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International Accounting Standards Board

INFORMATION FOR OBSERVERS

IASB Meeting: **Employee Benefits Working Group**
Paper: **Agenda Paper 2 – The Phase 2 project**

Purpose of this paper

1. The Board intends to perform a comprehensive review of the accounting for post-employment benefits in phase 2 of its project. This paper explores the issues that could be included in the scope of Phase 2, and approaches to the conduct of Phase 2.

Scope of Phase 2

2. The Board has yet to decide on the topics to be included in the second phase of its post-employment benefits project. An initial list includes:

    a. **Recognition of the obligation based on the benefit formula**. IAS 19 relies on the benefit formula to determine the obligation that is recognised for post-employment benefit promises. A review of this area would include consideration of the recognition of unvested benefits as a liability, and the liability recognised when the benefit formula attributes benefits unevenly over the service life of the employee.

    b. **Measurement of the obligation.** The employee-benefit model in IAS 19 is fundamentally different from the recognition and measurement models in other IFRSs. Some argue that IAS 19's requirement to measure the post-employment benefit obligation based on the projected benefit (including salary increases) is fundamentally flawed. This was a common complaint in the FASB's comment letter analysis related to SFAS 158. A comprehensive review of measurement would include:

i. review of the use of the projected unit credit (PUC) method used in computing the present value of the future benefits, and consideration of alternative measurement methods for all types of benefit arrangements. These measurement methods include the accumulated benefit obligation, the projected benefit obligation, fair value or settlement value.

ii. whether future increases in salary should be included in the measurement of the benefit liability

iii. the criteria for selecting input assumptions, including the relevant discount rate to be used.

c. **Presentation of a net pension obligation, rather than consolidation of pension assets and liabilities in the sponsor's financial statements.** IAS 19 assumes that a fund is not within the control of the sponsoring entity and requires that the net pension deficient or surplus is recognised. If a fund were within the control of the sponsoring entity, the assets and liabilities in the fund would be consolidated on a line-by-line basis in the sponsoring entity's financial statements. A review of this area would examine the application of the Board's project on consolidation to post-employment benefit arrangements.

d. **Disaggregation of components of defined benefit cost.** As discussed in paper 3C, the Board intends to propose three approaches to the presentation of components of defined benefit cost in the discussion paper for Phase 1 of the project. However, that is only an interim measure. Presentation would be revisited in Phase 2, drawing on the results from the phase 1 consultation, and in the light of developments in the Board's project on financial statement presentation.

e. **Multiemployer plans.** For a multiemployer defined benefit plan, IAS 19 requires an entity to account for its proportionate share of the defined benefit obligation, plan assets, and costs associated with the plan in the same ways as for a single-employer defined benefit plan. However, IAS 19 provides an exemption from defined benefit accounting when sufficient information is not available to apply defined benefit accounting. In that case, the entity applies defined contribution accounting and discloses that fact. This means that some plan liabilities may not be recognised on the financial statements.

3. In addition, there may be other areas that the Board might decide to address, for example, issues referred to the IFRIC that might be more appropriately dealt with as part of a comprehensive project.

Questions for participants

Which issues do you regard as priorities for addressing in phase 2, and why?

Are there aspects of the IAS 19 model which you think should be retained without further consideration?

Conducting Phase 2

4. Both the IASB and the FASB are conducting two-phase projects on post-employment benefit accounting. However, when the Board completes Phase 1, it will face different issues from those facing the FASB at the end of its Phase 1 project. The background of both Board's Phase 1 projects is set out in paper 1A.

5. In Phase 2, the Board intends to work towards a standard on post-employment benefits that is converged with the FASB. However, there is an issue in the timing. The FASB completed its Phase 1 project with the publication of SFAS 158 *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* in September 2006. It is ready to start work on Phase 2. In contrast, the Board intends to complete Phase 1 of its project before starting work on Phase 2.

6. The question that arises is the best way of working towards convergent standards for post-employment benefits accounting, given the difference in the timing and in the different starting points.

7. There are a number of ways to approach Phase 2:

    a. a comprehensive project

    b. a project phased by benefit type

    c. a project phased by problematic issues

d. a project phased by broad areas

These approaches are discussed below.

Comprehensive project

8. Under this approach, all issues are addressed comprehensively before implementing changes in accounting. Some argue that this approach is the most effective way to produce a cohesive, principles-based standard. However, others argue that there are improvements that should be made and promulgated sooner than would be possible in a comprehensive project. They criticise the length of time it takes to produce a comprehensive standard. They note that a phased approach would allow the Board and the FASB to work separately on issues relevant to only one Board, while working together on issues relevant to both.

Project phased by benefit type

9. One approach to a phased project would be to focus on types of benefit arrangements, such as defined benefit, defined contribution and other plan types, multiemployer plans and other post-employment benefit arrangements. Some argue that this type of phase approach may result in some improvements sooner, but may not result in a single, principles-based standard for similar arrangements.

Project phased by problematic issues

10. Another approach is to focus initially on key problem areas and address those areas in a targeted, phased project. For example, it may be possible to address some measurement issues on a standalone basis. The Board's Phase 1 project is an example of one phase of a project phased by problematic issues. The Board adopted that approach for Phase 1 because of the ability to deal with those identified issues quickly. However, the main disadvantage of tackling the rest of the project in this way is that it would result in serial changes to accounting and reporting. Some constituents have expressed understandable concern about the prospect of serial changes to the way benefit obligations are measured, or multiple changes to the way plans are reported in the financial statements. It would be particularly important in this approach to avoid implementing changes that could be reversed or modified in a later phase. It might also be possible, under this approach, that a project narrowly focussed on key problematic issues would make a comprehensive project unnecessary.

Project phased by broad areas

11. In this approach, each phase would represent a broad area – recognition and measurement, presentation and disclosure, and consolidation issues. For each phase, the objective would be to produce a high-quality standard that would survive without change for many years, and could align with the Board other projects.

Conclusion

12. The Board has already embarked on a phased approach by addressing cash balance plans (problematic issue, benefit type) and deferred recognition and smoothing (broad area, problematic issue). The question is whether the remaining issues should be addressed in the same way.

Question for participants
What approach do you think the Board should take in its Phase 2 project?
What are the advantages of your approach?