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IFRS Project Insights

Post-employment Benefits

15 February 2011

The objective of this project is to review all aspects of accounting for post-employment benefits. The project is divided into:

- a short-term project addressing the recognition and presentation of changes in defined obligations, plan assets and disclosures; and
- a comprehensive review of pension accounting, including contribution-based promises.

The IASB published ED/2010/3 (ED) *Defined Benefit Plans – Proposed amendments to IAS 19* for comment in April 2010.

The IASB began its redeliberations in September 2010 and plans to publish the final amendments on 31 March 2011. The amendments to IAS 19 relating to termination benefits will be published with the amendments arising from the ED, as a complete package of amendments to IAS 19.

At the November 2010 meeting, the IASB discussed the presentation of service cost and finance cost components, classification of post-employment benefits and financial statement disclosures, and made the following tentative decisions:

- require service cost and finance cost components to be presented in profit or loss, without specifying where in profit or loss they should be presented;
- permit a choice of presenting the remeasurement component either in profit or loss or in other comprehensive income (OCI);
- require service cost, finance cost and remeasurement components to be presented in the statement of comprehensive income unless another Standard requires or permits the capitalisation as part of the cost of an asset;
- prohibit subsequent reclassification (recycling) of the remeasurement component from OCI to profit or loss;
- permit, but not require the transfer of cumulative amounts recognised in OCI within equity;
- retain the existing classifications of post-employment and other long-term employment benefits in IAS 19;
- require the classification of short-term employment benefits be based on when the whole of the amounts resulting from that type of benefit are expected to be settled and the classification should be revisited if the benefit no longer meets the definition of a short-term employee benefit; and
- retain the disclosure objectives proposed in the ED but clarifying that information should be aggregated or disaggregated so that it remains useful and relevant (consistent with paragraph 70 of the Revenue Recognition ED).

The IASB reconsidered the detailed disclosure requirements in the ED and tentatively decided to eliminate some of those disclosures. The IASB also identified other possible disclosures that may be included in the final standard. However, the IASB agreed to discuss the proposed disclosures with the Employee Benefit Working Group (EBWG) and potentially have the disclosures field tested before making a final decision.

At the 13 December 2010 meeting, the Board discussed issues relating to settlements and curtailments, multi-employer plans and other matters addressed in the ED or arising from the comment letters to the ED and made the following tentative decisions:

Settlements and curtailments

The Board tentatively decided:

- to amend the definition of curtailment to limit it to a significant reduction in the number of employees covered by a plan. The definition would not include a reduction in benefits for future service but would acknowledge that past service cost sometimes arises if a change in benefits for future service results in a change in benefits attributed to past service;

- to amend the definition of settlements to exclude plan amendments that result in past service cost and curtailments;
- to amend the definition of non-routine settlements to exclude benefit payments on the basis of the terms of the plan;
- to require past service cost and gains and losses on curtailments and non-routine settlements to be presented in the service cost component;
- to require gains and losses on routine settlements to be presented in the remeasurements component; and
- to confirm the proposals relating to the disclosure of past service cost, curtailments and non-routine settlements but not require distinguishing between these items if they occur together and are presented in the same component.

Multi-employer plans

The Board tentatively decided:

- to retain the requirement in IAS 19 that an entity should account for its participation in a defined benefit multi-employer plan in the same way as for any other defined benefit plan unless there is insufficient information, then it would be accounted for as if it were a defined contribution plan;
- to confirm the disclosure requirements proposed for multi-employer plans, with the exception of limiting the disclosure of the withdrawal liability to qualitative information and to specify that an entity should recognise and measure any withdrawal liability in accordance with IAS 37; and
- to confirm the disclosures proposed in the ED for multi employer plans treated as if they were defined contribution plans with the following amendments:
  - to reduce the period for the required disclosure of future contributions from 5 years to 1 year.
  - to require an indication of an entity's level of participation in a plan which could be met by disclosing the proportion of total members or the proportion of total contributions.

Other issues

The Board tentatively decided:

- to require plan administration costs to be expensed as incurred (the staff will seek feedback on this decision from the Employee Benefits Working Group).
- to confirm the proposals for the accounting for taxes payable by the plan.
- to confirm the proposed clarification that mortality assumptions include current estimates of expected changes in mortality.
- not to incorporate IFRIC 14 into IAS 19.
- not to require entities to consider expected future salary increases in determining whether a benefit formula allocates a materially higher level of benefit in later years.
- not to make any additional amendments regarding interim reporting.
- to confirm the proposal in the ED to update the disclosures:
  - for defined benefit state plans to be consistent with the disclosures for defined benefit multi-employer plans if the information for the state plans is available.
  - for group plans to be consistent with the disclosures for defined benefit plans, and for group plans to allow the information to be included by cross-reference to disclosures in the parent's financial statements if:
    - the parent's financial statements separately identify and disclose the information required for the group plan, and
    - the parent's financial statements are available to users of the financial statements on the same terms as the financial statements of the entity and at the same time

Additionally, as proposed in the ED, actuarial gains and losses would no longer be affected by the expected rate of return on plan assets.

At the 21 January 2011 meeting, the Board tentatively decided the following:

- Entities would be permitted a one-time, irrevocable election on a plan-by-plan basis to present the remeasurement component in profit or loss rather than the default presentation of other comprehensive income. This election could be made either at inception of the plan or at anytime going forward; however, once the election to present in profit or loss has been made, there would be no ability to change the election. Entities would need to disclose the use of the election as well as information on the reason for making the election (this tentative decision was reversed at the 15 February 2011 IASB Meeting).
- If a curtailment or plan amendment is linked to a restructuring or termination benefit, the gain or loss should be recognised when the related restructuring costs or termination benefits are recognised. Otherwise, the gain or loss should be recognised when the curtailment or plan amendment occurs.
- If termination benefits are part of the detailed plan or restructuring, they should be recognised when the related restructuring costs are recognised if that is earlier. Otherwise, termination benefits should be recognised when the entity can no longer withdraw the offer of the benefits.
- A settlement should be recognised when it occurs.

At the 2 February 2011 meeting, the Board first discussed the timeline for the project. The staff indicated that a final standard would be issued on 31 March 2011. The Board then discussed the comments received on the ED relating to accounting for risk sharing features. The Board tentatively decided the following:

- to clarify that for a plan to be classified as a defined benefit plan, a benefit formula needs to give rise to a legal or constructive obligation that may require the employer to pay additional contributions as a result of current or past service costs.
- to provide no further guidance for determining whether an input into the calculation of the defined benefit obligation defines part of the terms of the benefit or is part of the actuarial assumptions (this determination requires judgement).
- to clarify that the benefit to be attributed in accordance with paragraph 67 of IAS 19 is the benefit net of the effect of employee contributions.
- to confirm the proposal that the effect of employee contributions should be deducted in determining the defined benefit obligation but withdraw the proposal that the effect of employee contributions should be presented as a reduction in service cost (presentation of the defined benefit costs net of any effect of employee contributions is addressed by the general disaggregation and presentation principles for defined benefit costs).
- to clarify that the assumptions used to estimate conditional indexation or changes in benefits should:
    - be reflected in the measurement of the obligation regardless of whether the indexation or changes in benefits are automatic or are subject to a decision by the employer, by the employee, or by a third party such as trustees or administrators of the plan, and
    - be mutually compatible with the other assumptions used to determine the defined benefit obligation.
- to clarify that limits on the legal and constructive obligation to pay additional contributions should be included in the calculation of the defined benefit obligation.

At the 15 February 2011 meeting, the IASB tentatively decided the following:

- to confirm the proposal in the exposure draft that the remeasurement component should be presented in Other Comprehensive Income (OCI) and therefore reversing the IASB's previous tentative decision from the 21 January 2011 meeting that would have allowed for an irrevocable election on a plan-by-plan basis to present the remeasurement component in profit or loss or OCI.
- the disclosure of risks that the participation in a defined benefit plan exposes an entity to should focus on those risks that are unusual or specific to the entity without requiring excessive detail about generic risks.

- to require, at a minimum, disaggregation of the defined benefit obligation when an actuarial valuation is performed and this information should be carried forward to periods where no actuarial valuation is performed.
- to require, at a minimum, the disclosure of the duration of the defined benefit obligation.
- costs related to managing plan assets should be deducted from the return on plan assets with no specific requirements for the presentation of other administration costs.
- the required effective date of the amendments will be no earlier than 1 January 2013.
- to confirm the following transition requirements:
    - for entities already applying IFRSs, the amendments to IAS 19 should be applied retrospectively in accordance with the general requirements of IAS 8, except that:
        - the carrying amount of assets outside the scope of IAS 19 need not be adjusted for changes in employee benefit costs that were included in the carrying amount before the beginning of the financial year in which this amendment; and
        - comparatives need not be presented for the disclosures for the sensitivity of the defined benefit obligation for the year of initial application of the amendments to IAS 19.
    - for entities adopting IFRSs for the first time, the amendments to IAS 19 should be applied retrospectively in accordance with the general requirements of IFRS 1, except that:
        - a temporary exemption for entities adopting IFRSs with a date of transition before the effective date of the amendments to IAS 19 that comparatives need not be presented for the disclosures for the sensitivity of the defined benefit obligation.
- the required effective date, early adoption and certain transition requirements will be decided at a future meeting as part of the Board's broader consideration of the feedback received from the Request for Views on effective dates and transition.

Summary of proposals in the Exposure Draft

Elimination of the corridor approach

The option to defer a portion of actuarial gains and losses that fall outside a specified corridor (being the greater of 10% of the defined benefit obligation (DBO) or 10% of the fair value of plan assets) would be eliminated.

All actuarial gains and losses would be recognised immediately in other comprehensive income (OCI).

The net pension asset or liability recognised in the statement of financial position would reflect the full amount of the overfunded or underfunded status of the benefit plans.

The option to recognise actuarial gains and losses in profit or loss would be eliminated.

Presentation of changes in the defined benefit obligation and fair value of plan assets

Changes in the DBO and fair value of plan assets would be segregated between service costs, finance costs and remeasurements.

- Service costs would be recognised in profit or loss. Curtailments and past service costs resulting from plan amendments would be recognised as costs of the period in which the plan amendment takes place, regardless of whether the related benefits are vested.
- Net interest expense would be presented as part of financing cost in profit or loss (currently, the presentation of interest expense within profit or loss is an accounting policy choice). Further, net interest income or expense would measure the expected change in the surplus or deficit due to the time value of money (the finance cost component would not include the part of the return on plan assets that does not arise from the passage of time). Net interest expense would be calculated by applying a single high quality corporate bonds discount rate to the net defined benefit liability or asset. The difference between the actual return on plan assets and the change in plan assets resulting from the passage of time would be recognised in OCI as a remeasurement component.
- Remeasurement components would be recognised as part of OCI.

- Actuarial gains and losses: these would include experience adjustments and the effects of changes in actuarial assumptions on the defined benefit obligation, i.e. those actuarial gains and losses related to the costs of providing the benefits. Actuarial gains and losses would no longer be affected by the expected rate of return on plan assets.
- Return of plan assets (net of the time value of money): this amount would include income earned from the plan assets as well as realised and unrealised gains or losses on these assets and would be reduced by the net interest expense recognised as a financing cost in profit or loss and by costs incurred to manage the plan assets.
- Gains/losses on non-routine settlements: whether routine or non-routine, gains and losses on settlement represent experience adjustments (the difference between the defined benefit obligation and the actual settlement price). Accordingly, all settlement gains and losses are recognised in OCI. To the extent that the gain or loss arises on a non-routine settlement, the ED proposes that it should be presented as a separate element of the remeasurement component (gains/losses on routine settlements would be presented as part of actuarial gains and losses).
- Changes in the limitation in recognition of net defined benefit asset: an entity with a plan surplus would continue to measure the net defined benefit asset at the lower of the surplus in the defined benefit plan and the present value of any refunds from the plan or reduction in future contributions to the plan.

Reclassification of amounts recognised in OCI to profit or loss would not be permitted, although an entity would be permitted to transfer cumulative amounts in OCI within equity.

Other proposed changes

The existing classification of employee benefits in IAS 19, between post-employment benefits and other long-term benefits, would be retained.

Classification of short-term benefits would be restricted to plans that are expected to be settled within 12 months after the end of the reporting period in which the related services have been rendered and before the completion of employment.

Only costs relating to the management of plan assets would be presented as a reduction of the return on plan assets. To the extent that future administration costs relate to the administration of benefits attributable to current or past service, the present value of the defined benefit obligation should include these costs.

Guidance from IFRIC 14 on the limit on a defined benefit asset and minimum funding requirements has been incorporated in the ED.

Disclosures

Proposed disclosure requirements include quantitative information on actuarial assumptions including separate disclosure of actuarial gains and losses arising from changes in demographic and financial assumptions and sensitivity analyses about actuarial assumptions used.

Narrative information on risks associated with defined benefit plans and the investment strategy for the plan assets, including factors that could cause contributions over the next 5 years to differ from current service cost would also need to be disclosed.

Entities involved in multi-employer plans would be required to present significantly more information than at present.

Termination benefits

Termination benefits to encourage employees to leave service voluntarily (voluntary termination benefits) would be recognised when employees accept the entity's offer of those benefits.

Termination benefits provided as a result of an entity terminating employment (involuntary termination benefits) would be recognised when the entity has communicated its plan of termination to the affected employees and the plan meets specified criteria, unless the involuntary termination benefits are provided in exchange for employees' future services (i.e. in substance they are a 'stay bonus'). In such cases, the liability for those benefits would be recognised over the period of the future service.

Thinking ahead

- The smoothing effect of the corridor approach would be eliminated. All actuarial gains and losses would be recognised immediately through OCI and the net pension asset or liability recognised in the statement of financial position would reflect the full amount of the overfunded or underfunded status of the benefit plans. Volatility will increase in OCI. Entities may need to review their debt covenants and performance metrics and discuss the potential affect of the changes with analysts.
- In many cases, using the rate representing the market yields on high quality corporate bonds could reduce net income, since net income would not reflect the benefit from the expectation of higher returns on riskier investments. Some entities believe that this could encourage more conservative investing which could then lead to a higher cost of providing the associated benefits.
- Entities would need to consider how to gather the necessary information to prepare the proposed disclosures. Some entities may require the assistance of actuaries.
- The classification between short-term and long-term benefits based on the expected settlement date rather than the date the obligation becomes due, as is currently required in IAS 19, may result in more plans being classified as long-term employee benefit plans (that is more plans that would need to be measured using actuarial assumptions and accounted for using the projected unit credit method).

Next steps

The final amendments are expected to be issued on 31 March 2011.