banks, except the net change in funded status calculations, which were performed by the author based on information included in the annual reports. Consolidated total revenue is presented net of interest expense and provision for credit losses. Where information (such as the measurement date, funding valuation dates, amortization periods and asset smoothing method, if any) was shown for multiple plans, Table 2 presents the relevant information for the principal pension plan(s). The next funding valuation date for BMO's principal pension plan was not explicitly stated in its annual report. However, funding valuations are required to be filed at least triennially. EARSL—expected average remaining service life.

Table 1¹⁵

Canadian Gross Domestic Product at Basic Prices, by Industry					
	2004	2005	2006	2007	2008
	millions of Canadian dollars (2002)				
All industries ¹	1,124,998	1,155,681	1,189,661	1,219,327	1,225,850
Finance and insurance, real estate and renting and leasing and management of companies and enterprises	215,074	222,475	231,381	240,536	246,944

1. North American Industry Classification System (NAICS), 2002.
 Source: Statistics Canada, CANSIM, table (for fee) 379-0027 and Catalogue no. 15-001-X.
 Last modified: 2009-08-03.

Given the implications for sponsors of DB pension/OPEB plans transitioning to IFRS, the following points can be noted regarding the Big 5 banks in particular:

- All except BMO use an early measurement date.
- Three of the five smooth asset values for expense purposes.
- All amortize past service costs over EARSL.
- All amortize gains and losses over EARSL, with four of the five using the 10 percent corridor.
- Both banks with pension accounting surpluses had valuation allowances, which would presumably be potentially exacerbated by the requirements of IFRIC 14.

Bank quarter-ends and year-ends are notoriously hectic and grueling periods. This will not be helped by the requirement to stop using an early measurement date and present the additional risk disclosures at the balance sheet date. However, the financial sophistication of the banks should place them in good stead to address these challenges relative to some other reporting entities.¹⁶

Like many other plan sponsors, the banks currently use, to a large extent, the dampening mechanisms available under CICA and FAS. It is interesting to note, however, that one of the required CICA

¹⁵ Statistics Canada [<http://www40.statcan.gc.ca/l01/cst01/econ41-eng.htm>]
Statistics Canada information is used with the permission of Statistics Canada. Users are forbidden to copy the data and re-disseminate them, in an original or modified form, for commercial purposes, without permission from Statistics Canada. Information on the availability of the wide range of data from Statistics Canada can be obtained from Statistics Canada's Regional Offices, its website at www.statcan.gc.ca, and its toll-free access number 1.800.263.1136.

¹⁶ On the other hand, smaller reporting entities in less regulated sectors and without parent company reporting requirements may have more time and flexibility to close their financial statements, whilst accommodating the expanded reporting requirements.

Table 2

CSM, where applicable	RBC	TD
Consolidated assets	723,859	563,214
Consolidated shareholders' equity	30,758	31,674
Consolidated total revenue	19,987	13,606
Consolidated net income	4,555	3,833
Non-Canadian principal subsidiaries in:	China, Australia, Caribbean, United States, Luxembourg, Singapore, The Netherlands, United Kingdom, Channel Islands, Ireland, Switzerland	United States, Bermuda, Caribbean, Hungary, United Kingdom, Ireland, The Netherlands, Australia, Japan, Singapore
Financial statement notes Future accounting changes - IFRS	The CICA has announced that Canadian GAAP for publicly accountable enterprises companies will be replaced with International Financial Reporting Standards (IFRS) over a transition period expected to end in 2011. We will begin reporting our financial statements in accordance with IFRS on Nov. 1, 2011. We have begun planning our transition to IFRS but the impact on our consolidated financial position and results of operations has not yet been determined.	The CICA Accounting Standards Board requires all Canadian publicly accountable enterprises to adopt International Financial Reporting Standards (IFRS) for years beginning on or after Jan. 1, 2011. The objective of the change is to move toward use of a single set of world-wide accounting standards, thereby facilitating and improving global capital flows, as well as improving financial reporting and transparency. The Bank will adopt IFRS for the fiscal year 2012 starting Nov. 1, 2011. The fiscal 2012 Consolidated Financial Statements will include comparative 2011 financial results under IFRS. Although much of Canadian GAAP is similar to IFRS, there are some GAAP differences that may significantly impact the Bank's processes and financial results.
		The Bank is currently in the planning phase of the conversion. This includes identifying the differences between existing Canadian GAAP and IFRS, identifying potential business impacts, developing the project plan, assessing resource requirements and providing training to staff. Over the next two years, the Bank will assess the implications of converting to IFRS, estimate the impact, implement the changes and perform work to ensure the accuracy of opening balances. It is currently not possible to fully determine the impact to the financial statements and any potential business impacts, as accounting standards and the interpretations of those standards are changing. The conversion to IFRS is a significant initiative for the Bank, for which substantial resources are being dedicated to ensure proper implementation.
Measurement date	September 30, 2008	July 31, 2008
Last funding valuation date	January 1, 2008	October 31, 2007
Next funding valuation date	January 1, 2009	October 31, 2008
FY2008 pension contributions	203	97
FY2008 OPEB contributions	43	8
Expected return on plan assets based on:	MRV - 3 year amortization of capital gains & losses	Fair value - no smoothing
Past service cost amortization	Over EARSL	Over EARSL
Gain or loss amortization	Over EARSL, no corridor	Over EARSL, 10% corridor
DB pension plan asset/(liability)		
■ Fair value of plan assets	5,826	2,138
■ Benefit obligation	(6,214)	(2,201)
■ Funded status	(388)	(63)
■ Unrecognized net actuarial loss	769	414
■ Unrecognized transitional (asset) obligation	(8)	
■ Unrecognized past service cost	62	64
■ Valuation allowance		
■ Post-measurement date contributions	14	29
■ Accrued benefit asset/(liability)	449	444
■ Weighted average discount rate	6.70%	6.30%

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BNS	BMO	CIBC
507,625	416,050	353,930
21,642	17,904	13,831
11,246	8,875	2,941
3,140	1,978	(2,060)
Malaysia, Caribbean, Costa Rica, Singapore, China, Ireland, Mexico, Chile, United States, El Salvador, United Kingdom, Peru	Brazil, United Kingdom, United States, Bermuda, Caribbean, Luxembourg, Ireland, China	United States, Caribbean, Ireland, United Kingdom, Singapore, Japan, Australia
In February 2008, the Canadian Accounting Standards Board (AcSB) confirmed that profit-oriented publicly accountable enterprises will be required to adopt International Financial Reporting Standards. IFRS will replace current Canadian GAAP for those enterprises. For the Bank, IFRS will be effective for interim and annual periods commencing Nov. 1, 2011, including the preparation and reporting of one year of comparative figures. The Bank is currently in the process of evaluating the impacts and implications from its conversion to IFRS.	Canadian public companies will be required to prepare their financial statements in accordance with International Financial Reporting Standards (IFRS), as issued by the International Accounting Standards Board, for financial years beginning on or after Jan. 1, 2011. Effective Nov. 1, 2011, we will adopt IFRS as the basis for preparing our consolidated financial statements. We will issue our financial results for the quarter ended Jan. 31, 2012 prepared on an IFRS basis. We will also provide comparative data on an IFRS basis, including an opening balance sheet as at Nov. 1, 2010.	In February 2008, the Accounting Standards Board of the CICA affirmed its intention to replace Canadian GAAP with IFRS. CIBC will adopt IFRS commencing Nov. 1, 2011, with comparatives for the year commencing Nov. 1, 2010. CIBC has initiated an IFRS transition project. At this point, it is too early to comment on the anticipated financial impact to the balance sheet and ongoing results of operation resulting from the transition to IFRS.
	In order to meet the requirement to transition to IFRS, we have established an enterprise-wide project and formed an executive steering committee. We are following a transition plan comprised of three phases: IFRS diagnostic assessment, implementation and education, and completion of all integration system and process changes. We are on track, having completed the diagnostic phase of our project, and we have entered the early stages of the implementation and education phase of our plan. Due to anticipated changes in International Accounting Standards prior to our transition to IFRS, we are not in a position to determine the impact on our financial results.	
July 31, 2008	October 31, 2008	September 30, 2008
November 1, 2006	October 31, 2008	October 31, 2007
November 1, 2009	October 31, 2011?	October 31, 2010
33	105	333
59	26	32
MRV - 3 year amortization of equity gains & losses	Fair value - no smoothing	MRV - 3 year amortization of actual vs expected MV differences
Over EARSL	Over EARSL	Over EARSL
Over EARSL, 10% corridor	Over EARSL, 10% corridor	Over EARSL, 10% corridor
5,537	3,476	3,794
(4,414)	(3,634)	(3,641)
1,123	(158)	153
318	1,129	877
(276)		
112	103	7
(179)		(19)
7		55
1,105	1,074	1,073
6.70%	7.30%	6.80%

Table 2

CSM, where applicable	RBC	TD
Pension plan asset allocation		
■ Equity securities	51%	57%
■ Alternative investments		8%
■ Debt securities	45%	32%
■ Other	4%	3%
DB pension plan expense		
■ Service cost	174	78
■ Interest cost	389	129
■ Expected return on plan assets	(438)	(150)
■ Amortization of net actuarial loss	103	14
■ Amortization of transitional (asset) obligation	(2)	
■ Amortization of past service cost	22	10
■ Change in valuation allowance		
■ Curtailment/settlement/SpecTerm impact		
■ Total expense	248	81
■ Weighted average discount rate	5.60%	5.68%
■ Weighted average expected asset return	7.00%	6.75%
■ DB pension expense incurred	496	301
■ Net change in funded status	517	301
OPEB plan asset/(liability)		
■ Fair value of plan assets	41	
■ Benefit obligation	(1,315)	(329)
■ Funded status	(1,274)	(329)
■ Unrecognized net actuarial loss	272	23
■ Unrecognized transitional (asset) obligation	1	
■ Unrecognized prior service cost	(283)	(48)
■ Post-measurement date contributions	3	2
■ Accrued benefit asset/(liability)	(1,281)	(352)
■ Weighted average discount rate	6.72%	6.30%
OPEB plan expense		
■ Service cost	16	12
■ Interest cost	83	23
■ Expected return on plan assets	(3)	
■ Amortization of net actuarial loss	29	5
■ Amortization of transitional (asset) obligation		
■ Amortization of prior service cost	(23)	(6)
■ Curtailment/settlement/SpecTerm impact		
■ Total expense	102	34
■ Weighted average discount rate	5.62%	5.60%
■ OPEB expense incurred	(159)	(58)
■ Net change in funded status	(133)	(58)

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BNS	BMO	CIBC
64%	45%	47%
		1
35%	44%	47%
1%	11%	5%
133	141	139
274	236	229
(396)	(298)	(272)
3	10	53
(39)		
11	14	2
10		
(1)		4
(5)	103	155
5.85%	5.60%	5.60%
7.25%	6.60%	6.80%
94	669	207
54	714	203
256	71	40
(1,040)	(705)	(694)
(784)	(634)	(654)
186	(41)	82
161		1
(6)	(38)	(170)
11		3
(432)	(713)	(738)
6.90%	7.30%	6.60%
40	19	15
66	51	41
(18)	(6)	(1)
12	12	7
18		
	(8)	(21)
		1
118	68	42
6.10%	5.50%	5.50%
7	(180)	(26)
30	(180)	(25)

disclosures is the DB expense incurred.¹⁷ This is very similar to the immediate recognition proposed under IFRS, with differences arising due to issues such as foreign exchange gains and losses, business acquisitions and special events (like curtailments). Table 3 summarizes the FY2008 DB pension expense recognized by the banks, the DB pension expense incurred as disclosed in the financial statement notes and the author's calculations of the change in DB plan funded status.¹⁸

Table 3

C\$M	RBC	TD	BNS	BMO	CIBC
Expense recognized	248	81	(5)	103	155
Expense incurred	496	301	94	669	207
Funded status change	517	301	54	714	203
Funded status change excluding gains on obligations	1,449	450	495	1,546	779
Net income	4,555	3,833	3,140	1,978	(2,060)

The investment losses incurred in FY2008 would have been offset to some extent by the actuarial gains on the obligations, triggered largely by increases in discount rates. Furthermore, banks using an early measurement date would not have reflected the full extent of the investment losses incurred up to their balance sheet dates.¹⁹ The author's research suggests that plans invested in asset classes similar to those of the bank plans might have earned average investment returns of 1 percent in August 2008 and negative 8 percent in each of September and October 2008.

The investment experience in 2008 may not have been typical. Nevertheless, whilst some of the banks may have reported, in management's discussion and analysis, on the sensitivity of the expected return on asset assumption adopted by management (using a change in rate of return of 1 percent, for example), Table 3 illustrates the potential volatility that mismatched investment performance can have on the financial results of plan sponsors. Had the 2008 market crash been unaccompanied by offsetting discount rate increases, Table 3 shows large potential increases in the DB pension expense amounting to over C\$1,400M or 70 percent of net income for the bank with the latest measurement date.

¹⁷ Paragraph 3461.154 (c)(i)—“each amount arising from events in the period, including the current service cost, any past service cost arising from a plan initiation or amendment in the period, the interest cost on the accrued benefit obligation, the actual return on plan assets, and actuarial gains and losses arising during the period on an accrued benefit obligation.”

¹⁸ Change in DB plan funded status is net of employer contributions, and is also presented excluding actuarial gains on obligations in FY2008.

¹⁹ Nor would they have reflected the higher discount rates that would have lowered DB pension obligations as at Oct. 31, 2008 relative to earlier measurement dates.

The next four charts illustrate the potential impact of the transition to IFRS for a broader group of plan sponsors²⁰ using the following metrics:

- Recognized pension expense (Chart 1) versus incurred pension expense (Chart 2) as a percentage of operating income, simulating the impact on the income statement of moving to immediate recognition as proposed under IFRS—the increase in the ratio using incurred expense is clear. It should be noted that the denominator is operating income (before minority interests and taxes) rather than net income as presented for the Big 5 banks in Table 2. CIBC is excluded given negative operating income in FY2008. Not all companies reported incurred pension expense. Hence Chart 2 includes slightly fewer companies than Chart 1, and also excludes fewer companies because of negative operating income.
- Pension balance sheet asset (Chart 3) versus pension unfunded liability (Chart 4) as a percentage of shareholders' equity, simulating the impact on the balance sheet of moving to immediate recognition as proposed under IFRS—the decrease in the ratio using the unfunded liability is also clear. It should be noted that the unfunded liability is presented as a positive quantity, so that a higher ratio using this metric indicates poorer funding.

The recognized pension expense shown in Chart 1 is the typical pension expense recorded under CICA and FAS (and to some extent IFRS, for entities that spread gains and losses). It consists of service cost plus interest cost less expected return on assets, adjusted for amortization of unrecognized (or net) balances. As mentioned above, the incurred pension expense shown in Chart 2 is very similar to the change in plan funded status proposed as the pension expense (net of employer contributions) under IFRS²¹—there is no equivalent under FAS.

The pension balance sheet asset shown in Chart 3 is the accrued benefit asset recorded on the balance sheet under CICA (net of any valuation allowance). The prepaid pension expense, which was the balance sheet measure under FAS (ignoring additional minimum liability issues) before FAS 158, is equivalent, both essentially representing the accumulation of the differences between employer contributions and the pension expense recorded. The pension unfunded liability shown in Chart 4 would become the balance sheet measure under IFRS after moving to immediate recognition. Since FAS 158, this plan funded status is one of the balance sheet measures under FAS, with net gains or losses, prior service costs and transitional balances being recognized via OCI also on the balance sheet.

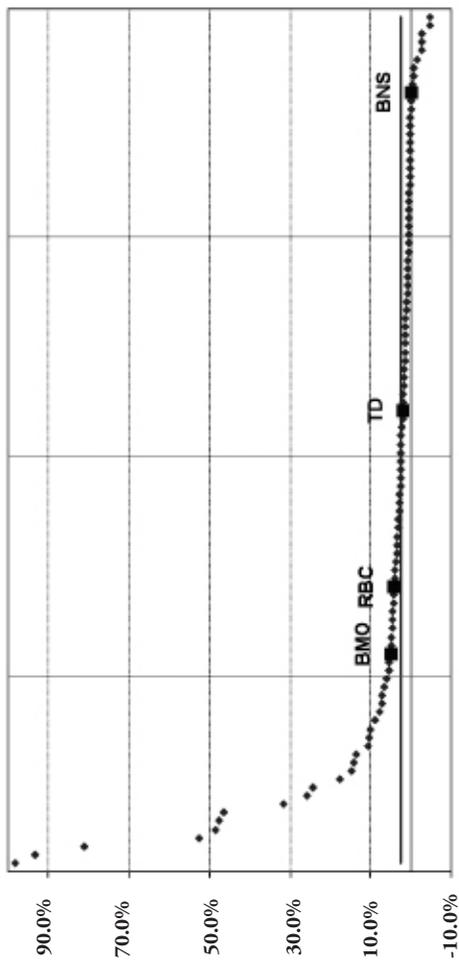
The terms “operating income” and “shareholders' equity” as used in the charts are based on current definitions/usages in the Canadian financial reporting context. Such definitions/usages may well change following the transition to IFRS, but that is beyond the scope of this paper.

²⁰ Based on Watson Wyatt's FY2008 Pension Finance Indicator (PFI) database, which contains financial information on the global pension and other post-employment plans of over 130 large Canadian companies, developed using publicly available information from corporate financial statements in Canada.

²¹ Immediate recognition of gains and losses in income or via SORIE/OCI are currently options under IFRS, though the former is not very popular.

Chart 1

Recognized Pension Expense / Operating Income



◆ All Companies ■ Financial Services (Banking) — Median — Quartiles

Financial Services (Banking)

Company	Ratio	Rank
Bank of Montreal	4.90%	29
Royal Bank of Canada	4.13%	37
Toronto-Dominion Bank	1.97%	58
Bank of Nova Scotia	-0.13%	96

Median-Entire Database

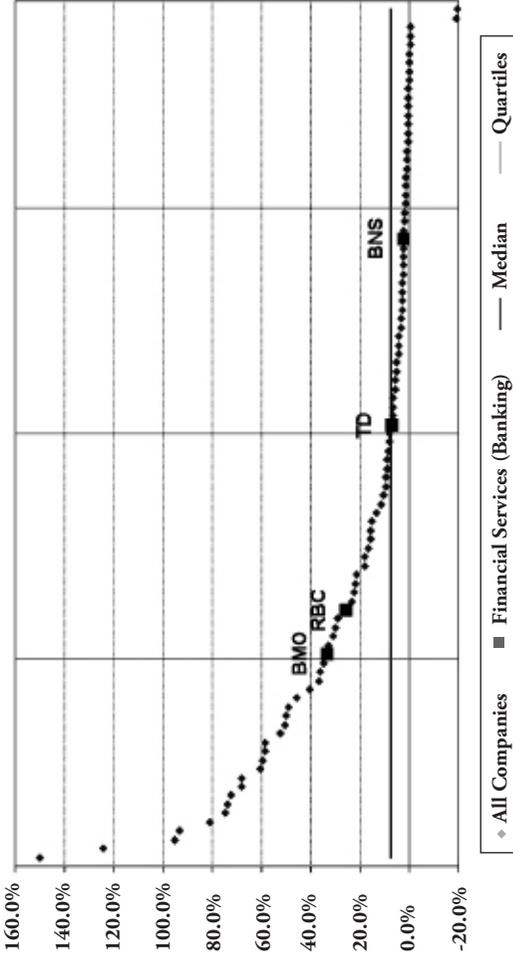
Category	Ratio	Rank
Median-Entire Database	2.42%	53
Median-Financial Services (Banking)	3.05%	

Notes:

29 companies with negative Operating Income excluded
 Not shown: 3 companies above 100.00%

Chart 2

Incurred Pension Expense / Operating Income



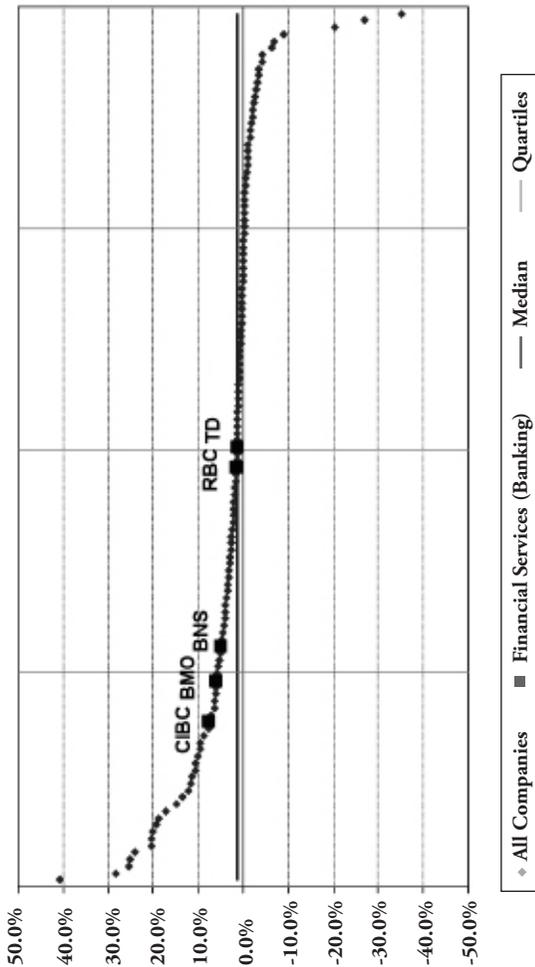
Financial Services (Banking)	Ratio	Rank
Bank of Montreal	33.47%	26
Royal Bank of Canada	25.70%	31
Toronto-Dominion Bank	7.33%	52
Bank of Nova Scotia	2.39%	73

Financial Services (Banking)	Ratio	Rank
Median-Entire Database	7.65%	51
Median-Financial Services (Banking)	16.51%	

Notes:
 23 companies with negative Operating Income excluded
 Not shown: 2 companies above 160.00% and three companies below -20.00%

Chart 3

Pension Balance Sheet Asset / Shareholders' Equity



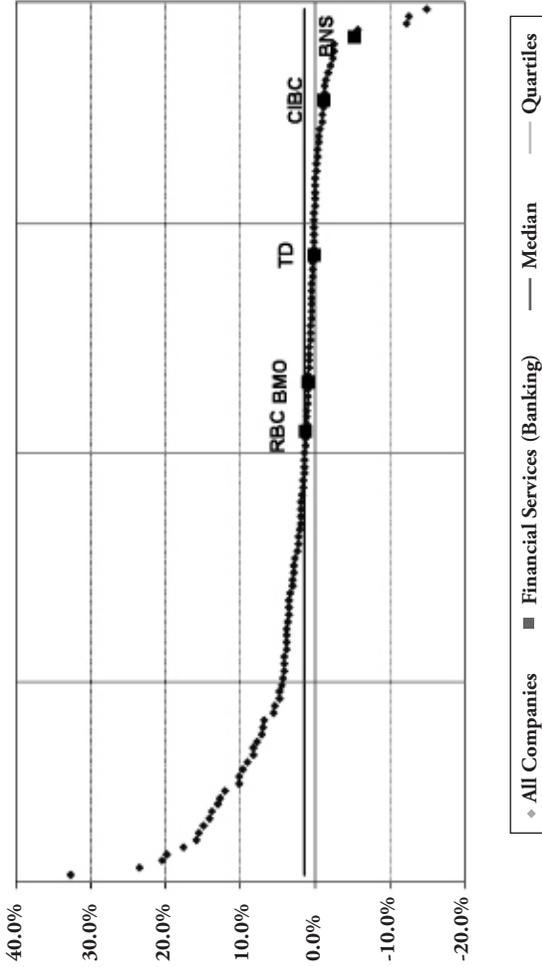
Financial Services (Banking)	Ratio	Rank
Canadian Imperial Bank of Commerce	7.76%	25
Bank of Montreal	6.00%	31
Bank of Nova Scotia	5.11%	36
Royal Bank of Canada	1.46%	62
Toronto-Dominion Bank	1.40%	65

Financial Services (Banking)	Ratio	Rank
Median-Entire Database	1.40%	65
Median-Financial Services (Banking)	5.11%	

Notes:

5 companies with negative Shareholder Equity excluded
 Not shown: 1 company above 50.00% and 1 company below -50.00%

Chart 4
Pension Unfunded Liability / Shareholders' Equity



Financial Services (Banking)	Ratio	Rank
Royal Bank of Canada	1.26%	68
Bank of Montreal	0.88%	75
Toronto-Dominion Bank	0.20 %	93
Canadian Imperial Bank of Commerce	-1.11%	115
Bank of Nova Scotia	-5.19%	124

Median-Entire Database	Ratio	Rank
Median-Financial Services (Banking)	1.35%	65
	0.20%	

Notes:
5 companies with negative Shareholder Equity excluded
Not shown: 4 companies above 40.00% and 2 companies below -20.00%

Table 2 earlier in this paper shows that the Big 5 banks have subsidiaries in a number of countries. From the author's experience in the Caribbean, it is known that there are subsidiaries of the Big 5 banks in that region that are publicly listed on local stock exchanges and that have to report under IFRS locally. A similar situation may exist for other subsidiaries of the Big 5 banks in other regions as well. Furthermore, four of the five reconcile their results to US GAAP in their annual reports. The Big 5 banks therefore have to contend with different accounting standards at present. Transition issues aside, there may be some appeal in having a consistent standard²² for all of their operations.

5. Conclusions

IFRS introduces global language for financial reporting, arguably with much to commend it from the perspectives of investors, regulators, rating agencies and other stakeholders in relation to transparency and related issues. However, from a pension/benefit plan perspective, the extent to which sponsors will show appetite for the resulting volatility²³ in a non-core area of their operations is unclear.

So far, it does not seem that the flight to defined contribution (DC) plans has been as intense in Canada as it has been in the United States,²⁴ the United Kingdom²⁵ and perhaps other countries. Of the 15 most profitable (including four of the Big 5 banks) of the 1,000 largest publicly traded Canadian corporations listed in *Report on Business* magazine's July/August 2009 issue,²⁶ at least 11 seem to offer DB plans to new employees.

A plan sponsor thinking about or having gone through the transition to IFRS might reasonably ask itself the following questions:

- Should our plan investment policy be changed in light of the requirement to recognize gains and losses immediately (albeit probably in OCI, as proposed in the 2010 Exposure Draft)?
- How can we manage funding deficits creeping onto our corporate balance sheet?
- What is our appetite to grant benefit improvements in light of the requirement to recognize past service costs immediately?
- Are we more inclined to freeze or wind up the plan in the absence of the historical curtailment/settlement impacts?

The author's own expectations, somewhat corroborated by discussions with plan sponsors, are that:

- There will be a stronger trend toward liability-driven investing, though sponsors will have to determine whether funding or accounting liabilities are the more appropriate benchmark to track.

²² The Roadmap of Convergence between IFRS and US GAAP would see the United States start moving to IFRS in 2014 for larger companies if certain milestones are met.

²³ Such volatility now centered largely on the balance sheet, the 2010 Exposure Draft having proposed the recognition of gains and losses in OCI rather than in the income statement.

²⁴ Based on a Watson Wyatt analysis [<http://www.watsonwyatt.com/us/news/press.asp?ID=21177>], starting in 2008, the majority of Fortune 100 companies were offering new salaried employees only a DC plan, such as a 401(k).

²⁵ Based on a recent Watson Wyatt survey [<http://www.watsonwyatt.com/news/press.asp?ID=22021>], around half of private sector DB schemes expect to close to existing members by 2012.

²⁶ <http://v1.theglobeandmail.com/v5/content/tp1000-2009/>.

- There is already very limited appetite to grant benefit improvements, especially in the private sector. This will not be helped by the impact of immediate recognition.
- Sponsors who were already considering a plan freeze or a wind-up may be more inclined to do so, absent the historical curtailment/settlement impacts. However, the fundamental considerations underlying such drastic actions will likely continue to be related to cost, risk, competitiveness and employee relations issues.

As a retirement actuary, I would like to hope that Canadian DB plan sponsors won't be fatally discouraged. Perhaps papers like this will not only ventilate the short-term transition impacts, but will also stimulate broader discussion of the merits of DB plans and how the underlying risks can be effectively managed in a new paradigm.

The author gratefully acknowledges the help of the following colleagues in preparing this paper: Kelin Nott (Toronto), who assisted with the generation of the charts presented herein; Matt Weaver (London), who provided technical review; and Ian Markham (Toronto), who provided broader peer review. However, the author is solely responsible for any errors persisting in this paper after such assistance.

Although a preliminary version of this paper was shared with the Big 5 banks, not all of them provided input on its contents.

In addition to the IASB's release of its long-awaited Exposure Draft on Proposed Changes to IAS 19 after the initial preparation of this paper (significantly changing the proposed recognition of gains and losses), the FY2009 annual reports of the Big 5 banks have also become available. Those annual reports have not been reviewed as it was not felt that they would fundamentally alter the main conclusions of this paper.

“Transition to IFRS in Canada from a Pension/ Benefits Perspective—Including a Look at the Big 5 Banks”

By Denis Dupont, FSA, FCIA

Thanks to the author’s timely initiative, we can clearly see the real impact that the transition to International Financial Reporting Standards (IFRS) will have on defined benefit (DB) pension and other postemployment benefit (OPEB) plans in Canada, one of the most challenging segments of financial reporting.

Geoffrey Melbourne presents primarily the Canadian reporting environment (CICA). The arguments and conclusions are readily applicable to the U.S. environment (FAS) when it completes its own convergence plans.

The paper is well-structured and researched. It starts with an efficient review of key differences between the current standard and the coming international standard (IFRS), discusses the upcoming changes to IFRS expected in 2013, and concludes with a numeric assessment of the transition impact for the five largest banks in Canada.

1. Sample of Five Banks

The selection of this group of plan sponsors was apparently made for convenience. Although these sponsors may be illustrative of large Canadian employers with large domestic DB pension plans, there is a sampling bias vis-à-vis the universe of all Canadian plan sponsors. When measured against income statement items such as operating income as was done in the paper, or against the sponsor’s balance sheet metrics such as shareholders’ equity, we would expect the sample variance of five large banks to underestimate the variance of all plan sponsors. In other words, given that the sample is composed of large stable institutions, we would expect stability and comparability within this group. We see instead a surprising range of results. Melbourne corrects the sampling bias by illustrating the metrics in charts where a broader sample of 130 organizations is shown. This glimpse into the distribution of outcomes shows frighteningly fat tails, which means that pension results may be very significant for some plan sponsors after the transition to IFRS.

Putting the pension results in the context of the sponsors’ financial results helps to assess the materiality of the pension plan results for the sponsor. Conclusions based on this sample should be interpreted cautiously.

2. Cash Contribution Context

The paper could have benefited from additional context in terms of cash costs.

As the year 2009 closes, we see continued weak investment performance combined with historically low bond yields. The funded status of DB pension plans has reached record lows in Canada. In addition, increases in longevity and reduced expectations of future investment returns have increased the cash costs of providing lifetime income at levels significantly higher than what was initially contemplated when the plans were established.

Actuaries have used and will continue to use professional judgment in advising plan sponsors on their funding requirements. But, provisions for adverse deviation and smoothing techniques could not contain the recent and current situation. More importantly, the solvency requirements in Canada force plan sponsors to fund their plan at a settlement rate and this has been the real driver for funding for several years now. The cash cost view is bleak for the vast majority of plan sponsors.

The IFRS transition occurs at an extraordinarily inopportune time: in the midst of a widely acknowledged funding crisis and secular trends to higher costs.

3. Pension Plan Accounting During this Crisis

Accounting policies currently employed by many plan sponsors are slowly recognizing higher costs and have in many instances significantly dampened the volatility of reported expenses. As Melbourne points out, the investment losses in FY2008 have been largely offset by gains on the liability side, triggered by the increase in discount rates in the third quarter of 2008. To be more precise, the increase was entirely driven by increases in corporate bond spreads to previously unseen levels, while government bond yields actually declined during the same period. With uncertainty and inconsistency over selection of a suitable discount rate, sponsors with similar pension plans have reported very different amounts, defeating the key objective of comparability.

As the global credit crisis subsides and the long-term corporate bond spread narrows, sponsors may report increases in accounting liability, revealing funding deficits and creating heavy losses for pension plans. The IFRS would not allow these losses to be deferred. All actuarial gains and losses must be recognized immediately either in the income statement or in other comprehensive income (OCI).

4. Impact of IFRS

Measuring and reporting at market values at a particular point in time can lead to short-term thinking as opposed to taking the longer-term view, which is the premise of pension plans.

This is where Melbourne's numerical research becomes very interesting. If the ultimate IFRS standards (those applicable in 2013 under the proposed rules) were in effect, if we remove the deferrals and smoothing of accounting costs, if we remove the distortion from the credit crisis, then the volatile nature of pension/benefit costs measured at market value becomes painfully clear.

Melbourne suggests that for FY2008 the recognized expenses would range from C\$450M to C\$1,449M instead of the C\$5 million income and C\$248 million expense actually reported. In relative terms, this is a five to 15 times larger expense and represents up to 70 percent of the sponsor's net income. These kinds of results can only bring sponsors to re-evaluate their pension policies at the most fundamental level. Although accounting has no direct impact on the cash costs of the plan, the increased volatility of the pension expense under IFRS may impede the sponsor's ability to access capital.

The paper concludes with suggested actions for plan sponsors, but the choices are tough: live with the volatility, reduce benefits, immunize the assets or settle the liabilities.

And, 2013 is only three years away.

“Transition to IFRS in Canada from a Pension/Benefit Perspective—Including a Look at the Big 5 Banks”

By Diana J. Scott, CPA

The author’s explanation of the transition from CICA 3461 to IAS 19 is very comprehensive and comprehensible. However, the release of the IASB’s Exposure Draft (ED) of proposed changes to IAS 19 diminishes the value of much of the analysis, which is always a risk when an article is written in anticipation of possible changes.

The author seems, in my view, to be unnecessarily concerned with the balance sheet volatility arising from immediate recognition of changes in a plan’s funded status. I would argue that putting the funded status on the balance sheet is essentially a non-event—analysts already adjust the balance sheet to reflect the funded status of the benefit plans. We saw this to be the case when companies following US GAAP adopted FAS 158 several years ago. And, it is hard to argue against the added transparency provided by reporting the plans’ funded status—rather than a relatively meaningless number (i.e., the difference between amounts expensed and amounts funded)—on the balance sheet.

The IASB’s proposal to recognize all remeasurement effects (primarily gains and losses, including asset returns in excess of the discount rate) through Other Comprehensive Income (OCI) generally results in reporting the components of cost with a more predictive value and over which the company has some control (service cost, past service cost and net interest income/expense) in profit and loss (P&L), and those with no real predictive value in OCI—again being responsive to the needs of the user of the financial statements.

I was surprised that Melbourne did not use the paper as an opportunity to discuss the merits of defined-benefit (DB) plans and how the implications of the proposed accounting can be effectively managed. He closes his paper by expressing a hope to stimulate that discussion, but left me wishing he had developed those points. One would think that after the recent economic downturn, employers wishing to retain or attract talented employees would be well-advised to provide some level of retirement benefit security through a DB pension plan. Although employers clearly face challenges dealing with increased regulatory requirements, the accounting implications need not create barriers if the investment risk and financial statement volatility can be managed.

For example, a discussion of strategies to mitigate the volatility of financial results that could result from plan changes would be worthwhile. This would also be a good forum to discuss investment strategies in light of the proposal to replace interest cost and expected return on plan assets with net interest income/expense, effectively assuming the plan assets will produce a return equal to the discount rate. In light of that proposal, some employers may be inclined towards liability-driven investment (LDI) strategies, while future P&L might actually be enhanced by investing in investments that are expected to produce higher returns.

But setting all that aside, this paper was well-done and is well worth reading.

Author's Response to Comments by Denis Dupont and Diana Scott

By Geoffrey Melbourne

I wish to thank Denis Dupont and Diana Scott for their constructive comments.

Preparing a paper on such a multi-faceted topic with broad editorial license requires the author to “pick his or her poison.” This paper sought to present both the academic and practical implications of the Canadian transition to International Financial Reporting Standards (IFRS) from a pension/benefit plan perspective.

I readily acknowledge that, as suggested by Dupont, convenience was a big motivator in my sample selection. Although this was done primarily for my own benefit, I suspect that many readers would also find the ability to drill down to be useful. Metrics for the broader group of plan sponsors show similar effects as for the limited sample, but obviously without much by way of individual detail.

Dupont rightly points out the heavy cash funding burden imposed by pension plans in recent times, so much so that temporary funding relief was found to be necessary across Canada. Of course, accounting standards do not alter the funding requirements, but the IFRS transition may amplify any concerns triggered by the funding crisis, especially as IFRIC 14 increases the likelihood of bringing funding deficits onto corporate balance sheets.

Scott wishes for an expansion of the teasers at the end of the paper on managing the risks imposed by Defined Benefit (DB) plans from an accounting perspective, bearing in mind their strong merits. The short answer is that it can safely be assumed that the author and various other stakeholders will be exploring those issues much further in other forums. It must be noted though that many plan sponsors, albeit to a lesser extent in Canada than in some other countries, as mentioned in the paper, have grown intolerant of the risks imposed by DB plans, however powerful their merits for attraction/retention of employees in societies with aging populations. Against the background of the recent market collapse, a round of accounting changes, especially with a few of the tentative decisions which thankfully have not made it to the exposure draft, would not necessarily help to endear these plans to their sponsors. On the contrary, the IFRS transition would provide a convenient and less painful exit for those sponsors ready to jump from the DB ship.

The exposure draft released after the initial preparation of the paper proposes a more lenient DB expense calculation, which may have resulted in a collective sigh of relief. On a personal note, the delay of the publication of the paper beyond the exposure draft release date did cause the author some unease. The final version of the paper seeks to highlight areas where the preliminary analysis has been superseded, rather than a more fulsome review of the exposure draft. Scott's suggestion of a discussion of the proposed new net interest income/expense calculation is worthy, but the issue is too hot off the press for the purposes of this paper.

It should not be assumed that all concerns about the IFRS transition have gone away with the release of the exposure draft. The absence of smoothing and early measurement, the impact of IFRIC 14, and the immediate recognition requirement (albeit in Other Comprehensive Income) will require fundamental changes to the approaches used by many plan sponsors. Interestingly, immediate recognition in OCI may placate to some extent stakeholders concerned about the level and volatility of reported earnings, but it retains all of the balance sheet effects which can be important for institutions operating in a fiduciary capacity and subject to capital adequacy standards, such as banks! On this note, Scott may well be correct that the analyst community has long been on top of this, but the financial industry bias towards deferred gain/loss recognition when Europe underwent the transition to IFRS in 2005 and the much more recent complaints from insurers in particular about the perils of mark-to-market accounting suggest that the issue is perceived to be non-trivial in other contexts.

