

INTERNATIONAL FINANCIAL REPORTING BULLETIN 2011/09 AMENDMENT TO IAS 19: *EMPLOYEE BENEFITS*



Background

The International Accounting Standards Board (IASB) has amended IAS 19 *Employee Benefits* (IAS 19 (2011)). The main changes relate to defined benefit plans. Changes have also been made to the requirements for other long-term employee benefits and to termination benefits.

The most significant amendment requires entities to recognise all changes in the defined benefit obligations and in the fair value of related plan assets when those changes occur. This eliminates the 'corridor' approach which permitted entities to leave actuarial gains and losses unrecognised if they were within a corridor (being the greater of 10 per cent of the plan assets and 10 per cent of the plan liabilities) and to defer recognition of actuarial gains and losses outside of that corridor.

A presentation amendment requires an entity to split the changes in the net defined benefit liability (asset) into three components, to be presented as follows:

- (i) Service cost – presented in profit or loss
- (ii) Net interest on the net defined benefit liability (asset) – presented in profit or loss; and
- (iii) Remeasurement of the net defined benefit liability (asset) – presented in other comprehensive income (OCI) and not recycled through profit or loss.

Entities may also see a reduction in reported profit as a result of removing the expected return on plan assets from profit or loss.

Past service cost (both vested and unvested) is recognised in profit or loss as part of the service cost in the period of the plan amendment. Previously, IAS 19 required unvested past service cost to be recognised over the vesting period.

Enhanced disclosures are required with a focus on the following specified objectives:

- (a) The characteristics of an entity's defined benefit plans and the amounts in the financial statements that result from those plans.
- (b) Risks arising from defined benefit plans, including a sensitivity analysis for each significant actuarial assumption.
- (c) Participation in multi-employer plans.

Transitional provisions apply such that the carrying amount of assets outside the scope of IAS 19 (e.g. property, plant and equipment or inventory) need not be adjusted for changes in employee benefit costs that were included in their carrying amount, and the sensitivity analysis does not need to be created retrospectively.

Action Required

IAS 19 (2011) makes significant changes in the accounting by employers for pensions and other post-employment benefits. Management will need to understand the requirements and consider the implications on the financial position, performance and reporting at an early stage. Entities that previously used the 'corridor' method can now expect greater volatility in OCI and the statement of financial position. Entities should also consider whether potential changes in reported performance or position affect agreements such as loan covenants, earn-outs or profit related pay.

STATUS

Final

EFFECTIVE DATE

Annual periods beginning on/after 1 January 2013, with earlier application permitted. Transitional provisions available.

ACCOUNTING IMPACT

Significant changes to measurement and presentation in accounting for defined benefit plans.

Requirements

Scope

The scope is unchanged. Employers should apply the revised IAS 19 in accounting for all employee benefits except those to which IFRS 2 applies.

Definitions

Many of the current definitions have remained unchanged. However, there are some minor amendments, and a number of new definitions have been added in order to be consistent with other changes made to the standard.

The most significant amendment is to the definition of short-term employee benefits and, by extension, other long-term employee benefits. The definition of short-term employee benefits has been amended from 'employee benefits that are due to be settled within twelve months after the end of the period in which the employees render the related service' to 'employee benefits that are expected to be settled wholly before twelve months after the end of the reporting period in which the employees render the related service' (i.e. to a basis of the expected timing of settlement). Therefore, a short term benefit arises when it is expected to be settled wholly before twelve months after the end of the reporting period in which employees render the related service. Expectations on when settlement will take place may change over time. The amendments clarify that an entity need not reclassify short-term employee benefits if the entity's expectations of the timing of settlement changes temporarily. Other long-term benefits are now defined as a residual i.e. "all employee benefits other than short-term employee benefits, post-employment benefits and termination benefits".

Accounting for short-term benefits

Accounting for short-term benefits remains on an undiscounted basis, and is recognised as the related service is rendered.

Post employment benefits: Distinction between defined contribution plans and defined benefit plans

It is clarified that the existence of a benefit formula does not, by itself, create a defined benefit plan. Instead, there needs to be a link between the benefit formula and contributions that creates a legal or constructive obligation for the employer to contribute further amounts to meet the benefits specified by the benefit formula if plan assets are insufficient.

Multi-employer plans, state plans and defined benefit plans that share risks between various entities under common control

The amendments made to IAS 19 do not affect the accounting for these types of plans. However, the disclosure requirements are substantially increased.

For example the additional disclosures for multi-employer defined benefit plans include:

- (a) For all plans, regardless of how they are accounted for, qualitative information about any agreed allocation of a deficit or surplus on wind-up of the plan, or the entity's withdrawal from the plan.
- (b) For plans that are accounted for as defined contribution plans:
 - i. the expected contributions to the plan for the next annual period (in line with the general requirement for defined benefit plans).
 - ii. An indication of the level of participation in a multi-employer plan compared with other plan participants. Examples of measures that might provide such an indication include the entity's proportion of the total contributions to the plan or the entity's proportion of the total number of active members, retired members, and former members entitled to benefits, if that information is available.

As previously, if the entity accounts for its proportionate share of the defined benefit obligation, plan assets, and costs associated with the plan in the same way as other defined benefit plans, the same disclosures as those required for other defined benefit plans are required for that proportionate share.

It is also clarified that an entity should apply the requirements of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* for guidance on when to recognise and how to measure a liability relating to the wind-up of a multi-employer defined benefit plan, or the entity's withdrawal from a multi-employer defined benefit plan.

Disclosure requirements for entities that participate in defined benefit plans that share risks between various entities under common control reflect the additional disclosures for defined benefit plans. However, an entity may include those disclosures by cross-reference to the required disclosures in another group entity's financial statements, if:

- that group entity's financial statements separately identify and disclose the information required about the plan; and
- that group entity'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 as, or earlier than, the financial statements of the entity.

Long-term employee benefits: defined benefit plans

A number of significant changes have been made to the recognition, presentation and disclosure requirements for defined benefit plans.

Recognition and Presentation

The amendments result in full recognition of the net defined benefit liability or asset (subject to the asset ceiling). This means immediate recognition of actuarial gains and losses (eliminating the corridor) and immediate recognition of past service cost whether or not vested. The components of defined benefit cost are redefined and recognition of the remeasurement of the defined benefit liability or asset (being actuarial gains and losses, the return of plan assets and any change in the effect of the asset ceiling) is required in other comprehensive income.

As a result entities must recognise all changes in the net defined benefit liability (asset) in the period in which those changes occur, and disaggregate and recognise defined benefit cost as follows:

- (a) service cost, relating to the cost of the services received, in profit or loss.
- (b) net interest on the net defined benefit liability (asset), representing the financing effect of paying for the benefits in advance or in arrears, in profit or loss.
- (c) remeasurements, representing the period-to-period fluctuations in the amounts of defined benefit obligations and plan assets, in other comprehensive income.

Prior to these amendments, IAS 19 permitted three options for the recognition of actuarial gains and losses:

- (a) leaving actuarial gains and losses unrecognised if they were within a 'corridor' and deferred recognition of actuarial gains and losses outside the corridor in profit or loss;
- (b) any systematic method that resulted in faster recognition of actuarial gains and losses in profit or loss (up to immediate recognition) provided the same basis was applied to gains and losses and the basis was applied consistently from period to period; or
- (c) immediate recognition in other comprehensive income.

The service cost component includes current service cost, past service cost (resulting from a plan amendment or curtailment and recognised immediately) and any gain or loss on settlement, but excludes changes in the defined benefit obligation that result from changes in demographic assumptions that are included in the remeasurements component together with other actuarial gains and losses.

Previously, IAS 19 included the expected return on scheme assets and the interest cost on the defined benefit obligation within profit or loss. This is now replaced with a single net interest component. The net interest on the net defined benefit liability (asset) requires an entity to calculate net interest using the same discount rate (generally a high quality corporate bond rate) as that used to measure the defined benefit obligation (the net interest approach). A deficit will result in interest expense and a surplus will result in interest income. Under the previous approach, a deficit could result in net finance income if the expected return on plan assets exceeded the interest cost on the defined benefit obligation.

The remeasurement component comprises:

- (a) actuarial gains and losses on the defined benefit obligation;
- (b) the return on plan assets, excluding amounts included in net interest on the net defined benefit liability (asset); and
- (c) any changes in the effect of the asset ceiling, excluding the amount included in net interest on the net defined benefit liability (asset).

The remeasurement component is recognised immediately in other comprehensive income. Subsequent reclassification of remeasurements from other comprehensive income to profit or loss is prohibited. However, an entity may transfer the amount recognised in other comprehensive income within equity.

Actuarial Assumptions

Tax payable by the Plan: The amendments clarify that:

- (a) the estimate of the defined benefit obligation includes the present value of taxes payable by the plan if they relate to service before the reporting date or are imposed on benefits resulting from that service, and
- (b) other taxes should be included as a reduction to the return on plan assets.

Administration costs: The amendments require administration costs to be recognised when the administration services are provided, with costs relating to the management of plan assets deducted from the return on plan assets. Previously the costs of administering the plan, other than those included in the actuarial assumptions used to measure the defined benefit obligation, were required to be deducted from the return on plan assets.

Mortality: The amendments make it explicit that the mortality assumptions used to determine the defined benefit obligation are current estimates of the expected mortality rates of plan members, both during and after employment. Standard mortality tables may need to be modified with estimates of mortality improvements.

Risk sharing: The amendments clarify the accounting for risk-sharing features such as employee and third-party contributions, conditional indexation and limits on the employer's share of cost. In summary these are reflected in the present value of the defined benefit obligation. An entity also needs to consider whether third-party contributions reduce the cost of the benefits to the entity, or are a reimbursement right.

Plan amendments, curtailments and settlements

The amendments made:

- require immediate recognition of all past service cost; and
- amend the definitions of past service cost, curtailments and settlements.

Past service cost arises from plan amendments and curtailments relating to employee service in prior periods, and is recognised as an expense at the earlier of the date that the plan amendment or the curtailment occurs and the entity recognising related restructuring cost or termination benefits. Under the previous IAS 19, unvested past service cost was recognised over the vesting period and curtailments were recognised when the entity was demonstrably committed to making the reduction. The standard does not define 'occurs' but the IASB notes that the timing would depend on individual facts and circumstances and how they interact with the constructive obligation requirements in IAS 19 (2011).

The amended definitions clarify that a settlement is a payment of benefits that is not set out in the terms of the plan. The payment of benefits that are set out in the terms of the plan, including terms that provide members with options on the nature of benefit payment such as an option to take a lump sum instead of an annuity, would be included in the actuarial assumptions with any difference between the estimated benefit payment and the actual benefit payment being an actuarial gain or loss.

Disclosure

The amendments set out the objectives for an entity's disclosures about its defined benefit plans which should:

- explain the characteristics of the defined benefit plans and the associated risks;
- identify and explain the amounts in the financial statements arising from the defined benefit plans; and
- describe how the defined benefit plans may affect the amount, timing and uncertainty of the entity's future cash flows.

The additional disclosures include:

- information about exposure to risk, focussed on any unusual, entity-specific or plan-specific risks and any significant concentrations of risk;
- distinguishing between actuarial gains and losses arising from demographic and financial assumptions;
- disaggregation of plan assets so that the disclosures distinguish the nature and risk of the assets, including making a distinction between those that have quoted market price in an active market and those that do not;
- significant actuarial assumptions with a sensitivity analysis for each one, showing how the defined benefit obligation would have been affected by reasonably possible changes in those assumptions;
- a description of any asset-liability matching strategies; and
- information about the funding (arrangement and policy), weighted average duration of the liability, and expected contributions in the next annual reporting period.

Additional disclosures are also required for multi-employer schemes as noted above.

Termination Benefits

Amendments are also made to the definition of, and accounting for, termination benefits. As a result, an entity recognises a liability and expense for termination benefits at the earlier of the following dates:

- when the entity can no longer withdraw the offer of those benefits; and
- when the entity recognises costs for a restructuring that is within the scope of IAS 37 and involves the payment of termination benefits.

Prior to the amendments IAS 19 specified that an entity should recognise termination benefits when the entity was demonstrably committed to providing those benefits.

Transition

IAS 19 (2011) is effective for annual periods beginning on or after 1 January 2013. Earlier adoption is permitted. It is required to be applied retrospectively in accordance with the general requirements of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, with two exceptions:

- The carrying amount of assets outside the scope of IAS 19 (e.g. property, plant and equipment or inventory) need not be adjusted for changes in employee benefit costs that were included in the carrying amount before the beginning of the earliest prior period presented in the first financial statements in which IAS 19 (2011) is applied. Thus entities may recognise previously unrecognised actuarial gains and losses and past service cost by adjusting equity, instead of by allocating part of those adjustments against the carrying amount of assets.
- In financial statements for periods beginning before 1 January 2014, an entity need not provide comparatives for sensitivity analysis disclosures for defined benefit obligations.

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