

ASSURANCE AND ACCOUNTING

EMPLOYEE FUTURE BENEFITS

What you need to know about Sections 3462 and 3463

Employee future benefits can be complex, this publication will cover some key areas of the guidance on employee future benefits in Part II and Part III of the CPA Canada Handbook. It will cover which entities these Sections apply to, what the Sections provide guidance on, the differences between the two Sections, the differences between funding and accounting valuations, and will provide a detailed example of how to roll-forward the defined benefit liability in the years between valuations.

Which Entities Apply these Standards?

Section 3462, Employee Future Benefits, in Part II of the CPA Canada Handbook—Accounting Standards for Private Enterprises (ASPE) is applicable to accounting for employee future benefits provided by:

- Private enterprises that apply ASPE; and
- Pension plans that apply the standards in Part IV of the CPA Canada Handbook—Accounting Standards for Pension Plans, and choose to apply the standards in Part II of the Handbook for issues not addressed in Part IV.

Section 3463, Reporting Employee Future Benefits by Not-for-Profit Organizations, in Part III of the CPA Canada Handbook—Accounting Standards for Not-for-Profit Organizations (ASNPO) is applicable to:

- Private sector not-for-profit organizations (NPOs) that follow ASNPO. This Section instructs NPOs to follow the requirements of Section 3462 in Part II of the Handbook in accounting for employee future benefits provided by an NPO, except for, specific guidance on the recognition and presentation of remeasurements and other items, which are contained in Section 3463.

What Do Sections 3462 and 3463 Cover?

These Sections provide guidance to entities on accounting for employee future benefits. The objective of accounting for employee future benefits is to recognize a liability and a cost during the reporting period when an employee provides the services that results in the future benefits.

These Sections provide guidance on accounting for different types of employee future benefit plans including defined contribution plans, defined benefit plans, and multi-employer and multiple-employer benefit plans. The Sections also provide guidance on accounting for termination benefits. Refer to the following publications available on bdo.ca for a high level overview of the accounting for each of these items: [ASPE at a Glance: Section 3462—Employee Future Benefits](#) and [ASNPO at a Glance: Section 3463—Reporting Employee Future Benefits by Not-for-Profit Organizations](#).



Main Difference between Section 3462 and Section 3463

For both private enterprises and private sector NPOs, when the entity has a defined benefit plan, it must be accounted for using an approach that results in the recognition of the full amount of the defined benefit obligation, net of the fair value of plan assets, on the balance sheet (adjusted for any valuation allowance in the case of a net asset) as illustrated below:

Defined benefit liability components	
Defined benefit obligation	\$50,000
Less: fair value of plan assets	(35,000)
Funded status—plan deficit (surplus)	\$15,000
Less: valuation allowance (if any)	0
Defined benefit liability	\$15,000

Plan obligations and plan assets must be remeasured at each balance sheet date. This can result in volatility in the income statement for private enterprises, since as the defined benefit liability is adjusted, remeasurements and other items¹ are required to be recognized in net income in the period they occur. The amount of remeasurements and other items must be disclosed in the notes to the financial statements unless it is separately presented on the face of the income statement.

However, for private sector NPOs, there is less volatility as Section 3463 requires remeasurements and other items to be recognized directly in net assets in the period they occur. NPOs must present remeasurements and other items as a separate line item on the statement of changes in net assets. This is the main difference between the requirements of Section 3462 and Section 3463.

Funding Valuations and Accounting Valuations

When an entity has a defined benefit plan, the defined benefit obligation is determined using an accounting valuation or a funding valuation depending on the circumstances. You may be wondering what the differences are between a valuation prepared for funding purposes and one prepared for accounting purposes.

Each type of valuation has a different objective and may use different actuarial assumptions which would result in different obligation and cost numbers.

- A funding valuation is prepared in accordance with legislative, regulatory or contractual requirements and its purpose is to determine the required contributions to the plan.
- An accounting valuation is prepared in accordance with generally accepted accounting principles using management's best estimates and the discount rate required by paragraph 3462.047.

The main differences between the two types of valuations are outlined below:

Main differences	Funding Valuation	Accounting Valuation
Obligation	Reflects the value of benefits earned on the valuation date, but does not include: constructive obligations, improvements for future service or future salary increases	Includes: constructive obligations, improvements for future service and future salary increases
Cost method	Varies as permitted by pension legislation and actuarial standards	Depends on whether future salary levels or cost escalation affect the amount of the employee future benefits. When they do, the projected benefit method is used. When they do not, the accumulated benefit method is used
Assumptions	The actuary is responsible for the selection of the assumptions, with input from the plan sponsor, and the discount rate is the expected rate of return on assets, net of fees and adjustments for margins for adverse deviations as selected by the plan sponsor	Management is responsible for the selection of the assumptions, and the discount rate used is either the yield on high quality corporate bonds of the same duration as plan obligations or the interest rate inherent in the amount at which the defined obligation could be settled

¹ Section 3462.006(z) defines remeasurements and other items as comprising the aggregate of: the difference between the actual return on plan assets and the return calculated using the discount rate used to determine the defined benefit obligation; actuarial gains and losses; the effect of any valuation allowance in the case of a net defined benefit asset, determined in accordance with paragraph 3462.086; past service costs; and gains and losses arising from settlements and curtailments.

In terms of when each type of valuation needs to be used²:

- For defined benefit plans where an actuarial valuation for funding purposes must be prepared in order to comply with legislative, regulatory or contractual requirements - an entity must make an accounting policy choice, and apply this same choice to each such plan, to measure the defined benefit obligation as of the balance sheet date using either:
 - An actuarial valuation prepared for accounting purposes; or
 - The most recently completed actuarial valuation prepared for funding purposes, provided the valuation meets the criteria in paragraph 3462.029D and provided the guidance in paragraph 3462.029AC is applied.
- For other defined benefit plans where there is no legislative, regulatory or contractual requirement to prepare an actuarial valuation for funding purposes—an entity must measure the defined benefit obligation as of the balance sheet date using an actuarial valuation for accounting purposes.

An actuarial valuation must be obtained at least every three years, but may occur more frequently. For example, a new actuarial valuation would be required when a significant event takes place. Section 3462 provides the following examples of events that may be significant and require a new actuarial valuation to be performed:

- A settlement;
- A curtailment; or
- A plan amendment such as a grant of benefits calculated by reference to past service.

The Section also states that a new actuarial valuation is not required when there is a significant change in the interest rate used in determining the discount rate to measure the defined benefit obligation.

In the years between valuations, the entity estimates the defined benefit obligation by performing a roll-forward technique as outlined in paragraph 3462.062. In doing so, the entity must exercise professional judgment and consider factors such as:

- The amount from the last actuarial determination of the defined benefit obligation;
- The increase in the obligation due to the passage of time (refer to paragraph 3462.064(a) for guidance on how to calculate);
- The increase in the obligation due to the rendering of service in the current year (refer to paragraph 3462.064(b) for guidance on how to calculate); and
- Any benefit payments.

Appendix A provides an example of rolling forward the defined benefit obligation and the current service cost.

PfAD and Stabilization Provision

In 2018, Ontario's pension regulator introduced a new reserve, the provision for adverse deviations (PfAD)³, in the going concern funding valuation for defined benefit plans. This reserve is meant to cover unexpected adverse deviations in such plans. Similarly, in 2016 Quebec enacted Bill 57, which eliminated the requirement to fund a pension plan on a solvency basis. Instead, plans are funded on a going concern basis with a new requirement to establish a reserve called a stabilization provision, the purpose of which is similar to that of the PfAD. Stakeholders had raised questions on whether the PfAD and the stabilization provision should be included in the measurement of the defined benefit obligation when an entity uses a funding valuation as there had been diversity in practice.

As a result, in 2020 the Accounting Standards Board (AcSB) amended Section 3462⁴ to clarify that the defined benefit obligation is measured at the amount that is required to be funded by contributions in accordance with legislative, regulatory or contractual requirements, which could include cash contributions or a posted letter of credit. This amount includes the aggregate of all underlying components of the legislative, regulatory or contractual requirements (e.g. the PfAD and stabilization provision would be included).

Consider the following excerpt from the valuation report received by an entity in Ontario who has made an accounting policy choice to use a funding valuation to measure the defined benefit obligation:

² Section 3462 was amended in 2020 to remove the previous accounting policy choice that allowed defined benefit plans without a funding valuation requirement to be measured on a funding valuation basis, due to the complexities in applying this method and the diversity it was causing in practice. These amendments are effective for fiscal years beginning on or after January 1, 2022, with simplified transitional provisions provided in Section 3462.

³ Since this time additional Provinces have also introduced the PfAD and more Provinces may do so in the future, so ensure to stay up to date with the pension requirements in your Province.

⁴ These amendments to Section 3462 are effective for fiscal years beginning on or after January 1, 2022 with early adoption permitted. Simplified transitional provisions have been provided.

December 31, 2020	
Going Concern Financial Status	
Market value of assets	\$5,500,000
Going concern funding liabilities	4,300,000
Provision for adverse deviations in respect of the going concern liabilities (PfAD)	200,000
Funding excess (shortfall)	\$1,000,000

Prior to the PfAD being introduced, the going concern funding liabilities amount would have been the amount used as the defined benefit obligation. Now for the December 31, 2020 year end, the amount that would be used as the defined benefit obligation when calculating the entity's pension liability is \$4,500,000. This is the combination of the going concern funding liabilities amount of \$4,300,000 plus the PfAD of \$200,000.

Conclusion

As can be seen from the above discussion, accounting for employee future benefits under ASPE and ASNPO can be complex. Reach out to your BDO advisor for any questions you have on applying Section 3462 or Section 3463.

The information in this publication is current as of January 31, 2021.

This publication has been carefully prepared, but it has been written in general terms and should be seen as broad guidance only. The publication cannot be relied upon to cover specific situations and you should not act, or refrain from acting, upon the information contained therein without obtaining specific professional advice. Please contact BDO Canada LLP to discuss these matters in the context of your particular circumstances. BDO Canada LLP, its partners, employees and agents do not accept or assume any liability or duty of care for any loss arising from any action taken or not taken by anyone in reliance on the information in this publication or for any decision based on it.

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APPENDIX A: CALCULATION OF THE DEFINED BENEFIT LIABILITY AND THE DEFINED BENEFIT COST

In this example, we will look at how to roll-forward the defined benefit obligation, calculate the defined benefit liability at year end, December 31, 2020, and calculate the defined benefit cost for the 2020 year under Section 3462.

Scenario: ABC Inc. is a private company that follows ASPE. The entity sponsors a defined benefit pension plan. ABC Inc. has previously made an accounting policy choice to use a funding valuation. The most recent funding valuation is as of December 31, 2019. The entity has a December 31st year end. This is not the year of transition to Section 3462. The entity is not in a Province that has PfAD or Stabilization Provision requirements.

Information and assumptions from the valuation and from the entity are as follows:

- Discount rate is 5%;
- Fair value of the plan assets at December 31, 2019 was \$1,500,000;
- Defined benefit obligation at December 31, 2019 was \$1,850,000;
- Current service cost (net of employee contributions) for the year ended December 31, 2019 was \$110,000;
- Employer contributions for 2020 are \$120,000 – made throughout the year;
- Employee contributions for 2020 are \$40,000 – made throughout the year;
- Benefits paid to the employees in 2020 are \$30,000; and
- Fair value of the plan assets at December 31, 2020 is \$1,700,000.

The first step is to calculate the actual return on plan assets for the year.

Step 1: Calculate the actual return on plan assets for the year

Fair value of plan assets at December 31, 2019	\$1,500,000
Add: contributions made during the year (employer + employee) = (\$120,000 + \$40,000)	160,000
Less: benefit payments made during the year	(30,000)
Subtotal	\$1,630,000
Fair value of plan assets at December 31, 2020	\$1,700,000
Actual return on plan assets for 2020	\$70,000

Next, we need to calculate the expected return on plan assets for the year using the discount rate required in paragraph 3462.084.

Step 2: Calculate the expected return on plan assets for the year

Fair value of plan assets at December 31, 2019	\$1,500,000
Add: average contributions made during the year (employer + employee) = $[(\$120,000 + \$40,000) / 2]$	80,000
Less: average benefit payments made during the year ($\$30,000 / 2$)	(15,000)
Subtotal	\$1,565,000
Multiplied by the discount rate	x 5%
Expected return on plan assets for 2020	\$78,250

Now we can calculate the difference between the actual and expected return on plan assets for the year.

Step 3: Calculate the difference between the actual and expected return on plan assets

Actual return on plan assets (Step 1)	\$70,000
Less: expected return on plan assets (Step 2)	78,250
Difference between the actual and expected return on plan assets	(\$8,250)

The next step is to roll forward the amount of the current service cost (net of employee contributions) to year end as the value we have been given above is for the year ended December 31, 2019. According to paragraph 3462.064(b) we do this by multiplying the current service cost amount for 2019 by (1 + discount rate of 5%).

Step 4: Roll-forward the current service cost

Current service cost net of employee contributions at December 31, 2019	\$110,000
Multiply by 1 + the discount rate of 5%	1.05
Current service cost net of employee contributions at December 31, 2020	\$115,500

Next, we need to determine the interest cost on the defined benefit obligation for the year.

Step 5: Calculate the interest cost on the defined benefit obligation

Defined benefit obligation at December 31, 2019	(\$1,850,000)
Add: average current service cost = [(current service cost net of employee contributions + employee contributions) / 2] = [(\$115,500 + \$40,000) / 2]	(77,750)
Less: average benefit payments made during the year (\$30,000 / 2)	15,000
Defined benefit obligation – average balance for the year	(\$1,912,750)
Multiplied by the discount rate	x 5%
Interest cost on defined benefit obligation	(\$95,638)

Then we need to roll forward the defined benefit obligation amount we know as of December 31, 2019 to its December 31, 2020 year end value. According to paragraph 3462.062, to do this we need to take into account the increase in the obligation due to the passage of time, the increase in the obligation due to the rendering of services in the current year, and any benefit payments made during the year.

Step 6: Calculate the defined benefit obligation at year end⁵

Defined benefit obligation at December 31, 2019	(\$1,850,000)
Add: interest cost on defined benefit obligation (Step 5)	(95,638)
Add: current service cost = (current service cost, net of employee contributions + employee contributions) = (\$115,500 + \$40,000)	(155,500)
Less: benefit payments	30,000
Defined benefit obligation at December 31, 2020	(\$2,071,138)

Now that we know the defined benefit obligation at the end of the year, and since we have been given the fair value of the plan assets at the end of the year, we can calculate the defined benefit liability at year end.

⁵ In this step an entity would need to consider the effect of the PfAD or Stabilization Provision if it was applicable in their Province

Step 7: Calculate the defined benefit liability at year end

Defined benefit obligation at December 31, 2020 (Step 6)	(\$2,071,138)
Fair value of plan assets at December 31, 2020	1,700,000
Defined benefit liability at December 31, 2020	(\$371,138)

This defined benefit liability amount will be recognized on the balance sheet at December 31, 2020.

Finally, we can calculate the defined benefit cost (i.e. the pension expense) for the year. According to paragraph 3462.079, the cost of the pension plan for the year consists of the current service cost, finance cost and remeasurements and other items.

Step 8: Calculate the defined benefit cost for the year

Current service cost, net of employee contributions	\$115,500
Net finance cost = (interest cost on defined benefit obligation - expected interest on plan assets) = (\$95,638 - \$78,250)	17,388
Remeasurements and other items (per 3462.085) = the difference between the actual return on plan assets and the return calculated using the discount rate referred to in paragraph 3462.084	8,250
+ actuarial gains and losses	
+ the effect of any valuation allowance in the case of a net defined benefit asset	
+ past service costs	
+ gains and losses arising from settlements and curtailments	
= (\$8,250 + \$0 + \$0 + \$0 + \$0)	
Defined benefit cost for 2020	\$141,138

The defined benefit cost for the year would be recognized in net income for ABC Inc.

If the entity was a not-for-profit organization, then the "remeasurements and other items" portion of the defined benefit cost for the year would be recognized directly in net assets.

It should be noted that actuarial gains and losses will only occur in the year a valuation is performed, they will not occur in the years between valuations when we are rolling forward the defined benefit obligation.

We can now do a check to prove the closing defined benefit liability of \$371,138 that we calculated in Step 7 by performing the following calculation.

Proof of defined benefit liability at December 31, 2020

Defined benefit liability at December 31, 2019 = [(\$1,850,000) + \$1,500,000]	(\$350,000)
Add: defined benefit cost for 2020	(141,138)
Less: employer contributions for 2020	120,000
	(\$371,138)