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International Accounting Standards Board

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Note: The observer note is based on the staff paper prepared for the IFRIC. Paragraph numbers correspond to paragraph numbers used in the IFRIC paper. However, because the observer note is less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

IFRIC meeting: **November 2007, London**

Project: **IAS 19 *Pensions* – Definition of plan assets (Agenda Paper 7D)**

INTRODUCTION

1. In April 2005, the IFRIC received a request for it to issue guidance on the accounting for insurance and investment policies issued to a pension plan by an entity that employs the staff included in the plan (or by a subsidiary that is consolidated in the same group as that entity). The submission asked how such contracts should be accounted for when determining plan assets in accordance with IAS 19. It also asked what the accounting treatment would be if the policies were transferable. The submission considered both the entity's consolidated and separate financial statements.

2. This paper sets out the staff's analysis of whether this issue should be taken on to the IFRIC's agenda.

BACKGROUND AND APPROACH

3. In considering this issue, the staff first considered the accounting in the entity's consolidated accounts. The staff considered separately situations in which a policy is issued to a long-term employee benefit fund and situations in which a policy is issued to the employing entity. The staff next considered the accounting in the separate financial statements of the employer. In doing so, the staff considered whether the accounting for a

policy held by a fund was consistent with the accounting for a policy held by an employer and whether the accounting in the consolidated and separate financial statements was consistent.

4. The staff noted that the definition of 'assets held by a long-term employee benefit fund' in IAS 19.7 excludes 'non-transferable financial assets issued by the reporting entity'. For each situation described above the staff therefore considered whether the accounting treatment differs depending upon whether the policy is a non-transferable financial instrument.

5. The staff noted the footnote to IAS 19.7 that states that 'a qualifying insurance policy [for the purpose of IAS 19] is not necessarily an insurance policy as defined in IFRS 4 *Insurance Contracts'*. In some jurisdictions, entities may be required to wrap investment contracts in insurance contracts to satisfy local law or regulation. Because of the footnote to IAS 19.7, it may not always be clear whether such policies can meet the definition of 'qualifying insurance policies'.

6. In concluding its analysis, the staff considered whether entities may be able to obtain different accounting outcomes by wrapping investment policies in insurance policies without significantly changing the economic effects of the contracts. In other words, would a different accounting outcome be obtained for an insurance policy that is identical to an investment policy in all respects other than its name?

7. It should be noted that, in making this determination, the staff has only considered the accounting for policies issued by a group entity. The analysis may differ if policies issued by entities that are not related-parties are also considered.

CONCLUSIONS

8. The table below summarises the staff's conclusions as to whether an investment or insurance policy is a plan asset when it is issued by a group company. The table summarises the treatment in both the separate financial statements and the group consolidated financial statements. A detailed analysis of how the staff reached these conclusions is set out in paragraphs 12 – 46 below.

	Investment Policies		**Insurance policies**	
	Not a non-transferable financial instrument	Non-transferable financial instrument	Not a non-transferable financial instrument	Non-transferable financial instrument
Consolidated financial statements				
Policies issued to the plan	Plan assets	Not plan assets	Plan assets	Not plan assets
Policies issued to the employer	Not plan assets			
Separate financial statements of the employer				
Policies issued to the plan :				
by the employer	Plan assets	Not plan assets	Plan assets	Not plan assets
by another group company	Plan assets			
Policies issued to the employer	Not plan assets			

Notes:

a) This summary assumes that all investment and insurance policies are issued by a group company.
b) All policies issued to a plan are assumed to meet criteria (a) and (b) in the definition of 'assets held by a long-term employee benefit fund' in IAS 19.7.

9. The staff particularly notes the following:

- The treatment in the group accounts is consistent regardless of whether the policy is an insurance policy or an investment policy. Entities will therefore receive the same accounting treatment regardless of whether an investment policy is 'wrapped' as an insurance policy. The staff does not therefore consider that the lack of a definition of an insurance contract in IAS 19 is an issue in this situation.

- A different treatment may be obtained depending on whether a policy that is not a non-transferable financial instrument is issued to the plan or to the employer. However, the staff notes that whether a policy is issued to the plan or to the employer changes the economic substance of the arrangement. In particular, a policy held by a plan is unlikely to be available to the employer's creditors (even in bankruptcy).

- If a policy (either an investment policy or an insurance policy) is issued to a plan by a group company that is not the employer then that policy may be considered to be a plan asset in the employer's separate financial statements but not in the group consolidated financial statements. The treatment in the separate financial statements could be considered to be inconsistent with the treatment in the group financial statements.

10. The staff considers that the analysis below demonstrates that the guidance in IAS 19 regarding this issue is sufficiently clear that significant divergence would not be expected to arise in practice.

11. An issue arises when a policy (either an investment policy or an insurance policy) is issued to a plan by a group company that is not the employer. This may result in inconsistent accounting for plan assets in the group and separate financial statements. However, the staff considers that this difference can be explained in a similar way to an intercompany balance. In the group accounts the policy does not give rise to an external payable or receivable. In the separate financial statements of the sponsor, there is a receivable from an entity outside of that entity. While the definition may result in different plan assets, the staff does not therefore consider that it gives rise to an incorrect accounting treatment.

STAFF ANALYSIS

Group consolidated accounts

12. IAS 19.7 states:

'*Plan assets* comprise:

(a) assets held by a long-term employee benefit fund; and

(b) qualifying insurance policies.

Assets held by a long-term employee benefit fund are assets (other than non-transferable financial instruments issued by the reporting entity) that:

(a) are held by an entity (a fund) that is legally separate from the reporting entity and exists solely to pay or fund employee benefits; and

(b) are available to be used only to pay or fund employee benefits, are not available to the reporting entity's own creditors (even in bankruptcy), and cannot be returned to the reporting entity, unless either:

(i) the remaining assets of the fund are sufficient to meet all the related employee benefit obligations of the plan or the reporting entity; or

(ii) the assets are returned to the reporting entity to reimburse it for employee benefits already paid.

A qualifying insurance policy is an insurance policy issued by an insurer that is not a related party (as defined in IAS 24 *Related Party Disclosures*) of the reporting entity, if the proceeds of the policy:

(a) can be used only to pay or fund employee benefits under a defined benefit plan; and

(b) are not available to the reporting entity's own creditors (even in bankruptcy) and cannot be paid to the reporting entity, unless either:

(i) the proceeds represent surplus assets that are not needed for the policy to meet all the related employee benefit obligations; or

(ii) the proceeds are returned to the reporting entity to reimburse it for employee benefits already paid.'

13. The footnote to IAS 19.7 states 'a qualifying insurance policy is not necessarily an insurance contract, as defined in IFRS 4 *Insurance Contracts*.'

Policies issued to a long-term employee benefit fund

14. The staff first considered the treatment of policies issued by a group company to a long-term employee benefit fund. For the purpose of this analysis, the staff has assumed that the policies meet criteria (a) and (b) in the definition of 'assets held by a long-term employee benefit fund' in IAS 19.7.

15. If this is not the case, the policies will not meet the definition of a plan asset regardless of whether they are an investment policy or an insurance policy.

16. An investment or insurance policy issued by a group company cannot meet the definition of a 'qualifying insurance policy' since the policy is issued by a related party.

17. However, a policy issued by a group company that is held by a long-term employee benefit fund will meet the definition of an 'asset held by a long-term employee benefit fund' as long as it is not a 'non-transferable financial instrument'.

18. The staff considers that, in most cases, an investment or insurance contract will be a financial instrument (the only situation in which this is unlikely to be true would be an insurance policy that is not settled in cash). Furthermore, in most cases, an investment or insurance policy issued by a group entity covering the employees in a fund will not be transferable. The staff therefore considers that, in most cases, investment and insurance policies issued to a plan by a group company will be non-transferable financial instruments. Such policies will not meet the definition of plan assets.

19. The staff therefore concludes that, if an investment or insurance policy is issued to an employee benefit fund by a group company and it meets criteria (a) and (b) in the definition of 'assets held by a long-term employee benefit fund' in IAS 19.7' then it will be a plan asset so long as it is not a 'non-transferable financial instrument'. If the policy is held by a long-term employee benefit fund then its treatment will be the same regardless of whether it is an investment or an insurance policy. In many cases, such policies will be non-transferable financial instruments and so will not meet the definition of plan assets

Policies issued to an employer

20. The staff next considered the treatment of policies issued by a group company to the employer.

21. An investment or insurance policy issued by a group company to an employer cannot meet the definition of a 'qualifying insurance policy' since the policy is issued by a related party.

22. Similarly, since it is issued to the employer, it is not 'held by an entity (a fund) that is legally separate from the reporting entity and exists solely to pay or fund employee benefits'. The investment or insurance policy cannot therefore meet the definition of an 'asset held by a long-term employee benefit fund'.

23. Such a policy is not therefore a qualifying insurance policy or an asset held by a long-term employee benefit fund and so is not a plan asset regardless of whether it is an investment or insurance policy or whether it is a non-transferable financial instrument.

Application of IFRS 4

24. IG 1.21 of IFRS 4 states

<u>*Contract type*</u>
'An insurance contract issued by an insurer to a defined benefit pension plan covering the employees of the insurer, or of another entity consolidated within the same financial statements as the insurer.

<u>*Treatment in phase I*</u>
The contract will generally be eliminated from the financial statements, which will include:

(a) *the full amount of the pension obligation under IAS 19 Employee Benefits, with no deduction for the plan's rights under the contract.*

(b) *no liability to policyholders under the contract.*

(c) *the assets backing the contract.'*

25. The staff noted that IFRS 4.IG1.21 considers exactly the same situations as are discussed above. The staff therefore considered whether the conclusions reached above are consistent with the requirements of IG 1.21 if the policy is an insurance policy.

26. The staff notes that the guidance in IG 1.21 suggests that, when an insurance policy is issued to a fund, it will generally be eliminated from the financial statements and not be treated as a plan asset.

27. The staff concluded above that an insurance policy issued to the fund by a group company is only a plan asset if it is not a non-transferable financial instrument. If it is a non-transferable financial instrument then it will not be a plan asset and will be accounted for as described in IG 1.21.

28. As discussed above, the staff considers that, in most cases, an insurance contract will be a financial instrument. Furthermore, in most cases, an insurance policy covering the employees in a fund will not be transferable. The staff therefore considers that, in most cases, insurance policies will be non-transferable financial instruments. Such policies will not meet the definition of plan assets.

29. The staff considers that this is consistent with IG1.21 which states that 'the contract will *generally* be eliminated from the financial statements' (emphasis added).

Separate financial statements

30. The staff next considered the accounting for the investment or insurance policies in the separate financial statements of the employer.

Policy issued to the long-term employee benefit fund

31. The staff first considered policies issued by the employer. It then considered policies issued by other group companies. In both cases, the staff has considered the accounting in situations in which the policy qualifies as a plan asset and those in which it does not.

Policies issued by the employer

Policies that meet the definition of plan assets

32. If a policy meets the definition of plan assets then it will be taken into account in measuring the position of the pension plan. The employer will have a liability to the plan in respect of the insurance or investment policy.

33. The staff considers that, whether the policy is an insurance policy or an investment policy may affect the measurement of the liability in the books of the employer but that guidance on measuring that liability is included within the relevant standards (in particular, IAS 37, IAS 39, and IFRS 4).

34. The staff does not therefore consider that divergence is likely to emerge in the accounting for policies issued by the employer that meet the definition of plan assets.

Policies that do not meet the definition of plan assets

35. If a policy does not meet the definition of plan assets then it will not be taken into account in measuring the position of the plan. Instead, the employer will not recognise either an asset or a liability for the policy.

36. The staff notes that the difference between this situation and the situation in which the policy does meet the definition of a plan asset is that, if the policy forms part of plan assets, the entity will recognise a reduced pension liability and a liability for the investment or insurance policy. In contrast, if the policy does not meet the definition of a plan asset, the entity will recognise an increased pension liability but no liability in respect of the insurance or investment policy.

37. The staff recognises that plan assets are measured using IAS 19 whereas a liability for the insurance or investment policy may be measured using IAS 37, IAS 39, or IFRS 4. However, the staff concludes that the difference in treatment is largely a presentational issue.

38. The staff does not therefore consider that divergence is likely to emerge in the accounting for policies issued by the employer that do not meet the definition of plan assets.

Policy issued by a group company other than the employer

39. If the policy is issued by a group company other than the employer then the employer will not have a liability regardless of whether the policy forms part of plan assets. The liability will only arise in the separate financial statements of the issuer of that policy.

40. However, in this case, the reporting entity is the employer. Since the employer (the reporting entity) does not issue the policy, it cannot be a ‘non-transferable financial instrument *issued by the reporting entity*’. In other words, as long as the conditions in IAS 19.7 are met, the policy will form part of plan assets regardless of whether it is a non-transferable financial instrument.

41. This means that ‘non-transferable financial instruments’ that are issued by an entity that is not the employer and meet the other criteria for being an ’asset held by a long-term employee benefit fund’ in IAS 19.7 will be treated as a plan asset in the employer’s separate financial statements but not in the consolidated group financial statements.

42. While this treatment could be seen as being inconsistent, the staff considers that it could also be seen as being similar to an inter-company balance. In the group accounts, the liability of the entity issuing the policy is eliminated against the corresponding asset. This

elimination is appropriate because the group does not have any external asset or liability. In the individual company accounts, the asset is not eliminated as it falls due from a party outside of the reporting entity.

Policy issued to the employer

43. The staff notes that, if the investment or insurance policy is issued to the employer, it can only be issued by another group company (ie it cannot be issued by the employer).

44. Such a policy cannot be a ‘qualifying insurance policy’ since it is issued by a related party. Similarly, such a policy cannot be an ‘asset held by a long-term employee benefit fund’ as it is not ‘held by an entity that is legally separate from the reporting entity and exists solely to pay or fund employee benefits.’

45. A policy issued by a group company to an employer (rather than a fund) cannot therefore be considered as part of plan assets in the separate financial statements.

46. The entity issuing the policy should therefore recognise a liability in respect of that policy. The employing entity should recognise an asset to the extent that relevant accounting standards permit.

SHOULD THE ISSUE BE TAKEN ON TO THE IFRIC AGENDA?

47. The staff considered whether the issue should be taken on to the IFRIC agenda with reference to the agenda criteria set out in the IFRIC Due Process Handbook.

Widespread and practical relevance

48. As discussed above, the staff considers that the key issue that arises in this situation occurs when a policy (either an investment or an insurance policy) is issued to a plan by a group company that is not the employer. In this situation, a perceived inconsistency may arise between the treatment of the policy in the group accounts and the separate financial statements of the sponsor.

49. This inconsistency will arise only if the policy:

    (a) is held by an entity (a fund) that is legally separate from the reporting entity and exists solely to pay or fund employee benefits; and

    (b) is available to be used only to pay or fund employee benefits, is not available to the reporting entity's own creditors (even in bankruptcy), and cannot be returned to the reporting entity, unless either:

        (i) the remaining assets of the fund are sufficient to meet all the related employee benefit obligations of the plan or the reporting entity; or

(ii) the assets are returned to the reporting entity to reimburse it for employee benefits already paid.

50. The staff also notes that, whilst there is an inconsistency between the group and separate financial statements, the treatment in the group accounts is consistent with the treatment of other similar policies. Additionally, the inconsistency can be justified on the basis that the group does not have an external payable or receivable but the individual company does.

51. As the issue only arises in individual financial statements in a limited number of situations, the staff considers that it is not an issue of widespread or practical relevance.

Significantly Divergent interpretations

52. The submission received by the IFRIC did not suggest that divergence existed in this area. The staff has not performed a detailed analysis to whether divergence does exist.

53. However, as demonstrated above, in the staff's view, the guidance in this area is sufficiently clear that divergence is unlikely to emerge in practice. The issue that may arise is that, in some circumstances, IAS 19 may give rise to a perceived inconsistency between the accounting in the group accounts and in the separate financial statements.

54. The staff does not therefore consider that significant divergence exists in this area.

Improvement to financial reporting

55. For the same reasons as discussed above, whilst the staff considers that financial reporting could be improved in this area, it does not consider that issuing guidance will result in a *significant* improvement to financial reporting.

Sufficiently narrow in scope?

56. The staff considers that the issue is extremely narrow in scope, applying only to situations in which a related party other than the employer issues an investment or insurance policy which covers post employment benefits for the employer's staff. The investment or insurance policy must not be a non-transferable financial instrument and must meet criteria (a) and (b) in the definition of an asset held by a long-term employee benefit fund. The issue principally relates to separate financial statements.

57. While the staff considers that the issue is narrow enough for the IFRIC to be able to reach a consensus, the staff concludes that the issue is too narrow to warrant the issue of an Interpretation.

Ability to reach a consensus

58. Since the staff considers that the existing guidance in this area is sufficiently clear to

avoid significant divergence emerging, the staff considers that the IFRIC would be able to reach a consensus in this area.

Relationship with an IASB project

59. The IASB is currently undertaking the first phase of its post-employment benefits project. This project includes the accounting for pensions. The first phase is intended to significantly improve pensions accounting by 2011. A discussion paper in respect of this phase is due to be issued in the first half of 2008.

60. The staff notes that plan assets are not being considered as part of the first phase of this project. While the issue may be considered as part of the second phase of the project, the staff notes that this is not going to take place until after 2011.

61. The staff therefore concludes that the issue is not related to a current Board project.

CONCLUSIONS

62. The staff considers that the accounting literature in this area is sufficiently clear that divergence is unlikely to emerge in practice. In limited situations, the issue may result in a perceived inconsistency between the accounting for plan assets in the group accounts and separate financial statements.

63. In performing its analysis, the staff concluded that the perceived inconsistency would only arise in situations in which an investment or insurance policy was issued to a plan by a group entity that is not the sponsor of the scheme. Furthermore, the policy would need to meet the other criteria to be regarded as an 'asset held by a long-term employee benefit fund' and not be a non-transferable financial instrument. Additionally, the staff did not consider that the perceived inconsistency gave rise to an incorrect accounting outcome.

64. The staff therefore concludes that the issue does not have widespread or practical relevance and that it is too narrow for the IFRIC to develop an Interpretation. The staff therefore recommends that this issue is not taken on to the IFRIC agenda.

65. [Paragraph omitted from observer note].