

Employee Benefits Working Group Meeting – 28 April 2009

Update on recent activities (Agenda paper 1)

After a short introduction by the chairman, who said that the IASB values the input given by the subject-related working groups, the IASB staff updated working group members on the latest project developments since the last meeting of the working group in [January 2009](#). During its [April Meeting](#), the IASB had decided that entities should recognize all changes in the value of plan assets and the change in the post-employment benefit obligation in the income statement in the period in which they occur, presenting the remeasurement component separately net of tax effects. Moreover, unvested past service cost should be recognized immediately in the period of a plan amendment. At present, the IASB intends to work out detailed proposals for disclosures, which will be discussed at the IASB meetings in June and July 2009. The publication of an Exposure Draft of amendments to IAS 19 is planned for November 2009.

When asked for their comments on the present state of affairs, a number of working group members criticized the IASB's decision to include future salary increased in the identification of back-end-loaded plans (para 3(c) of the Agenda Paper), as doing so would have a "catastrophic effect" on a large number of plans in their jurisdiction: The plans in question are defined contribution plans with a minimum guaranteed return, which are almost fully insured but would experience a very substantial increase in the recorded liabilities of many entities, which causes major concern for actuaries, preparers, users and regulators in this jurisdiction.

More generally, a number of working group members criticized the IASB's decision to mandate full recognition of all changes in the defined benefit obligation and plan assets in the income statement in the period in which they occur, particularly as they regarded the underlying measurement method (the "projected unit credit method") as flawed. Even though working group members agreed that measurement of defined benefit plans was a major issue, especially in the present financial crisis, some argued this should be addressed in a later stage of the project. Some members were concerned that the increased earnings volatility induced by abolishing the "corridor method" for deferring actuarial gains and losses, which in their view did not properly reflect the long-term nature of defined benefit pension plans, would lead to widespread closures of defined benefit schemes to further accrual in a number of jurisdictions and consequential curtailment gains. Two members pointed out that the abolition of the "corridor method" would create substantial problems for entities in their jurisdictions, particularly as measurement for accounting purposes interacts with measurement for (compulsory) funding purposes. However, other members pointed out that such deferral mechanisms themselves represented a major problem for the comparability of financial statements between entities.

One of the IASB Board members present indicated that the board would not go back on its decision to abolish the "corridor method", nor would it allow earnings smoothing by use of a different discount rate than the one presently required by IAS 19 (market yields at the reporting date of high quality corporate bonds). Some working group members had argued that requiring the use of a long-term risk free rate plus a risk spread of a certain (fixed) number of basis points would better reflect the long-term nature of the underlying liabilities. A number of working group members indicated their dissatisfaction with the Board's refusal to issue more guidance on determining the discount rate, pointing out that the lack of such guidance and the substantially increased volatility of "high-quality" corporate bond yields during the financial crisis had posed substantial problems for entities around the world in 2008, even though consequential decreases in pension liabilities to some extent helped to ease the pain of sharply declining plan asset values. One working group member pointed out that guidance on the determination of the discount rate should be required, together with sufficient disclosures to enable users to understand the determination process. By refusing to give such guidance, the IASB's measurement method for defined benefit plans was increasingly regarded as "irrelevant", even "bizarre" by users and regulators in some jurisdictions.

A number of working group members argued that if the corridor was abolished, the remeasurement component should be recognized in other comprehensive income (OCI) rather than profit or loss, pointing out that a lot of public support for the abolition of the “corridor” method in the comment letters had hinged upon the right presentation, which a majority of commentators had argued was in OCI. One participant remarked that it was irrelevant where components of pension expense were recognized as there would only be one statement of comprehensive income in the future (as proposed in the recent IASB discussion paper *Preliminary Views on Financial Statement Presentation*).

Disclosures – General (Agenda Paper 2)

As the major part of the meeting was intended to discuss various approaches to disclosures, the staff gave an overview of comments received concerning disclosures in the comment letters on the IASB’s discussion paper, as almost half of the respondents had discussed disclosure issues and a majority of respondents had commented that the Board should require additional disclosures to provide users with better information to help them understand the impact of liabilities and assets arising from post-employment benefit plans. In particular, commentators had argued for additional disclosures on mortality assumptions used, expected return on plan assets, sensitivity analyses of both plan liabilities and assets, as well disclosures about the risks associated with the post-employment benefit promises and the assets held to fund the benefits. Working Group members had been issued a questionnaire ahead of the meeting asking what they believed the objectives for post-employment benefits disclosures should be.

There was a lengthy discussion whether or not disclosures should be principles-based or rules-based. While a preparer representative argued that disclosure requirements should be principles-based and prescriptive requirements limited, so as not to overburden preparers, particularly as only a very limited number of users actually understood post-employment benefits disclosures, a representative of the actuarial profession rejected this argument as it would tempt preparers to disclose “as little as they can get away with” and hence jeopardize comparability. There seemed to be some support for the principles-based objectives published by the UK Accounting Standards Board in its Reporting Statement *Retirement Benefits – Disclosures*, which had been distributed to working group members ahead of the meeting (Agenda Paper 2E). A majority of the working group supported the notion that post-employment benefit plans give rise to a unique type of liabilities (together with an asset-liability linkage not found elsewhere in the financial statements) and special disclosures should be required to enable users to understand the risks (and rewards) associated with such assets and liabilities. As a consequence, a substantial part of the discussion revolved around how specific risks such as sensitivity, estimation and cash flow risks could be captured by appropriate disclosures. Some working group members regarded the disclosure objectives and requirements of *IFRS 7 Financial Instruments: Disclosures* as a good starting point for developing post-employment benefit disclosures, focusing both on the asset and liability side of defined benefit plans in order to enable users to understand the interaction between them.

Materiality (Agenda Paper 4):

The IASB Staff gave an overview of the problems currently encountered in terms of post-employment benefit disclosures and materiality: In practice, immaterial information may be disclosed because a standard (such as IAS 19) specifically requires it, while material information may not be disclosed as there is no specific requirement to do so. When asked what they perceived as the problem with materiality in relation to post-employment benefit disclosures, some members pointed out that, particularly in a litigation-prone environment, entities would never extend disclosures beyond the absolute minimum required by any standard, so as to avoid facing potential legal claims from investors and other third parties. Others warned that in such a situation, vital information might be lost to users if disclosure requirements were simplified. Some working members pointed out that present disclosure requirements and the lack of clarity of what “materiality” actually meant, have led to the degeneration of preparing and auditing financial statements into “Checking the boxes”, a problem that extended beyond pensions and was pervasive throughout all areas of financial reporting. Giving guidance on

materiality, possibly on a standard-by-standard basis and by using examples (rather than merely as a framework concept) might thus help preparers and auditors, particularly in litigation-prone environments, while one of the Board members present pointed out that to provide such guidance could run counter to accomplishing principles-based disclosure requirements. Some members remarked they would like the IASB to take on a project on the issue of materiality.

Defined Benefit Plan Asset Disclosures

Fair value disclosures (Agenda Paper 6)

Working Group members were given an overview of the Fair Value disclosures to be proposed in the forthcoming Exposure Draft *Fair Value Measurements* (Fair Value ED) by one of the IASB staff on that project. The Exposure draft will affect plan assets as described in IAS 19, because the standard requires them to be measured at Fair Value, even though measurement of the defined benefit obligation will not be affected by the ED. While the current disclosure requirements in IAS 19 will not be impacted by the Fair Value ED, consequential amendments (new disclosures) will be developed as part of the post-employment benefits project.

The working group members were asked whether or not they agreed with the disclosure requirements proposed by the Fair Value ED. Members of the working group argued that Fair Value was not the only relevant piece of information, but in some instances (particularly when derivatives are employed to hedge [parts of] the liability) information about the nominals and the market referred to were more important. Moreover, if Fair Value was defined as an exit value, this generally would not apply to post-employment benefits, as entities rarely intended to settle their liabilities by selling them to external parties (such as insurers) but by payment of benefits to the employees. Hence requiring extensive Fair Value disclosures would enhance costs to preparers at very little benefit to users. While some working group members viewed the proposed Fair Value hierarchy as useful and applicable to post-employment benefits, others expressed doubts about its relevance. It was also argued by some working group members that information about asset liquidity would be useful to users, as it would allow users to assess an entity's ability to cope with changing economic circumstances and to make benefit payments as they fell due. Most working group members agreed that disclosures should enable users to assess the risks associated with the pension plan. To that end, proposals coming from the working group included disclosing information about the asset-liability match in a pension plan, requiring information about the risk levels of plan assets and the risk correlation between plan assets and post-employment benefit liabilities.

Other plan asset disclosure issues (Agenda Paper 6a)

Working group members were asked whether they thought the present minimum categories of plan assets and the related disclosures in IAS 19 were appropriate, or if there was any particular category of plan assets which should be subject to further disclosures. Working group members reiterated the view that an entity should describe its asset-liability management and hedging of liabilities, alongside the geographical location of the plan(s) and the legal environment for investment decisions (for example if the entity's management or independent trustees were responsible for determining the investment strategy of a pension fund), as well as information about how investment decisions were taken, as this was regarded as useful information. One working member pointed out that such information would be better placed in the management discussion and analysis (MD&A) rather than the financial statements.

Some working group members were concerned that present requirements were too unspecific – for example many entities included “managed funds” in their plan asset disclosures without any further discussion as to how these funds were actually structured, what they were invested in or how investment decisions in such funds were taken. This, however, was regarded by many as a vital piece of information necessary to understand the risks of post-employment benefit plans and their financing. Again, the disclosures on financial instruments in IFRS 7 were seen as a good starting point to tackle this issue.

Risk Disclosures

General (Agenda Paper 7)

The working group discussed appropriate risk disclosures for defined benefit plans. Currently, to provide information about estimation risks, IAS 19 requires the disclosure of principal actuarial assumptions, which may include mortality rates. In particular, working group members were asked whether a sensitivity analysis, regulatory funding arrangements, restrictions on defined benefit assets and liabilities and asset-liability matching should be disclosed and whether there should be risk disclosures similar to those proposed in the IASB's Exposure Draft 10 Consolidated Financial Statements for unconsolidated structured entities.

A number of working group members argued that additional disclosures, especially about mortality assumptions (and how frequently these are updated) should be required, even though a member of the actuarial profession noted that mortality information was very difficult to assess by non-actuaries and that the use of standardized mortality tables could pose a problem if an entity's employee population differed from the average population used to generate the table. Another member proposed to require disclosures of assumptions often neglected hitherto, such as expected retirement age, withdrawal (turnover) rates, as the volatility of these assumptions may be material and therefore the defined benefit obligation was sensitive to changes in these assumptions, perhaps even on a similar scale as to changes in the discount rate or inflation rates.

Even though in practice preparers often argued against sensitivity analyses as they are costly to prepare, it became clear from the discussions that a large number of working group members would advocate requiring a sensitivity analysis of material actuarial assumptions. While most members agreed that a sensitivity analysis would assist users in a general risk assessment of defined benefit plans, one member argued this type of information would also have the advantage of giving analysts an indication how changes in certain variables (such as the discount rate) between the end of the reporting period and the date the financial statements were issued impacted on an entity's liability. It was also argued that sensitivity information reflected the fact that in measuring post-employment benefit obligations there generally was no one "right" figure but rather a range of possible outcomes. When the chairman asked for an indicative vote by show of hands, all except one member were in favour of requiring a sensitivity analysis. In terms of its format, working group members did not seem to be convinced that following a "through the eyes of management" approach, i.e. giving entities relative freedom relating to the assumptions they would or would not disclose, depending on whether or not these were reported to management internally, would be more useful than prescriptive requirements.

Regulatory Disclosures

As many different funding arrangements in practice could impose hugely different burdens on companies, some working group members (particularly those from jurisdictions where funding is compulsory) noted that disclosing funding requirements was necessary to understand the cash-flow risk exposure of the entity. Staff pointed out that these disclosures should already be made under the "general disclosures about the nature of the plan" which are required under current IAS 19, even though this did not seem to be the case in practice. When asked whether there were any other regulatory disclosure requirements they would like to see, some working group members noted that information about foreign plans with restrictions on the recoverability of pension surpluses and the nature of such restrictions should be disclosed, as well as information about an entity's inability to control an pension funds' investment strategy.

Alternative presentation of risks (Agenda Paper 7a)

The working group discussed alternative risk disclosures for defined benefit plans, as the marketplace has developed various types of risk disclosures for pensions (such as ratios, graphs and fan charts that

illustrate the security, affordability, fluctuation and expenditure relating to an entity's pension plan). Some observers claim such disclosures better assess the risk arising from pensions than the information currently provided in the financial statements. The working group members were asked whether they thought such disclosures were useful or whether they thought there were any other disclosures that would provide similar information. Some working group members supported such graphical trend disclosures, as this would make risk information easier to digest for users, but there did not seem to be widespread support for including such measures in the financial statements, in addition to current requirements.

Multi-Employer plan disclosures (Agenda Paper 8)

The working group members were given an overview of current disclosure requirements for multi-employer plans under IAS 19 and were asked whether they thought these were adequate, particularly in the context of entity's using the exemption of IAS 19.30. Moreover, working group members were asked whether they thought **all** entities participating in a multi-employer plan should provide disclosures about the risks associated with that participation or these disclosures should be restricted to a limited number of entities (entities for which the risk is significant or material or entities that use the exemption of IAS 19.30).

There was a short debate during, during which one of the working group members noted that even though in his jurisdiction about 80 per cent of employees were covered by multi-employer plans, there was very little actual disclosure by their employers, as the exemption of IAS 19.30 was widely used, which was confirmed by the regulator representative from the same jurisdiction. There seemed to be widespread but not unanimous agreement that even though the current requirements in IAS 19 were adequate for such plans, compliance with them was not. In answering a questionnaire distributed to the working group in the lead up to this meeting, a number of members had argued the contribution levels, the method to calculate participants' rate of contribution, the existence of minimum funding requirements, the percentage of total contributions to the plan as well as future contribution targets should be disclosed in order to assess future cash-flow requirements of the plan and hence the risk exposure of the sponsoring employer.

Aggregation/Disaggregation (Agenda Paper 5):

The working group discussed whether it was appropriate to mandate a level for the disclosure of disaggregated information, for entities with more than one defined benefit plan (multi-national entities), what criteria should be applied for disaggregation and what type of information should be disclosed on a disaggregated basis. There are different views on how an entity could or should disaggregate those disclosures. The options are:

- Presentation on a "through the eyes of management approach" consistent with IFRS 8
- Disaggregation based on the risk profiles of the defined benefit plans
- Disaggregation based on the geographical location of the defined benefit plan.
- Other specified criteria

While information based on different risk profiles (such as funded vs. unfunded plans, post-employment benefits vs. medical benefits, or jurisdiction-by-jurisdiction) was supported by some, a disaggregation by business segment was not seen as to provide useful information, as plan requirements and regulations often depended on the jurisdiction in which the plan was set. One member proposed to require disaggregated information for a group's major subsidiaries (i.e. plan-by-plan) based on their materiality.

Any other business / Outlook

None of the working group members had any other business, hence the staff gave a brief summary of the meeting and outlined the further steps to be taken in this project. In particular, the staff intend to discuss the disclosure requirements with the Board during the summer months with the aim of

publishing an Exposure Draft towards the end of 2009 followed by a comment phase. Post-employment benefit promises classified as “contribution-based” in the discussion paper will be addressed subsequent to this publication. The staff remarked that it would remain to be seen whether or not this deadline could be met, as there were different opinions among IASB Board members about various topics relating to post-employment benefits at present. The chairman concluded the meeting by thanking the working group members for taking the time and for assisting the Board in moving the project forward. No indication about potential future meetings of the working group was given.

This summary is based on notes taken by observers at the Employee Benefits Working Group meeting and should not be regarded as an official or final summary.