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International Accounting Standards Board

This observer note is provided as a convenience to observers at IFRIC meetings, to assist them in following the IFRIC's discussion. Views expressed in this document are identified by the staff as a basis for the discussion at the IFRIC meeting. This document does not represent an official position of the IFRIC. Decisions of the IFRIC are determined only after extensive deliberation and due process. IFRIC positions are set out in Interpretations.

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:	**September 2007, London**
Project:	**IAS 19 – *Employee Benefits* Changes to a plan caused by government (Agenda Paper 6B)**

Background

1. At its November 2004 meeting, when examining the activities of other Interpretative bodies, the Agenda Committee noted the issuance of two pronouncements addressing the accounting for changes to a plan caused by government. The first, issued by the French Comité d'urgence, clarifies that changes in the retirement age should be accounted for as a past service cost and expensed on a straight line basis over the average period until the benefit becomes vested (in accordance with IAS 19 Employee Benefits paragraph 96). The second, an FASB Staff Position, clarifies that the introduction of a subsidy for employers for medical payments to employees should be accounted for as a change in actuarial estimates.

2. The Agenda Committee noted that past service costs and actuarial gains and losses are recognised differently under IAS 19. Thus, different classification would give rise to different accounting. The Agenda Committee also noted that

the issue may arise in several jurisdictions. The Agenda Committee requested that the staff develop a more detailed paper on this issue for consideration at a future meeting.

3. The IFRIC also received a request to provide guidance on the accounting treatment of a change caused by the US government in post retirement medical plans.

Issue

4. The issue is how to account for a change in a defined benefit plan resulting from a government action: as an actuarial gain or loss or as a past service cost?

Staff analysis

5. The staff performed the following analysis:

   - What are the recent changes to defined benefit plans caused by governments and their accounting treatment in their respective jurisdiction?
   - When should the effects of a change caused by a government be treated as an actuarial gain or loss?
   - When should the effects of a change caused by a government be treated as a plan amendment/past service cost?

A) What are the recent changes to defined benefit plans caused by governments and their accounting treatment in their respective jurisdiction?

The changes in the US Medicare legislation

6. The Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the "Act") was signed into law on 8 December 2003. The Act introduces a tax free federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least "actuarially equivalent" to the Medicare Part D benefit. The federal subsidy is based on 28% of an individual beneficiary's annual prescription drug costs between $250 and $5,000. The detailed regulations necessary to implement the Act have not been issued, including those that would specify the manner in which actuarial equivalency must be determined and the evidence required to demonstrate actuarial equivalency.

7. FASB Staff Position No. FAS 106-2 provides guidance on the accounting for the effects of the Act for employers that sponsor postretirement heath care plans that

provide prescription drug benefits. The FASB concluded that actuarial gain treatment was appropriate because the subsidy represents a change in the Medicare reimbursement program. Other changes in that program that affect an employer's net health costs are treated as actuarial gains/losses. Paragraph 30 of FAS 106 lists Medicare reimbursement rates as one of the principal actuarial assumptions used in measuring the postretirement benefit obligation.

The French Pension Reform

8. In France, before the Reform, there were two types of retirement regime:
   - At the employee’s initiative, being subject to social charges,
   - At the employer’s initiative, so-called "mises à la retraite", not being subject to social charges.
9. In 2003, with the Pension Reform or “loi Fillon”, retirement at the employer’s initiative is no longer allowed if the employees have not reached the age of 65. However, a collective agreement could, upon specific conditions, re-establish this possibility. In 2007, the “loi de financement de la sécurité sociale” suppressed the effects of these collective agreements. From 2010, retirement before the age of 65 must result from a negotiation between the employee and the employer and will not be subject to social charges for the entity.
10. The Comité d’urgence of the Conseil National de la Comptabilité (CNC) issued « Avis N. 2004-A » to address the accounting issues arising from the “loi Fillon” and concluded that the effects of the Pension Reform should be considered as past service cost and expensed on a straight-line basis over the average period until the benefits become vested. The accounting treatment is still under consideration after the 2007 law.

Other reforms

11. The staff note that changes to plans caused by government are widespread. In addition to the two reforms outlined above, the staff is aware of :
    - The Pension Protection Act of 2006 in the US,
    - The Pension Act in 2004 in the UK,
    - Pension reforms in Italy.

B) When should the effects of a change caused by a government be treated as an actuarial gain or loss?

12. Paragraph 7 of IAS 19 states that "Actuarial gains and losses comprise:

    (a) experience adjustments (the effects of differences between the previous actuarial assumptions and what has actually occurred); and

    (b) the effects of changes in actuarial assumptions."

13. Paragraph 73 of IAS 19 also states that "actuarial assumptions are an entity's best estimates of the variables that will determine the <u>ultimate cost of providing post-employment benefits</u>".(emphasis added)

14. Regarding the US changes to the Medicare legislation, the staff note that paragraph 88 of IAS 19 states that "assumptions about medical costs shall take account of estimated future changes <u>in the cost of medical services</u>, resulting from both inflation and specific changes in medical costs" and paragraph 91 of IAS 19 states that "The cost of meeting claims may be reduced by benefits from state or other medical providers". Therefore, the subsidy is seen as a reduction in the net cost of medical services, which is one of the key actuarial assumptions used to determine the benefit obligation. The new legislation causes the estimate of net medical costs to be revised. The staff believe that, under IAS 19, the effect of the subsidy should be accounted for as an actuarial gain. This view is consistent with FAS FSP 106-2.

15. Therefore, the staff believe that, when a change in a plan caused by a government affects actuarial assumptions, the effects of this change should be accounted for as an actuarial gain or loss.

C) When should the effects of a change caused by government be treated as a plan amendment/past service cost?

16. Paragraph 7 of IAS 19 defines past service cost as being "the increase in the present value of the defined benefit obligation for employee service in prior periods, resulting in the current period from the introduction of, or changes to, post-employment benefits or other long-term employee benefits. Past service cost may be either positive (where benefits are introduced or improved) or negative (where existing benefits are reduced)".

17. Paragraph 7 of IAS 19 is silent on the initiator of the change. Further, paragraph 97 of IAS 19 states that "past service cost arises when <u>an entity</u> introduces a

defined benefit plan or changes the benefits payable under an existing defined benefit plan” (emphasis added).

18. Paragraph 86 of IAS 19 states that:

‘Actuarial assumptions do not reflect future benefit changes that are not set out in the formal terms of the plan (or a constructive obligation) at the balance sheet date. Such changes will result in:

(a) past service cost, to the extent that they change benefits for service before the change; and

(b) current service cost for periods after the change, to the extent that they change benefits for service after the change.’ (emphasis added)

19. The staff believe that a change should lead to similar accounting treatment whether it is caused by an entity or by a government. BC 55 of IAS 19 states:

‘The Board rejected proposals that:

(a) …

(b) …

(c) even if past service cost is generally recognised on a delayed basis, past service cost should not be recognised immediately if the past service cost results from legislative changes (such as a new requirement to equalise retirement ages for men and women) or from decisions by trustees who are not controlled, or influenced, by the entity's management. The Board decided that such a distinction would not be practicable.’

20. This Basis for Conclusion indicates that the Board did not believe that the accounting should differ depending on the originator of the change.

21. Therefore, the staff believe that, when a change in a plan caused government affects benefits for service before the change, this change should be accounted for as past service cost.

Staff recommendation

22. The staff believe that IAS 19 provides clear guidance to determine whether a change in a defined benefit plan should be treated as an actuarial gain or loss or as past service cost. Some changes made by government demonstrably affect the benefits to be received by the employees and are thus plan amendments resulting in past service costs. Others, such as the US Medicare legislation, affect the employer's cost of providing the plan but not the benefits received by the employees and are thus actuarial gains/losses.

23. For these reasons, the staff recommend the IFRIC not take this issue on to its agenda. Does the IFRIC agree with this recommendation and the draft wording for that reason set out in Appendix 1?

Appendix: draft wording for not taking the item on to the agenda

[Appendix omitted from observer note.]