30 Cannon Street, London EC4M 6XH, United Kingdom
Tel: +44 (0)20 7246 6410 Fax: +44 (0)20 7246 6411
Email: iasb@iasb.org Website: www.iasb.org

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:** | **22 February 2007, London** |
| **Project:** | **Post-employment benefits** |
| **Subject:** | **Recognition of changes in defined benefit pension obligations (Agenda paper 8C)<br>Draft discussion paper section (Agenda paper 8D)<br>A pension accounting alternative (Agenda paper 8E)** |

# AGENDA PAPER 8C: RECOGNITION OF CHANGES IN DEFINED BENEFIT PENSION OBLIGATIONS

## INTRODUCTION

1. This cover note accompanies a draft discussion paper section on the recognition and presentation of changes in pension plan assets and defined benefit obligations. It explains the approach in the discussion paper and seeks the Board's approval of that approach.

2. The staff notes that this paper, and draft discussion paper section that accompanies it, have not yet been discussed with the working group. The staff intends to discuss the contents of these papers and the Board's response to

them with the working group in due course. The views of working group members will be presented to the Board at a future meeting.

## STAFF RECOMMENDATION

3. The staff recommends that the discussion paper sets out presentation proposals in the context of IAS 1. An appendix should show how the proposals in the financial statement presentation project would apply.
4. Such a decision on the structure of the discussion paper should allow the staff and Board to concentrate on the issues in the discussion paper, without distraction from the mechanism of delivery.

## THE APPROACH

5. At its November meeting, the Board directed the staff to consider how changes in plan assets and defined benefit obligations would be presented using the proposals being developed in the financial statement presentation project. The Board noted that the project timetables anticipate final guidance in December 2009 for financial statement presentation, and August 2010 for post-retirement benefits. Consequently, some Board members argued that the post-retirement benefits discussion paper should not present proposals that rely on IAS 1 because IAS 1 would no longer exist when the project is finalised.
6. However, when the Board took the decision to add this project to its agenda, it noted that a four-year timetable for phase 1 of the post-retirement benefits project does not permit the project to be tied to progress on other projects. The staff reiterates their view that the Board can hope to achieve their aims for this project only if we work with the tools at hand, ie with IAS 1.
7. The published timetables inevitably suffer the risk of delays. If the discussion paper relied on the financial statement presentation proposals, any delays to that project would risk further progress on the post-retirement benefits project. Similarly, the proposed presentation of pension components in the financial statement presentation project might result in significant controversy that might delay the financial statement presentation project. Tying progress in one

project to another would mean that any difficulties encountered by either project could risk delaying or derailing both.

8. In the staff's view, constituents would be interested in how the pension proposals would look under IAS 1 *and* under the financial statement presentation proposals. Constituents will naturally look to find the interactions between two projects that are open for consultation at the same time. Together, the financial statement presentations and post-retirement benefit discussion papers would set out the Board's most recent thinking.

9. However, the main body of the discussion paper should set out proposals in the context of IAS 1. If the financial statement presentation project is finalised later than anticipated, constituents would look to IAS 1 when applying the requirements arising from this project. It would be unfair to constituents if we did not spell out the consequences for the presentation of changes in pension obligations and plan assets under IAS 1.

## STAFF RECOMMENDATION

10. The staff recommends that the discussion paper presents proposals in the context of IAS 1. An appendix should show how the proposals in the financial statement presentation proposals would apply.

## AGENDA PAPER 8D: DRAFT DISCUSSION PAPER SECTION

[paragraphs 1-53 omitted from observer notes]

## PRELIMINARY VIEWS

54. The Board's preliminary view is all changes in the post-employment benefit obligation and in the value of plan assets should be presented in profit or loss in the period in which they are incurred.

[Paragraphs 55-67 omitted from observer notes]

### Alternatives to the Board's Preliminary Views

68. [Start of paragraph omitted from observer notes] The two alternatives proposed are:

    (a) only service costs are presented in profit or loss. This alternative has the benefits of simplicity.

    (b) only the return on plan assets (other than dividends and interest calculated using the effective interest method) is presented outside profit or loss. This alternative has the benefit that it presents changes in post-employment benefit plans assets and liabilities as much like changes on other assets and liabilities as possible.

69. [Paragraph omitted from observer notes]

#### Alternative 1

70. Alternative 1 is consistent with the view that all costs other than service costs arise as a consequence of deferring payment of employee remuneration. In Alternative 1:

    (a) service costs, current and past, would be presented in profit or loss; and

    (b) all other components would be presented outside profit or loss.

71. Thus:

(a) the actual return on plan assets is not divided into an expected return and an actuarial gain or loss;

(b) interest cost and the return on plan assets are presented in the same statement;

(c) actuarial gains and losses on the defined benefit obligation are not divided into different types; and

(d) items presented outside profit or loss in an earlier period are not recycled to the income statement.

72. [Paragraph omitted from observer notes]

**Alternative 2**

73. In Alternative 2, an entity would present:

(a) service cost, interest cost and actuarial gains and losses on the defined benefit obligation in profit or loss;

(b) dividends and historical cost interest income on the plan assets in profit or loss; and

(c) other changes in the fair value of plan assets in the statement of other recognised income and expense.

74. Thus, in Alternative 2:

(a) the actual return on plan assets is not divided into an expected return and an actuarial gain or loss;

(b) actuarial gains and losses on the defined benefit obligation are not divided into different types; and

(c) items presented outside profit or loss in an earlier period are not recycled to the income statement.

[Paragraphs 75-80 omitted from observer notes]

# AGENDA PAPER 8E: A PENSION ACCOUNTING ALTERNATIVE

## INTRODUCTION

1. At the February Board meeting, I will propose another alternative to the presentation of pension expense. Consistent with the project team's view, my suggestion is placed in the context of IAS 1. It includes items that would be reported outside of profit or loss (in the second statement) and does not contemplate recycling.

2. [Paragraph omitted from observer note].

3. At the team's request, I've submitted this proposal on my own account. They have had more than enough to occupy their time with other tasks. My goal is to demonstrate that there is a straightforward and workable alternative presentation scheme. The result has a degree of arbitrariness – as is true for any scheme for separating parts of the computation from others. As outlined in this paper, I consider this method superior to the two alternatives already in the draft included in February Board papers.

4. This is a preliminary description, and we invite Board member comments. If Board members conclude that this approach is a useful addition to the initial discussion document, then we will develop it further.

## COST ACCOUNTING FOR PENSIONS

5. My suggestion draws on the price and volume variances that many of us learned (painfully, in my case) from Horngren's textbook on cost accounting. I propose that we isolate price variances and report them outside of profit or loss. All remaining recognized changes in the pension obligation would be reported in profit or loss.

6. Pricing variances would include changes in the discount rate applied to the closing balance of the pension obligation and changes in the fair value of plan assets. Everything else would be included in profit or loss. That list would include

interest cost for the current period, dividends received on plan assets, interest earned on plan assets (using the current rate inherent in the fair value), service cost, and the affect of plan amendments.

7. I’ve illustrated how this approach might work using the example from the beginning of Appendix A to IAS 19.

| | **20X1** | **20X2** | |
|---|---|---|---|
| Present value of obligation, 1 January | 1,000 | 1,141 | |
| Interest cost | 100 | 103 | (a) |
| Current service cost | 130 | 140 | (a) |
| Past service cost—non-vested benefits | | 30 | (a) |
| Past service cost—vested benefits | | 50 | (a) |
| Benefits paid | (150) | (180) | |
| Affect of change in discount rate (estimated) | 159 | 190 | (a), (c) |
| Actuarial (gain) loss on obligation (balancing figure) | (98) | (277) | (a) |
| Present value of obligation, 31 December | 1,141 | 1,197 | |
| Fair value of plan assets, 1 January | 1,000 | 1,092 | |
| Dividend and interest income (assumed) | 75 | 85 | (b) |
| Contributions | 90 | 100 | |
| Benefits paid | (150) | (180) | |
| Change in fair value of plan assets | 77 | 12 | (b), (c) |
| Fair value of plan assets, 31 December | 1,092 | 1,109 | |
| Change in the PV of obligation (a) | 291 | 236 | |
| Earnings on plan assets (b) | (152) | (97) | |
| | 139 | 139 | |
| Amount reported outside of profit or loss (c) | 82 | 178 | |
| Amount reported in profit or loss (remainder) | 57 | (39) | |

8. The discount rate at the beginning of the period is used in computing service cost, interest cost, and past service cost. The example doesn’t provide enough information to insert some of the numbers more precisely. The effect of the change in discount rates is a rough estimate, based on an average maturity of 15 years. The amount of dividends and interest is assumed. Realized gains or losses on plan assets (the difference between proceeds and fair value at the beginning of the period) would be reported with other changes in fair value. The amount of actuarial gain or loss from changes in estimate remains a plug figure, but with different components.

9. [Paragraph omitted from observer note].

10. [Paragraph omitted from observer note].

11. I don't see any precise mechanism for recycling the amount reported outside of profit or loss. Recycling is usually driven by a realization or consumption notion. However, discounting and interest cost are part of every number in the computation of pension cost. It would be difficult, if not impossible, to isolate the part of benefits paid (the "realized" part of the obligation) that is attributable to previously recognized changes in rates. We could, perhaps, make a rough approximation based on the ratio between (a) cumulative service costs and actuarial gain or loss and (b) cumulative benefits paid or some other ratio. If the Board concludes that recycling must be part of any proposal to report amounts outside profit or loss, then we will investigate possible devices.

12. [Paragraph omitted from observer note].

13. There remains the question of transition, and I admit that I have not fully considered the issue. Again, if Board members conclude that this is a useful addition to the discussion document, we will include it in a general discussion of transition.

14. [Paragraph omitted from observer note].