

IFRS in Focus

IASB amends accounting for post-employment benefits

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The Bottom Line

- The amendments require the recognition of changes in the defined benefit obligation and in plan assets when those changes occur, eliminating the corridor approach and accelerating the recognition of past service costs.
- Changes in the defined benefit obligation and plan assets are disaggregated into three components: service costs, net interest on the net defined benefit liabilities (assets) and remeasurements of the net defined benefit liabilities (assets).
- Net interest is calculated using a high quality corporate bond yield. This may be lower than the rate currently used to calculate the expected return on plan assets, resulting in a decrease in net income.
- The amendments are effective for annual periods beginning on or after 1 January 2013, with earlier application permitted.
- Retrospective application is required with certain exceptions.

Introduction

On 16 June 2011, the International Accounting Standards Board (IASB) issued amendments to IAS 19 *Employee Benefits* (2011) (the "amendments") that change the accounting for defined benefit plans and termination benefits.

The objective of this limited scope project was to improve the financial reporting of employee benefits by:

- reporting changes in defined benefit obligations and in the fair value of plan assets in a more understandable way;
- eliminating some presentation options currently allowed under IAS 19, thus improving comparability;
- clarifying requirements that have resulted in diverse practices; and
- improving disclosure about the risks arising from defined benefit plans.

For more information please see the following websites:

www.iasplus.com

www.deloitte.com

The Amendments

Elimination of the corridor approach

The most significant amendment will require an entity to recognise changes in defined benefit obligations and plan assets when they occur, thus eliminating the 'corridor approach' permitted under the previous version of IAS 19.

All actuarial gains and losses are to be recognised immediately through other comprehensive income (OCI) (the option to recognise actuarial gains and losses in profit or loss has also been removed) in order for the net pension asset or liability recognised in the statement of financial position to reflect the full value of the plan deficit or surplus.

Observation

On transition to the amended Standard, an entity currently using the corridor method may have to recognise a larger liability (or a smaller asset) in the statement of financial position, which could affect its compliance with debt covenants and impair its ability to pay dividends.

On an ongoing basis, there will be greater volatility in the statement of financial position and in OCI due to immediate recognition of actuarial gains and losses, but the profit or loss impact of amortising actuarial gains and losses will no longer occur.

Change in presentation approach

The amendments introduce a new approach for presenting changes in defined benefit obligations and plan assets in the statement of profit or loss and other comprehensive income. Entities will need to segregate changes in the defined benefit obligation and the fair value of plan assets into those associated with service costs, net interest on the net defined benefit liability (asset) and remeasurements.

Service cost component – recognised in profit or loss and includes current service cost, vested and unvested past service cost (together with gains and losses from curtailments) and gains or losses on settlements. The distinction between past service cost and curtailments in the previous version of IAS 19 is no longer necessary as both of these items are now recognised immediately.

Net interest component – net interest is recognised in profit or loss and is calculated by applying the discount rate by reference to market yields at the end of the reporting period on high quality corporate bonds (or government bonds when no deep market for bonds exists) to the net defined benefit liability or asset at the beginning of each reporting period. The difference between the actual return on plan assets and the change in plan assets resulting from the passage of time will be recognised in OCI as part of the remeasurement component.

Observation

In many cases, using the rate representing the market yields on high quality corporate bonds to calculate the net interest will reduce net profit or loss, since the net interest will not reflect the benefit from the expectation of higher returns on riskier investments.

Remeasurement component – recognised in OCI and comprises actuarial gains and losses on the defined benefit obligation, the actual return on plan assets net of the interest on plan assets included in the net interest component and any changes in the effect of the asset ceiling. Actuarial gains and losses include experience adjustments and the effects of changes in actuarial assumptions. Remeasurements are never reclassified to profit or loss but may be transferred within equity (e.g., to retained earnings).

Disclosures

The amendments set objectives to improve the understandability and usefulness of disclosures, allowing users of financial statements to evaluate better the financial effect of liabilities and assets arising from defined benefit plans. The objectives are to:

- explain the characteristics and related risks of defined benefit plans;
- identify and explain the amounts in the financial statements; and
- describe how defined benefit plans may affect the future cash flows.

To meet these objectives the amendments require an entity to provide additional disclosures:

- a narrative description of the risks that the entity judges to be significant or unusual (e.g., plan assets are invested primarily in single class of investments where a concentration risk arises);
- actuarial gains and losses arising from changes in demographic assumptions separately from those arising from changes in financial assumptions;
- the fair value of plan assets divided into classes that distinguish the nature and risks of those assets and subdivided into assets that do and do not have a quoted market price;
- significant actuarial assumptions used to determine defined benefit obligations;
- how a reasonably possible change to the significant actuarial assumptions would affect the defined benefit obligation (sensitivity analysis);
- a narrative description of asset-liability matching strategies such as annuities or longevity swaps; and
- the expected contribution for the next annual reporting period and the weighted average duration of the defined benefit obligations.

The amendments also add disclosure requirements on multi-employer defined benefit plans by requiring qualitative information about any agreed deficit or surplus allocation on wind-up of the plan, or the entity's withdrawal from the plan. If an entity accounts for a multi-employer defined benefit plan as if it were a defined contribution plan, disclosures of the level of participation in the plan and the expected contribution for the next reporting period are required.

Observation

Judgement will often be required to determine the significant actuarial assumptions to be disclosed, which actuarial assumptions have a material effect if they are changed and what is the range of reasonably possible change for the sensitivity analysis.

Other amendments

Classification of employee benefits

The amendments define short-term employee benefits as employee benefits that are "expected to be settled wholly before twelve months after the end of the annual reporting period" and other long-term benefits as all employee benefits other than short-term employee benefits, post-employment benefits and termination benefits.

Observation

The definition of a short-term benefit plan is modified to use "*expected to be settled wholly*" in place of currently used "*due to be settled*" in distinguishing short-term and long-term benefit plans. The modification may result in more plans being classified as long-term employee benefit plans that will need to be measured using actuarial assumptions.

Termination benefits

While there is no fundamental change in the definition of a termination benefit, the amendments provide additional guidance to assist in distinguishing between benefits payable in exchange for termination of employment and those payable in exchange for service. For example, if an entity makes an offer to an employee of benefits available for more than a short period, or there is more than a short period between the offer and the expected date of actual termination, the offer is less likely to be deemed a termination benefit.

To align the timing of recognising amounts resulting from plan amendments, curtailments, termination benefits and restructuring, the amendments require that:

- if a plan amendment is linked to a restructuring or termination benefit, the gain or loss should be recognised at the earlier of:
 - when the plan amendment or curtailment occurs; and
 - when the related restructuring costs or termination benefits are recognised.
- if a termination benefit is linked to a restructuring, the termination benefit should be recognised at the earlier of:
 - when the entity can no longer withdraw an offer of the benefits; or
 - when the related restructuring costs are recognised under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

All of these amounts are recognised at the same time if they are related to each other.

Other changes

The amendments also clarify a number of practical issues. For example, the amendments clarify that a settlement is a “transaction that eliminates all further legal or constructive obligations for part or all of the benefits provided under a defined benefit plan, other than a payment of benefits to, or on behalf of, employees that is set out in the terms of the plan and included in the actuarial assumptions”. Therefore, settlements that are recognised in profit or loss are limited to payments that are not in accordance with the terms of the plan. The amendments also clarify that only tax paid by the plan and costs related to the management of the assets are deducted from the return on plan assets.

Effective date and transition

The amendments are effective for annual periods beginning on or after 1 January 2013. Earlier application is permitted.

Retrospective application is required in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, with two exceptions:

- when benefits costs are included in the carrying amount of assets outside the scope of IAS 19 (e.g., inventories), these assets do not need to be adjusted on adoption; and
- in financial statements for periods beginning before 1 January 2014, comparative information does not need to be presented for the disclosures for the sensitivity of the defined benefit obligation.

Appendix – Illustrative example

An entity whose financial period ends on 31 December has a defined benefit plan. The table below provides information about the plan. Assume there are no actuarial gains or losses in prior periods and no contributions to the plan or benefits paid in 20X2. The average remaining life of the employees participating in the plan is assumed to be 10 years.

	1 January 20X2	31 December 20X2
Present value of defined benefit obligation	CU70	CU105
Fair value of plan assets	CU40	CU45
Net defined benefit liability	CU30	CU60
Service cost		CU15
Discount rate (high quality corporate bond yield)		2%
Expected rate of return on plan assets		4%

The following tables compare the effect on the entity's financial statements of applying each of the three accounting policies for recognition of actuarial gains and losses (immediately in profit or loss, immediately in OCI or deferral via the corridor method) under the previous version of IAS 19 with the effect of applying the revised Standard.

Statement of financial position at 31 December 20X2

(in CU)	Before the amendments			After the amendments
	P&L	OCI	Corridor	
Net defined benefit liability	60	60	44.8	60

Under the corridor approach, the actuarial loss of CU15.2 arising in the period is not recognised in the statement of financial position, but would begin to be recognised on a systematic basis in 20X3.

Statement of profit or loss and comprehensive income in 20X2

(in CU)	Before the amendments			After the amendments
	P&L	OCI	Corridor	
Net defined benefit liability	60	60	44.8	60
Service cost	15	15	15	15
Interest cost	1.4	1.4	1.4	–
Expected return on plan assets	(1.6)	(1.6)	(1.6)	–
Net interest	–	–	–	0.6
Actuarial gains and losses	15.2	–	–	–
Profit or Loss	30	14.8	14.8	15.6
OCI	–	15.2	–	14.4
Total comprehensive income	30	30	14.8	30

Under all three options under the previous version of IAS 19, CU15 of service cost, CU1.4 (2% of the CU70 obligation at 1 January 20X2) of interest cost and CU1.6 (4% of the CU40 plan assets at 1 January 20X2) of expected return on plan assets are recognised in profit or loss.

Under the amendments, the expected return on plan assets is no longer recognised. Instead, net interest, calculated to be CU0.6 (2% of the CU30 net defined benefit liability at 1 January 20X2), is recognised in profit or loss along with the service cost. Remeasurements calculated to be CU14.4 (CU18.6 of actuarial losses on the defined benefit obligations less CU4.2 of net return on plan assets) are recognised in OCI.

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