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International
Accounting Standards
Board

This document is provided as a convenience to observers at Standards Advisory Council meetings, to assist them in following the Council's discussion. It does not represent an official position of the IASB. Board positions are set out in Standards.

Note: These notes are based on the staff paper prepared for the Council. Paragraph numbers correspond to paragraph numbers used in the Council paper.

INFORMATION FOR OBSERVERS

SAC Meeting: **February 2008, London**

Project: **Post-employment benefits**
(Agenda Paper 6)

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1. The IASB has implemented a two-phase project on post-employment benefits. The first phase of the project aims to make limited improvements to IAS 19 *Employee Benefits* in a reasonably short time frame. The main improvements the Board is considering in phase one are:

    a. the removal of the options for deferred recognition of gains and losses in defined benefit plans and the presentation of the cost of defined benefit promises

    b. a new classification of benefit promises into contribution-based promises and defined benefit promises, with a new measurement attribute for contribution-based promises.

    The Board expects to publish a Discussion Paper for phase one in March/April.

2. The second phase will be a comprehensive review of the accounting for post-employment benefits, to be conducted with the US standard setter, the FASB.

Phase one Discussion Paper

Deferred recognition

3. Under IAS 19, an employer has an option to defer recognition of gains and losses. This means for instance a company could recognise a pension asset on the statement of financial position even when the plan is running a funding deficit.

4. The Board proposes that gains and losses should be recognised immediately in the period they occur. This would mean that funding surpluses would be shown as assets on the statement of financial position and funding deficits as liabilities, and would bring the accounting for pensions in line with the accounting for other types of obligations of the employer.

Presentation of the cost of defined benefit promises

5. Given the decision on immediate recognition, the Board also considered how the components of the cost of defined benefit promises should be presented. Currently, IAS 19 requires service cost, interest cost and the expected return on assets to be recognised in profit or loss. Actuarial gains and loses can be deferred and amortised gradually into profit or loss or recognised immediately in the statement of recognised income and expense.

6. The IASB decided to invite constituents to give their views on three possible presentation options for defined benefit promises.

   Approach 1 All changes to be recognised in profit or loss.

   Approach 2 Only service costs and related gains and losses to be recognised in profit or loss. All other gains and losses are the result of deferred settlement and would be recognised in other comprehensive income.

   Approach 3 Service cost and related gains and losses, interest cost and interest income to be recognised in profit or loss and all other changes (ie remeasurements) to be recognised outside of profit or loss. The Discussion Paper includes three methods of determining interest income.

New classification of benefit promises

7. Under IAS 19 a promise is either defined benefit or defined contribution, and there can be confusion and disagreement over the treatment of promises that appear to be neither or to have characteristics of both.

8. The Discussion Paper creates a new category of promises that are based on contributions plus a return linked to assets or indices. The term coined for these types of promises is contribution-based. Contribution-based promises include all promises currently classified as defined contribution and some promises currently classified as defined benefit. Two examples of the latter are:

Promise 1 The employer promises to make contributions of 5 per cent of the employee’s current salary (ie the employee’s salary during the current reporting period) into a fund for each year of service. The benefit promise at retirement is a lump sum equal to the contributions plus the actual return on the assets in which the contributions are invested, with a guaranteed minimum return of 4% per year.

Promise 2 The employer promises to make contributions of 5 per cent of the employee’s current salary (ie the employee’s salary during the current reporting period) into a fund for each year of service. The benefit promise at retirement is a lump sum equal to the contributions increased with the compound return on a specified equity index.

Measurement of contribution-based promises

9. The current measurement methodology in IAS 19, the projected unit credit (PUC) method, does not work for contribution-based promises. For promises with guarantees, the PUC method could significantly underestimate the liability by ignoring the value of the guarantee. For promises that depend on equity returns, the PUC could result in an overestimation of the liability by projecting at the expected return on equities and discounting at the (lower) high quality corporate bond yield.

10. The Discussion Paper arrives at a new measurement attribute by using a building block approach to measuring contribution-based promises, similar to the approach used in the Insurance project. The Board's preliminary view is that the measurement of an entity's liability for a contribution-based promise should incorporate the following characteristics:

    a. explicit, unbiased, market-consistent, probability-weighted and current estimates of the contractual cash flows.

    b. current market discount rates that adjust the estimated future cash flows for the time value of money; and

    c. the effect of risk, other than non-performance risk in the liability. In other words, the entity would assume that the benefit promise does not change.

11. The Board believes that the measurement attribute *fair value assuming that the benefit promise does not change* best communicates the above characteristics. A key objective in choosing this new measurement attribute is to give users a measurement basis that they can understand and use for making economic decisions.

Presentation for contribution-based promises

12. The Board's preliminary view is that the change in the liability for contribution-based promises should be disaggregated into service cost and other value changes only. The Board noted that some may argue that there should be as much consistency as possible between the presentation of contribution-based and defined benefit promises. Therefore, the Invitation to Comment asks whether the disaggregation and presentation of changes in the liability for contribution-based promises should mirror the requirements for disaggregation and presentation of changes in the liability for defined benefit promises.