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**International
Accounting Standards
Board**

This document is provided as a convenience to observers at IASB meetings, to assist them in following the Board's discussion. It does not represent an official position of the IASB. Board positions are set out in Standards.

These notes are based on the staff papers prepared for the IASB. Paragraph numbers correspond to paragraph numbers used in the IASB papers. However, because these notes are less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

Board Meeting: 21-22 September 2006, London

Project: Accounting Standards for Small and Medium-sized Entities

Subject: Revised Draft of Section 28 Employee Benefits of a Draft Exposure Draft of an IFRS for SMEs (Agenda Paper 15B)

Background

1. Board Agenda Paper 15B presents the latest draft of Section 28 *Employee Benefits* of the draft IFRS for SMEs. The draft reflects comments of the Board on the version of Section 28 discussed at the June 2006 meeting, as well as some drafting comments submitted by Board members.
2. The glossary definitions related to employee benefits are presented immediately after the revised draft of Section 28.
3. The draft discussed at the June 2006 meeting did not include standards on accounting for defined benefit plans. Instead, SMEs were cross-referred to IAS 19 *Employee Benefits*. At that meeting, the Board concluded that because many SMEs provide benefits under deferred benefit plans or government-mandated programmes that are similar to defined benefit plans, the IFRS for SMEs should include guidance on defined benefit plan accounting directly, rather than by cross-reference to IAS 19. Consequently the most significant change to the previous version of Section 28 is the inclusion of wholly new paragraphs 28.14 to 28.28 on defined benefit plans
4. During August, staff invited Board members to comment informally on a revised draft of Section 28 that included standards on defined benefit plans. A number of substantive issues arose as a result of those comments. Those issues are set out in this agenda paper for Board discussion in September.

Issues for Board consideration

Actuarial method

5. The issue: Should the IFRS for SMEs require a single actuarial method for accounting for defined benefit plans by SMEs and, if so, which method?
6. The August preliminary draft had said:

In determining the present value of its defined benefit liability, an entity shall use an actuarial valuation method that is generally accepted by the actuarial profession. If the defined benefit plan is actuarially funded, the actuarial valuation method used to determine funding shall be presumed to be the actuarial valuation method used to measure the obligation unless the method used for funding is not generally accepted by the actuarial profession.
7. Informal comments by Board members and review by IASB staff expressed concern about allowing an SME to use any actuarial method to measure its cost and its liability under a defined benefit plan for financial reporting purposes. Commentators noted that actuaries use a wide range of methods to make funding recommendations to their clients. Those methods are not necessarily consistent with the definitions of assets, liabilities, income and expense in the IASB Framework and in the draft IFRS for SMEs. In particular, for funding purposes, some of those methods:
 - (a) try to measure and take into account projected benefits (including benefits expected to arise from future employee service) rather than accrued benefits (those that have that have already been earned as a result of past service);
 - (b) focus on future events (ie future employee service) rather than past events;
 - (c) focus more on cost allocations to periods (ie spreading expected total benefits over an employee's expected period of service) than on measuring an entity's existing obligation that has arisen from past events; and
 - (d) are inconsistent with definitions of fair value in IFRSs and in the draft IFRS for SMEs. Moreover, those methods result in a wide range of measures of benefit cost for a period and the benefit obligation at the end of a period.
8. Staff therefore recommends that the IFRS for SMEs require a single actuarial method that is most consistent with the objective of financial reporting by SMEs – the projected unit credit method. Despite its name, the projected unit credit method is an accrued benefit method rather than a projected benefit method. That method is required by IAS 19 and is widely used and understood today.

Board decision requested: Does the Board concur with the staff view, reflected in paragraph 28.18, that an SME shall use the projected unit credit method to determine the present value of its defined benefit obligations and the related current service cost and, where applicable, past service cost?

Recognition of actuarial gains and losses

9. Paragraph 28.26 provides an accounting policy choice for SMEs regarding actuarial gains and losses. An SME must choose:
 - (a) to recognise the actuarial gains and losses in profit or loss unless the defined benefit cost is (i) included in the cost of producing inventories in accordance with paragraph 13 or (ii) included in the cost of property plant and equipment in accordance with paragraph 17; or
 - (b) to recognise those actuarial gains and losses as a separate component of equity in the balance sheet and in the statement of changes in equity.
10. Both of those methods are simple for an SME to apply and are consistent with IAS 19, and result in measures of the defined benefit liability that are consistent with the definition of a liability. Besides full recognition in profit or loss or in equity, IAS 19 allows additional methods of recognising actuarial gains and losses, including:
 - (a) Spread the gains and losses as expense over the average remaining working lives of employees.
 - (b) Spread the gains and losses as expense using any systematic method that results in faster recognition than spreading over the average remaining working lives of employees.
 - (c) Non-recognition of the gains and losses as expense if they are less than both 10% of the present value of the defined benefit obligation and 10% of the fair value of plan assets.
11. Staff proposes that additional accounting policy choices in (a), (b) and (c) in the preceding paragraph should not be included in Section 28 because they add complexity to defined benefit accounting for SMEs.

Board decision requested: Does the Board concur with the staff view, reflected in paragraph 28.26, that an SME should recognise actuarial gains and losses in their entirety either in profit or loss or directly in equity, and that the non-recognition and partial recognition (spreading) options of IAS 19 should not be included in the IFRS for SMEs?

Recognition of past service cost

12. Section 28 does not provide for deferred recognition of unvested past service cost. Increases or decreases in past service cost that result from introduction of a new defined benefit plan or from changing the benefits in an existing plan are recognised immediately. Paragraph 28.19 states:

If a defined benefit plan has been introduced or changed in the current period, the entity shall increase or decrease its defined benefit liability to reflect the change, and shall recognise the increase (decrease) as an expense (income) in measuring profit or loss.
13. This is different from IAS 19, which provides (IAS 19.96) that:

In measuring its defined benefit liability under paragraph 54, an entity shall, subject to paragraph 58A, recognise past service cost as an expense

on a straight line basis over the average period until the benefits become vested. To the extent that the benefits are already vested immediately following the introduction of, or changes to, a defined benefit plan, an entity shall recognise past service cost immediately.

14. Staff supports the immediate recognition of past service cost in the IFRS for SMEs because that method is simple for an SME to apply and results in measures of the defined benefit liability that are consistent with the definition of a liability.

Board decision requested: Does the Board concur with the staff view, reflected in paragraph 28.19, that an SME should recognise increases or decreases in past service in their entirety in profit or loss when they arise?

Definition of a defined benefit liability

15. If the Board concurs with the two preceding staff proposals (full recognition of actuarial gains and losses and past service cost) the glossary definition of defined benefit liability in the IFRS for SMEs will necessarily be different from that in IAS 19. The two definitions are as follows:

a. IAS 19:

defined benefit liability	<p>The net total of the following amounts:</p> <ol style="list-style-type: none"> (a) the present value of the defined benefit obligation at the balance sheet date; (b) plus any actuarial gains (less any actuarial losses) not recognised; (c) minus any past service cost not yet recognised; (d) minus the fair value at the balance sheet date of plan assets (if any) out of which the obligations are to be settled directly.
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b. IFRS for SMEs:

defined benefit liability	<p>The present value of the defined benefit obligation at the balance sheet date minus the fair value at the balance sheet date of plan assets (if any) out of which the obligations are to be settled directly.</p>
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16. Items (b) and (c) in the IAS 19 definition drop out of the IFRS for SMEs definition.

Board decision requested: Does the Board concur with the proposed definition of defined benefit liability in the IFRS for SMEs? (It would essentially be a consequence of the decisions on the two preceding items.)

Other long-term benefits

17. Paragraph 28.30 requires an SME to recognise a liability for other long-term employee benefits on the same basis as in IAS 19, with one exception. For any actuarial gains or losses arising on other long-term benefit plans, an SME is permitted to recognise those actuarial gains and losses using the same accounting policy for actuarial gains and losses that it chose for its defined benefit plans in accordance with paragraph 28.26. Thus an SME would recognise actuarial gains and losses related to other long-term benefits when they occur, either in profit or loss or directly in equity. Except possibly for long-term disability benefits, a typical SME is not likely to encounter significant actuarial gains or losses on its other long-term benefits. A single consistent accounting policy for all actuarial gains and losses is simpler for an SME to apply, and the result would be transparent (disclosure required in paragraph 28.41).

Board decision requested: Does the Board concur with the proposed accounting policy choice for actuarial gains and losses arising in connection with other long-term benefits?

Disclosures about defined benefit plans for the past four years

18. The August preliminary draft of Section 28 had proposed the following disclosure:
- the amounts for the current annual period and the previous four annual periods of the present value of the defined benefit obligation, the fair value of the plan assets and the surplus or deficit in the plan.
19. Informal comments by Board members and other IASB staff were mixed regarding whether this disclosure is burdensome for an SME. Similar disclosure is required by IAS 19.120A(p). Those who favour adding this requirement to Section 28 believe that, after an SME has followed the IFRS for SMEs for four years, the information would be available; therefore disclosing it would not be burdensome or costly to an SME. Moreover, they believe that this information, showing data over a five year period, provides important insight into the trend of the funding status of an SME's defined benefit plans. Those who do not support adding this requirement believe that the benefits do not outweigh the costs and that the balance sheet and other disclosures provide sufficient information about the current funding status of the SME's defined benefit plans. On balance, staff did not include this disclosure in the draft of Section 28 that is in this Agenda Paper. However staff raises the issue for Board decision. If added, it would logically be item (m) in paragraph 28.40.

Board decision requested: Does the Board favour adding this disclosure item to paragraph 28.40?

Other matters?

20. Are there other issues Board members wish to raise regarding Section 28?

Notes for Observers

21. The revised draft of Section 28 in Agenda Paper 15B is part of an exposure draft (ED) that is not yet a public document. Accordingly, it is not available to observers. Section 28 was the only Section not included in the draft ED posted on the IASB's website in August 2006.