

MERCER



MARSH MERCER KROLL
GUY CARPENTER OLIVER WYMAN

1166 Avenue of the Americas
New York, NY 10036
212 345 7000 Fax 212 345 7414

www.mercer.com

April 14, 2009

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



LETTER OF COMMENT NO. 127

Sent via e-mail to commentletters@iasb.org

Subject: Preliminary Views on Financial Statement Presentation

Dear Sir:

On behalf of Mercer¹, we appreciate the opportunity to provide these comments on the discussion paper on *Financial Statement Presentation*. We applaud the joint FASB and IASB effort to provide financial statement users with more useful information about a reporting entity's activities. We are pleased to provide these comments and observations in our capacity as actuaries and preparers of financial statement information, particularly employee benefit plans, including pensions, other postretirement and other postemployment benefits.

We agree with the general principles outlined in the discussion paper, particularly with the idea that it is not possible to capture the richness and nuance of a business's activities in a single number. We encourage the boards to extend the cohesiveness and disaggregation principles to the other areas of financial reporting that were specifically excluded from the scope of this project, such as "earnings per share" or the treatment of other comprehensive income; we believe that critical reexamination of those areas in light of the new financial presentation framework will suggest that some of those items no longer fit in the new framework and should be dropped or significantly modified.²

Overall, we feel that the new presentation format has the potential to provide better and more useful information to investors and other providers of capital. And, since perceptions

¹ Mercer is a leading global provider of consulting, outsourcing and investment services, with more than 25,000 clients worldwide.

² We are grateful to the American Academy of Actuaries, whose draft comment letter we have relied on extensively for this paragraph and parts of our comments on Questions 1, 11 and 13.

MERCER



MARSH MERCER KROLL
GUY CARPENTER OLIVER WYMAN

Page 2
April 14, 2009
International Accounting Standards Board

often become reality, an improved presentation format may encourage clearer management thinking and fewer decisions that are based on engineering a particular reported result. We also recognize that *Financial Statement Presentation* is an ambitious project, and may require a considerable amount of work to educate users and preparers to think differently about the meaning and interpretation of financial statement terms.

Our response to selected questions follows.

Q1. Would the objectives of financial statement presentation proposed in paragraphs 2.5–2.13 improve the usefulness of the information provided in an entity’s financial statements and help users make better decisions in their capacity as capital providers? Why or why not? Should the boards consider any other objectives of financial statement presentation in addition to or instead of the objectives proposed in this discussion paper? If so, please describe and explain.

As noted above, overall we agree with the objectives of cohesiveness, disaggregation and liquidity/flexibility as outlined in the paper. In particular, we are attracted to the idea that a business’s activities can be tracked from one part of the financial statements to another and to disclosures that clarify amount, timing, and uncertainty of future cash flows.

However, while disaggregation can help convey the relative magnitude of certain vs. uncertain cash flows, properly communicating uncertainty will require disclosure of more than a single line item in the financial statements – investors need to know not only that a cash flow is uncertain, but also something about the degree of uncertainty or the range of likely outcomes. Modern financial statements include many elements of comprehensive income that depend on judgment, assumptions, or market fluctuations (described as *subjective comprehensive income* in Chapter 4), and all of these elements pose a risk of uncertainty in future cash flows. We suggest that additional disclosures might be required in the financial statements (either in the notes or on the face of the statements themselves) in cases where uncertainty is significant. Possible disclosures could include a description of potential material adverse deviations from expected results or an appropriately quantified range of likely future results.

What the principles make clear is that no single number or ratio can adequately explain the complexity and nuance of a modern, complex organization – and that investors are willing to expend the effort to fully understand the full range of a business’s activities. As discussed later in our response to Q6, this concept gives the boards an opportunity to fully extend the principles of cohesiveness and disaggregation into all aspects of the financial statements,

MERCER



MARSH MERCER KROLL
GUY CARPENTER OLIVER WYMAN

Page 3
April 14, 2009
International Accounting Standards Board

potentially eliminating certain single summary numbers or elements of comprehensive income that don't fit into the logic of the new framework.

Q2. Would the separation of business activities from financing activities provide information that is more decision-useful than that provided in the financial statement formats used today (see paragraph 2.19)? Why or why not?

Conceptually, we agree that separating business from financing activities makes sense; although the distinction between the two is not always as clear cut as the discussion paper seems to imply. For example, since cash is fungible, operations can be financed by some combination of borrowing from suppliers (accounts payable and operating?) and borrowing from money lenders (financing?). Economically, the company is in the same place either way, and it is not clear that an arbitrary distinction adds value to the analysis.

As another example, consider a company's decision to provide pension benefits to its employees (assuming, for the sake of argument, that the *Financial Statement Presentation* disaggregation principles have been applied to the accounting for pension benefits).

An employer pretty clearly incurs an operating cost when an employee earns a year of benefit accrual. The employer then faces a series of decisions:

- The cost can be fully settled with the employee via a cash outflow, as would happen with a defined contribution plan or a fully insured defined benefit plan, or
- The employer can commit to making a future payment, as would happen with a typical defined benefit plan. Then,
 - The employer can contribute cash to a trust or other financial instrument and the cash is then *invested*, or
 - The employer can accrue a liability on the books and use the cash elsewhere in the business – either as operational or investing capital, or as a reduction of *financing* needs.

One can read the discussion paper to imply that since the accumulation of pension accruals relates to operating activities, it should be considered “operating.” However, we believe that based on the above, a pension program has “financing” and potentially “investing” components as well.

Thus, the boards may need to either have more flexible definitions of the major categories, or do a significant amount of education in the preparer community to help them understand the rationale for the particular approach taken.

MERCER



MARSH MERCER KROLL
GUY CARPENTER OLIVER WYMAN

Page 4
April 14, 2009
International Accounting Standards Board

Q5. The proposed presentation model relies on a management approach to classification of assets and liabilities and the related changes in those items in the sections and categories in order to reflect the way an item is used within the entity or its reportable segment (see paragraphs 2.27, 2.34 and 2.39–2.41).

a. Would a management approach provide the most useful view of an entity to users of its financial statements?

b. Would the potential for reduced comparability of financial statements resulting from a management approach to classification outweigh the benefits of that approach? Why or why not?

In general, we favor the management approach; management's financial reporting should correspond to how the business is managed and how it is discussed with outside investors.

However, we suspect a significant amount of education and outreach to the preparer community may be necessary in some countries (for example, the United States where the accounting is at present "rules-based").

Having disclosures that properly communicate uncertainty might go a long way toward alleviating this issue.

Q6. Paragraph 2.27 proposes that both assets and liabilities should be presented in the business section and in the financing section of the statement of financial position. Would this change in presentation coupled with the separation of business and financing activities in the statements of comprehensive income and cash flows make it easier for users to calculate some key financial ratios for an entity's business activities or its financing activities? Why or why not?

Separating the financial statements as proposed should make it easier for users to calculate *relevant* financial ratios.

However, we strongly encourage the boards to eliminate those statistics – no matter how deeply embedded in the public consciousness – that are no longer relevant or truly *meaningful* in the new *Presentation* framework. For example, having made a persuasive case that different types of business activities should be measured and reported separately, the discussion paper nevertheless retains the current single summary notions of "profit and loss" or "earnings per share." As a single, aggregate number, each conveys less information – and less useful or potentially misleading information – than the new, separate display of financial information would provide.

MERCER



MARSH MERCER KROLL
GUY CARPENTER OLIVER WYMAN

Page 5
April 14, 2009
International Accounting Standards Board

Q9. Are the business section and the operating and investing categories within that section defined appropriately (see paragraphs 2.31–2.33 and 2.63–2.67)? Why or why not?
Q10. Are the financing section and the financing assets and financing liabilities categories within that section defined appropriately (see paragraphs 2.34 and 2.56–2.62)? Should the financing section be restricted to financial assets and financial liabilities as defined in IFRSs and US GAAP as proposed? Why or why not?

See our answer to Q2 regarding the definition of the categories.

As noted in the discussion paper, we encourage the boards to give some more consideration to the reporting of items that change functional categories between periods or are part of more than one functional category within a period. As indicated by the simple pension example in Q2, and the current discussions on improving IAS 19, pension plans could potentially have elements in all the major functional areas. As such, they make an excellent laboratory for testing the practical implementation of the *Financial Statement Presentation* ideas on a small scale, and we believe that it is useful to continue cross-fertilizing both sets of discussions and bringing them along in parallel.

Q11. Paragraph 3.2 proposes that an entity should present a classified statement of financial position (short-term and long-term subcategories for assets and liabilities) except when a presentation of assets and liabilities in order of liquidity provides information that is more relevant.
a. What types of entities would you expect not to present a classified statement of financial position? Why?
b. Should there be more guidance for distinguishing which entities should present a statement of financial position in order of liquidity? If so, what additional guidance is needed?

For some types of liabilities, the uncertain timing of cash flows often means that neither concept (short term vs. long term or order of liquidity) is useful. For example, whether an insurance claim will occur in the short term or the long term is often part of the insurance risk. Alternatively, with regard to liquidity, some insurance contracts can be, but rarely are, exchanged for cash on demand, for example, life insurance contracts that contain cash value provisions. For these types of situations, categorization by the type or nature of risk involved might provide more useful information.

Q13. Paragraph 3.19 proposes that an entity should present its similar assets and liabilities that are measured on different bases on separate lines in the statement of financial position. Would this disaggregation provide information that is more decision-useful than a presentation that permits line items to include similar assets and liabilities measured on different bases? Why or why not?

Disaggregation by type or degree of risk and uncertainty can provide information that is just as useful as separation by measurement basis. When the valuation of an item in the

MERCER



MARSH MERCER KROLL
GUY CARPENTER OLIVER WYMAN

Page 6
April 14, 2009
International Accounting Standards Board

statement of financial position is highly uncertain, the measurement basis can be less important than an understanding of the degree of uncertainty.

We encourage the boards to consider allowing preparers the flexibility to disclose this information in the notes to the financial statements rather than on the face of the statements themselves. Including this amount of detail on the face of the financial statements risks providing so much detail that it will obscure the overall picture.

Once again, we would like to thank both boards for the opportunity to comment. Please contact Warren Singer at either +44 20 7178 3423 or warren.singer@mercercor.com or me at either +1 212 345 7160 or wendy.mcfree@mercercor.com if you have any questions.

Yours faithfully,

A handwritten signature in cursive script, appearing to read 'Wendy E. McFee'.

Wendy E. McFee
Chair, Mercer Global Accounting Standards Group

Copy: Steve Alpert
Zainal Kassim
Warren Singer
Jim Verlautz