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International Accounting Standards Board

INFORMATION FOR OBSERVERS

IASB Meeting:	**Employee Benefits Working Group**
Paper:	**Agenda Paper 3C – Recognition and Presentation: Presentation alternatives**

1. As noted in paper 1A, the Board's project on post-employment benefits interrelates with its project on financial statement presentation. The Board has decided to address the deferred recognition features of IAS 19 without waiting for completion of the financial statement presentation project. The Board has noted the importance to this project of matters to be discussed in Phase B of the financial statement presentation project. Neither Phase A nor Phase B of the financial statement presentation project specifically address the presentation and display of components of post-employment benefit cost. However, the general thinking being developed in Phase B will determine the presentation of post-employment benefit costs in due course and in the meantime may help form views on their presentation under IAS 1.

2. Accordingly, the Board concluded that it would be premature to express a preliminary view on presentation at this stage of the project. Instead, the Board decided to present three approaches to presentation that illustrate ways in which information about components of post-employment benefit costs could be presented.

3. The Board intends to identify approaches in which the usefulness of information about components of post-employment benefit cost could be enhanced. Usefulness will be assessed with reference to the qualitative characteristics of financial statements, in particular, relevance. In this context, the Board noted the following arguments:

   (a) Some users consider post-employment benefit obligations to be financing in nature. This is because the entities can determine the size of their post-employment benefit obligations through financing-type decisions. Paragraph 16 of the Framework states that "information about financial structure is useful in predicting future borrowing needs and how future profit and cash flows will be distributed among those with an interest in the entity; it is also useful in predicting how successful the entity is likely to be in raising further finance."

   (b) Some constituents argue that some components of changed in post-employment benefit obligations are unusual, abnormal or infrequent, for example, those changes that arise from events outside management control, or those that cannot be classified as operating. The Framework[1] notes that predictive value "is enhanced … by the manner in which information on past transactions and events is displayed". Specifically, "the predictive value of the income statement is enhanced if unusual, abnormal and infrequent items of income or expense are separately disclosed".

   (c) Separate identification of some components of post-employment benefit cost should provide information about variability of the employer's performance. The Framework states this is important to assess potential changes in the economic resources that [the entity] is likely to control in the future.

4. The Board has not expressed any view on the arguments in paragraph 3. Nonetheless, the Board believes that distinguishing some components of post-employment benefit costs from others would enhance the relevance of information on the financial statements. Separate disclosure of those components is already required in the notes to the financial statements. The question is whether any distinction should also be reflected in the primary statements.

[1] Paragraph 28

5. Some IFRSs do distinguish between types of items by recognising some items outside profit or loss. However, IFRSs provide no general principle for recognising items outside profit or loss. IAS 1 requires items to be recognised in profit or loss other than specific exceptions that were created on an ad-hoc basis.

6. Some Board members argue that there is no conceptual basis for recognising any items outside profit or loss and opposed creating further exceptions. However, other Board members argue that the Board could achieve a significant improvement in financial reporting for post-employment benefit costs in the short-term only if it considered approaches in which some components of the cost are recognised outside profit or loss. Those Board members note that the Amendments to IAS 1 resulting from Phase A of the financial statement presentation project result in an equal status for all items of income and expense that are recognised in the single statement of comprehensive income. Items of income and expense recognised outside profit or loss are part of comprehensive income, and not recognised directly in equity. Thus, there is no conceptual basis to assign a superior status to components displayed in profit or loss, compared to those in other recognised income and expense.

7. The Board believes many constituents are resistant to recognising all changes in defined benefit plans in the period in which they occur because they are concerned that presenting all those changes in profit or loss would not give sufficient prominence to the different nature of some of those changes. Some of the Board contend that the presentation of some components of changes in post-employment benefit obligations outside profit or loss could address some of these concerns, and would be the best way to improve financial reporting of post-employment benefit plans until the comprehensive Phase 2 project and Phase B of the financial statements presentation project is completed. Those Board members argue that the single statement of comprehensive income that will be required by IAS 1 provides an adequate framework to permit transparent reporting of all post-employment benefit costs. Those Board members believe that it is more important that all costs are recognised in comprehensive income than where in comprehensive income they are recognised.

8. Accordingly, two of the alternative approaches present some components of post-employment benefit cost outside profit or loss.

9. The Board acknowledged that an approach that recognised some components of post-employment benefit cost outside profit or loss would prompt questions about whether any such amounts should be recycled. IAS 19 does not permit recognition of gains and losses in profit or loss that had been recognised outside profit or loss in an earlier period. In the Basis for Conclusions to IAS 19, the Board noted "there is not a consistent policy on recycling in IFRSs and that recycling in general is an issue to be resolved in its project on reporting comprehensive income." It also noted that "the question of recycling…remains open in IFRSs" and that it "does not believe that a general decision on the matter should be made in the context of [amendments to IAS 19]. The decision […] not to recycle actuarial gains and losses is made because of the pragmatic inability to identify a suitable basis". The Board remains convinced by this logic for Phase 1 of this project. It will consider the question of recycling more widely in its project on financial statement presentation.

The approaches

10. The three approaches set out below present information about post-employment benefit cost in different ways. Each approach seeks to present information that is useful, drawing on constituents' expressed opinions and views, and discussion from the Board's financial statements presentation project. The advantages and disadvantages of the approaches are discussed. The staff would welcome elaboration of these advantages or disadvantages from working group members.

Approach 1

11. All changes in the defined benefit obligation and in the value of plan assets are presented in profit or loss in the period in which they are incurred.

Approach 2

12. This approach presents the costs of service in profit or loss. All other costs are reported as consequences of deferring payment of employee remunerations and financing that deferred payment.

13. Accordingly:

    (a) service costs, and the gains and losses associated with them are recognised in profit or loss. Thus, service costs, and actuarial gains and losses on the defined benefit obligation except those arising from changes in the discount rate would be recognised in profit or loss.

(b) all other changes are recognised outside profit or loss. This includes interest cost, changes in the discount rate and all changes in plan assets.

Approach 3

14. This approach presents changes arising from changes in financial assumptions outside profit or loss. Thus, changes in the computed “price” of the pension obligation and fair value of plan assets are recognised outside profit or loss.

15. Accordingly, profit or loss would include:

(a) service cost,

(b) interest cost,

(c) actuarial gains and losses on the defined benefit obligation except those arising from changes in the discount rate,

(d) dividends received on plan assets, and

(e) interest earned on plan assets (using the current rate inherent in the fair value).

16. The Board does not intend to conclude which is the most appropriate approach in the discussion paper. Not all Board members agree that all the approaches are acceptable. Similarly, some of the arguments presented in the discussion are not supported by some Board members. However, the Board intends to include the three approaches and the arguments for and against them in the discussion paper to give a complete analysis of the approaches and to obtain a variety of constituent views.

Discussion of the three approaches

Consistency with other IFRSs

17. Some argue that only approach 1 is consistent the Framework and IAS 1, and that it is the most consistent with other IFRSs. This is because the Framework states that items of income and expense are presented in the income statement and IAS 1 provides no general principle for recognising items outside profit or loss. Items that are recognised outside profit or loss are specific exceptions that were created

on an ad-hoc basis. Approach 1 does not require that the Board create further exceptions.

18. In addition, approach 1 is consistent with other IFRSs, as follows:

    (a) IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, which requires the effect of changes in accounting estimates be included in profit or loss for the period if the change affects the current period only but not future periods.

    (b) IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, which requires changes in liabilities, including changes in long-term liabilities (such as an asset retirement obligation), to be recognised in profit or loss in the period they occur.

19. Approaches 2 and 3, in recognising components outside profit or loss, are inconsistent with the general approach under IFRSs. In particular, approach 2, which requires that interest cost is presented outside profit or loss, would be inconsistent with most other IFRSs, that require interest cost to be recognised as an expense in profit or loss, as discussed further below.

Perceived offsets

20. Some constituents argue that, if some components of post-employment benefit cost are presented outside profit or loss, it is important to examine potential interrelationships between different components. Those most often suggested by constituents are the interrelationship between:

    (a) the interest cost on the post-employment benefit obligation and interest income on plan assets. Many constituents regard such offset as being an important economic effect of a funded plan. The interest cost that arises from discounting the post-employment benefit obligation represents changes in the carrying amount of the liability because of the passage of time. Thus, they argue that interest cost on defined benefit obligations should be offset by interest income on plan assets that also arises because of the passage of time.

    (b) between the total return on plan assets and the change in the post-employment benefit obligation. Many constituents argue that an offset exists between the effect of changes in economic assumptions, particularly interest rates, on plan assets and defined benefit obligations. Thus, they argue that presentation of changes in plan assets should be consistent with the presentation of changes in the defined benefit obligation.

21. The three approaches accommodate these views because they recognise the components that constituents believe may offset either both in profit or loss or both in other comprehensive income.

Remeasurements

22. Preparers regularly maintain that net income should be a reflection of operations, or a business model, or management control. They often assert that price changes on items that are notionally long-term are external to operations, the business model, or management control.

23. Although many recognised price changes are presented in profit or loss, some argue that all of the items currently reported outside of profit or loss are recognised price or value changes. Approach 3 draws on these views by proposing that changes in price of the obligation and in the fair value of plan assets are presented outside profit or loss.

24. In contrast, approach 1 does not differentiate between remeasurement changes and other costs, and approach 2 would introduce an item in other comprehensive income that is not a remeasurement change, and thus is different from the other items there.

Financing

25. Employee benefit plans involve deferred payment of a current benefit. Thus, the components of the defined benefit cost for each period includes both the current benefit and the effects of deferring payment of benefits from the current and previous periods. Some users favour separate presentation of the financing costs and the costs relating to employee service in the period. Although they regard information about financing as useful and relevant to the financial statements, they consider it different from information about the operating and business activities of entities.

26. In contrast, some preparers regard post-employment benefit cost as a single operating component. They regard all the amounts paid in post-employment

benefits as relating to employee service costs. Those preparers do not favour identifying a financing component and an operating component.

27. All the approaches could accommodate the view that employee benefit plans have a financing component. Approaches 1 and 3 could identify a financing component within profit or loss. Approach 2 would emphasis the distinction between the financing component and service component by recognising the financing component outside profit or loss. However, that approach would be inconsistent with the general requirement in IFRSs that financing costs are recognised in profit or loss.

Disaggregation of fair value changes

28. Research from the financial instruments team indicates that many users do not find information about disaggregation of changes in the fair value of assets to be decision-useful. Approaches 1 and 2 do not require any disaggregation of changes in the fair value of assets.

Practicality

29. Approach 1 avoids the need for any potentially arbitrary and complicated rules about the allocation of cost to profit or loss and other recognised income and expense. Approach 1 is also permitted by the existing version of IAS 19, and has been implemented by entities in the past. The Board regards Approach 1 as the least complicated to implement and understand.

30. Approach 2 uses the information that entities are already required to collect to apply the present version of IAS 19. As such it should also be easy to implement. The separation between service costs and other costs in this approach is intuitive to understand and provides the cleanest division of components of post-employment benefit cost.

31. Approach 3 requires the calculation of interest earned on plan assets using the current rate inherent in the fair value. Accordingly, approach 3 requires the calculation of information not currently required by IAS 19.

Conclusions

32. The three approaches have been devised to try to accommodate as many of the frequently expressed views from preparers and users as possible, while still

requiring immediate recognition of all gains and losses in comprehensive income. The Board decided that it should not conclude on one approach at this stage of the project.

33. The Board intends to make only interim decisions in this discussion paper. The Board's debates have been in the context of a short-term project to improve the accounting for post-employment benefits. The decisions in Phase 1 of this project will not dictate the outcome of Phase 2. However, the information received in response to the Discussion Paper will inform the Board's thinking in the future.

Questions for participants

What information about the components of defined benefit costs is useful?

What are the advantages or disadvantages of each of the alternative approaches?

Which approach do you support? Why?