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**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: February 2008, London

Project: Post-employment benefits

Subject: Sweep issues arising from the second preballot draft of Preliminary Views on Amendments to IAS 19 *Employee Benefits* (Agenda Paper 5)

Introduction

1. In January, the Board reviewed the second preballot draft of Preliminary Views on Amendments to IAS 19 *Employee Benefits*. Board members identified two issues that the staff believes should be discussed by the Board as a whole. This paper discusses these issues:
 - (a) the Board's preliminary view on the inclusion of credit risk in the measurement of contribution-based promises.
 - (b) the use of the term 'fair value excluding non-performance risk' to describe the measurement of the liability for contribution-based promises.
2. An extract of the Discussion Paper showing the proposed changes as a result of comments received on the two issues above are set out in Paper 5A. [Agenda Paper 5A is not reproduced in Observer Notes.]
3. If a Board member wishes to raise any other issue for discussion at the February Board meeting, the staff would appreciate as much advance notification as possible.

Next steps

4. After the Board discussion, the staff intends to circulate a ballot draft that will reflect the Board's decisions and the other comments received on the second preballot draft and hopes to meet the following timetable: [not reproduced in Observer Notes].

Summary of staff recommendations

5. The staff recommends that the Discussion Paper is redrafted to:
 - (a) clarify what is meant by the Board's preliminary view that the measurement of a contribution-based promise should not include the possibility that an entity may reduce the benefits promised (see paragraphs 6-20)
 - (b) express no preliminary view on credit risk and ask a question in the Invitation to Comment on whether and how credit risk should be taken into account (see paragraphs 6-20).
 - (c) change the term used to describe the measurement of contribution-based promises to 'fair value assuming the benefit promise does not change' (see paragraphs 21-24).

Issues

Possible reduction in benefits and credit risk

6. The draft of the Discussion Paper defines non-performance risk as the risk that an entity will reduce or default on its obligation.
7. The Discussion Paper goes on to state that non-performance risk includes:
 - (a) the possibility that an entity might not be able to make the payments necessary to satisfy the liability and
 - (b) the possibility that an entity may reduce the benefits for past service.
8. The preliminary view states that all non-performance risk, including credit risk, should be excluded from the measurement of contribution-based promises.
9. Some Board members do not agree that the Board decided that credit risk should be excluded from the measurement of contribution-based promises. The staff also notes that there is confusion over the use of the terms 'credit risk' and 'non-performance risk' and how those terms relate to the factors noted in paragraph 7 above.

10. This paper seeks to clarify the use of the terms ‘non-performance risk’ and ‘credit risk’, how those terms relate to the factors noted in paragraph 7 above and how the Discussion Paper might be amended. Three particular issues have arisen:
- (a) what does ‘the possibility that an entity may reduce the benefits for past service’ include?
 - (b) what does credit risk include?
 - (c) should we use the term non-performance risk in the Discussion Paper?
11. The Board previously agreed that the possibility that an entity might reduce the benefits for past service should not be included in the measurement of contribution-based promises. From discussions with Board members, the staff now thinks that there are two ways of interpreting that decision.
12. The first is that no possible reductions in benefits should be included in the measurement, *including reductions caused by an inability to make the necessary payments*. Such an interpretation would lead to the conclusion that no credit risk should be included in the measurement, because credit risk always involves the possibility of reductions in benefits caused by an inability to make the necessary payments.
13. The second interpretation is that the Board’s decision would be more precisely stated as:
- The possibility that an entity might reduce the benefits for past service *for reasons other than an inability to make the payments necessary* should not be included in the measurement of contribution-based promises.
- This interpretation would then allow the question of credit risk to be discussed separately.
14. Next, there is confusion over what the term ‘credit risk’ includes. Consistent with the second interpretation of what is included in ‘the possibility that an entity might reduce the benefits for past service’, some argue that (a) in paragraph 7 is credit risk and (b) in paragraph 7 is other non-performance risk. That could be clarified by amending the description as follows:
- (a) the possibility that an entity might not be able to make the payments necessary to satisfy the liability and

(b) the possibility that an entity might reduce the benefits for past service, for reasons other than an inability to make the payments.

15. Others regard both (a) and (b) as being credit risk for the particular pension liability in question. They argue that it does not matter *why* the entity reduces the benefits, any reduction in benefits should be regarded as default by the entity.
16. Finally, the staff on the fair value measurement project have expressed concern over the use of the term ‘non-performance risk’ in the Discussion Paper. They note that it is not an established IFRS term and they worry that some aspects of (b) above may not fall within a future definition of the term that may be developed in the fair value measurement project. In particular, they think that changes in the benefits promised that are not caused by financial difficulties may not be included in any such definition. They would prefer the post-employment benefit Discussion Paper to avoid using the term.
17. Given these issues, the staff has redrafted the section on non-performance risk in the Discussion Paper to:
- (a) avoid the use of the term ‘non-performance risk’
 - (b) to discuss whether the possibility that an entity might reduce the benefits for past service, for reasons other than an inability to make the payments, should be included in credit risk. For the reasons given in the Discussion Paper, the staff recommends that it should not and
 - (c) to discuss whether credit risk should be included in the measurement of contribution-based promises. For the reasons given in the Discussion paper, the staff recommends that the Board does not express a preliminary view on this matter.
18. The staff also proposes to amend Question 8 in the invitation to comment on credit risk as follows:

Question 8

- (a) Are there alternative measurement approaches that better meet the measurement objectives described in this paper? Please describe the approaches and how they better meet the measurement objectives.
- (b) To what extent should ~~Do you agree that non-performance~~ credit risk ~~should not~~ be included as a component of the measurement approach at this

stage of the Board's employee benefits project? ~~If not, w~~How should this be done?

19. The staff will also make any other consequential amendments to the Discussion Paper necessary. In particular the staff recommends that the examples in paragraphs 200 - 201 are amended (see Agenda Paper 5A).

Description of measurement attribute

20. In the second preballot draft, the term used for the measurement methodology for contribution-based promises was *fair value excluding non-performance risk*. However, some Board members pointed out that this term is problematic.
21. The term *fair value excluding non-performance risk* assumes that non-performance risk is (i) a defined term and (ii) already included in fair value. However, as discussed above, non-performance risk is not a defined term and whether or not it should be included in the fair value of the liability is yet to be determined as part of the fair value measurement project.
22. The original term used for the measurement methodology for contribution-based promises was *fair value assuming the benefit promise does not change*. In their response to the first preballot draft, some Board members expressed a preference for a more explicit reference to the risk characteristics included in the measurement attribute.
23. As discussed above, however, the staff's attempt to do this has led to difficulties since it prejudices the outcome in the fair value measurement project. Therefore the staff proposes that the Discussion Paper reverts to the original term for measuring contributions promises at the *fair value assuming the benefit promise does not change*. This emphasises the point that on which the Board has a preliminary view, ie that the measurement should not include the possibility of the entity changing the benefits, and leaves the question of credit risk to be explained at the appropriate place in the Discussion Paper.