

INTERNATIONAL FINANCIAL REPORTING BULLETIN 2010/13

DEFINED BENEFIT PLANS: PROPOSED AMENDMENTS TO IAS 19



Background

The International Accounting Standards Board (IASB) has issued for comment an Exposure Draft (the ED) of proposed changes to the recognition, presentation and disclosures related to defined benefit plans. The ED forms part of the IASB's project to improve the accounting for employee benefits. The proposals in the ED reflect the IASB's consideration of comments it received in response to its discussion paper *Preliminary Views on Amendments to IAS 19* which was published in March 2008 (the 2008 DP). The IASB believes the proposals in the ED would make it easier for users of financial statements to understand how an entity's defined benefit plans affect its financial position and performance, and how they may affect its future cash flows. The IASB's objective is to finalise, during the first quarter of 2011, short-term, targeted improvements to the accounting for defined benefit plans.

The ED sets out proposals that would require entities to recognise all changes in defined benefit obligations and in the fair value of plan assets when those changes occur. This would eliminate the 'corridor approach' option in IAS 19 which permits entities to leave actuarial gains and losses unrecognised if they are within a corridor (being the greater of 10 per cent of the plan assets and 10 per cent of the plan liabilities) and defer recognition of actuarial gains and losses outside the corridor.

The presentation proposals would require an entity to split the changes in the defined benefit obligation and the fair value of plan assets into three components, to be presented as follows:

- (i) Service cost component – presented in profit or loss;
- (ii) Finance cost component (ie net interest on the defined benefit liability or asset) – as part of finance costs in profit or loss; and
- (iii) Remeasurement component – other comprehensive income.

The disclosures proposals would require entities to 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) Risk arising from defined benefit plans, including sensitivity analyses of changes in demographic risk.
- (c) Participation in multi-employer plans.

In response to requests in the comment letters received on the 2008 DP, the ED also addresses the following practice issues:

- (a) How expected future salary increases affect the attribution of benefits to different periods.
- (b) How risk-sharing and conditional indexation affect the measurement of defined benefit obligations.
- (c) When the measurement of defined benefit obligations include tax and administrative costs.
- (d) The classification of employee benefits as long-term and short-term.

Finally the ED proposes to incorporate, without substantive change, the requirements of IFRIC 14 *IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*, and clarifications responding to some questions received by the IFRIC.

STATUS

Exposure Draft

EFFECTIVE DATE

To be confirmed

ACCOUNTING IMPACT

Significant changes proposed for recognition, presentation and disclosure of defined benefit plans

Proposals

Scope

The proposals would apply to all entities that have defined benefit plans.

Definitions

One of the proposals is to replace the terms 'post-employment benefit' and 'post-employment benefits' throughout IAS 19 with the term 'long-term employee benefits'. In addition, though many of the current definitions in IAS 19 will remain unchanged, several definitions will be amended to be consistent with the terminology change above with some being deleted and others added in order to be consistent with the other changes being proposed in the ED.

The ED proposes to reorganise the definitions under the following three headings:

- Definitions of employee benefits;
- Definitions relating to the classification of long-term employee benefit plans; and
- Definitions relating to the recognition and measurement of long-term employee benefit plans.

The definitions that will be substantially amended or deleted are:

- Other long-term employee benefits;
- Vested employee benefits;
- Current service cost;
- Interest cost; and
- Past service costs.

and the following definitions will be added:

- Service cost;
- Net interest on the net defined benefit liability (asset);
- The net defined benefit liability (asset);
- The deficit or surplus in a defined benefit plan;
- Remeasurement of a net defined benefit liability (asset);
- Minimum funding requirements;
- A curtailment; and
- A non-routine settlement.

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

The proposals in the ED will not affect the accounting for these types of plans. However the disclosure requirements will be changed substantially. The disclosure requirements being proposed for multi-employer plans and State plans are:

- A description of the funding arrangements, including the method used to determine the entity's rate of contributions and any minimum funding requirements;
- The extent to which the entity can be liable to the plan for other entities' obligations under the terms and conditions of the multi-employer plan;
- The total number of, and the entity's proportion of, the number of active members, retired members, and former members entitled to benefits, if that information is available;

- Details of any agreed deficit or surplus allocation on wind-up of the plan, or the amount that is required to be paid on withdrawals of the entity from the plan;
- 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; and
- If the entity accounts for the plan as if were a defined contribution plan in accordance with paragraph 30 (which requires an entity to account for a multi-employer defined benefit plan as a defined contribution plan when sufficient information is not available to use defined benefit accounting):
 - (i) the fact that the plan is a defined benefit plan;
 - (ii) the reason why sufficient information is not available to enable the entity to account for the plan as a defined benefit plan;
 - (iii) the expected contributions to the plan for the next five annual reporting periods, and a description of the contractual agreement or other basis used to determine the expected contributions; and
 - (iv) information about any deficit or surplus in the plan that may affect the amount of future contributions, including the basis used to determine that deficit or surplus and the implications, if any, for the entity.

For defined benefit plans that share risks among various entities under common control, the ED proposes to replace existing disclosure requirements with the new ones which are discussed in the presentation and disclosure section below.

Long-term employee benefits: defined benefit plans

As indicated above, the ED is proposing a number of significant amendments to the recognition, presentation and disclosure requirements for defined benefit plans.

Some of the amendments are minor and are being made to clarify the proposed terminology and definition changes described above and to remove various sub-headings, illustrative examples and explanatory paragraphs from IAS 19.

The most significant change proposed is the removal of the 'corridor approach' for the recognition of actuarial gains and losses. Consequently, all actuarial gains and losses would be recognised when they occur.

Another significant change is in respect of the steps required to account for a defined benefit plan. The proposals in the ED would require an entity to:

- (a) Determine the deficit or surplus which involves:
 - (i) Using actuarial techniques to make a reliable estimate of the amount of benefit that employees have earned in return for their service in the current and prior periods. This requires an entity to determine how much benefit is attributable to the current and prior periods and to make estimates (actuarial assumptions) about demographic variables (such as employee turnover and mortality rates) and financial variables (such as future increases in salaries and medical costs) that will affect the cost of the benefit.

- (ii) Discounting that benefit using the Project Unit Credit Method in order to determine the present value of the defined benefit obligation and the current service cost. The present value of the defined benefit obligation is the gross obligation, before deducting the fair value of any plan assets, or adjusting for the effect of the limit in paragraph 115B (which requires an entity to measure the net defined benefit asset, when it has a surplus in a defined benefit plan, at the lower of the surplus in the defined benefit plan and the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan).
 - (iii) When a plan has been introduced, changed or curtailed, determining the resulting past service cost and gain or loss on curtailment.
 - (iv) Determining the fair value of any plan assets.
- (b) Determine the amount of the net defined benefit liability (asset) from the amount of deficit or surplus calculated in the previous step. This involves assessing:
- (i) The present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan.
 - (ii) Whether an additional liability needs to be recorded because of the interaction between a minimum funding requirement and the limit in paragraph 115B (described above).
- (c) Determine the amounts presented in the statement of comprehensive income which involves determining:
- (i) Net interest on the net defined benefit liability (asset).
 - (ii) The amount of actuarial gains and losses.

When an entity has more than one defined benefit plan, the entity applies these procedures for each material plan separately.

Another significant amendment is in respect of the amounts required to be recognised in an entity's financial statements. The proposals in the ED would require an entity to recognise:

- The net defined benefit liability (asset) in the statement of financial position; and
- Changes in the net defined benefit liability (asset), except to the extent that another Standard requires or permits their inclusion in the cost of an asset, in the statement of other comprehensive income.

The proposals in the ED also require an entity to measure the 'availability of economic benefits' which requires an entity to determine:

- A reduction in net defined benefit asset (which may result from a change in the present value of any future economic benefits available in the form of refunds from the plan, reductions in future contributions to the plan or a combination of both); and
- Any additional liability arising from minimum funding requirements.

The explanatory paragraphs for determining a reduction in the net defined benefit asset and an additional liability arising from a minimum funding requirement primarily consist of the guidance in IFRIC Interpretation 14 *IAS 19 – The Limit on a Defined Asset, Minimum Funding Requirements and their Interaction* and in the November 2009 amendment to IFRIC 14, *Prepayments of a Minimum Funding Requirements, Amendments to IFRIC 14* which the ED is proposing to incorporate into IAS 19 without substantial amendment.

Presentation and disclosure

The proposals in the ED would require an entity to present the following in its statement of comprehensive income:

- Service costs, and gains and losses arising from curtailments, in profit or loss;
- Net interest on the defined benefit liability (asset) as part of finance costs in profit or loss; and
- Remeasurements of the net defined benefit liability (asset) in other comprehensive income. Those remeasurements would be transferred immediately to retained earnings and would not be reclassified (ie recycled) to profit or loss in a subsequent period.

It is proposed that net interest on the defined benefit liability (asset) would be determined by multiplying the net defined benefit liability (asset) throughout the period by the discount rate specified in paragraph 78 as determined at the start of that period, taking account of any material changes in the net liability (asset).

Paragraph 78 requires the discount rate to be determined by reference to period end market yields on high quality corporate bonds unless the country does not have a deep market for such bonds in which case the period end market yield on government bonds is used. Also the currency and term of the bonds needs to be consistent with the currency and estimated term of the post-employment benefit obligation.

The proposals would also replace a number of existing disclosures with information that:

- Explains the characteristics of its defined benefit plans;
- Identifies and explains the amounts in its financial statements arising from its defined benefit plans; and
- Describes how its defined benefit plans may affect the amount, timing and uncertainty of the entity's future cash flows.

The ED also contains a number of explanatory paragraphs which would provide additional guidance on the information to be included in the presentation and disclosure items listed above, including guidance on characteristics of defined benefit plans, explanations of amounts in the financial statements and the amount, timing and uncertainty of future cash flows.

Consequential amendments to other accounting standards

The proposals set out in the exposure draft would result in consequential amendments being made to a wide range of other accounting standards and interpretations. These include:

- deleting the exemptions related to IAS 19 in Appendix D of IFRS 1 *First-time Adoption of International Financial Reporting Standards* as they would no longer be required;
- to amend IFRS 4 *Insurance Contracts*, IFRS 7 *Financial Instruments: Disclosures*, IAS 32 *Financial Instruments: Presentation* and IAS 39 *Financial Instruments: Recognition and Measurement* for the scope exclusion for 'employers' assets and liabilities under employee benefit plans' to 'employers' assets and liabilities within the scope of IAS 19 *Employee Benefits* to be consistent with the conclusions in the IFRIC rejection notice November 2005 – Employee long-service leave;
- replace references to 'settlements' with 'non-routine settlements' in IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*;
- amend IAS 1 *Presentation of Financial Statements* for the references to 'actuarial gains and losses' to be consistent with the proposals in the exposure draft; and
- to IAS 24 *Related Party Disclosures* to amend the definition of 'compensation' to be consistent with the changes to definitions of 'long-term employee benefits' and 'short-term employee benefits' proposed in the exposure draft.

Effective date and transition

As this is an exposure draft, an effective date has not yet been determined.

The proposals include full retrospective application.

Comment period

The IASB has requested the submission of comments on its proposals by 6 September 2010.

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