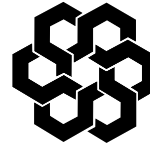


30 Cannon Street, London EC4M 6XH, England
Phone: +44 (0)20 7246 6410, Fax: +44 (0)20 7246 6411
Email: iasb@iasb.org Website: http://www.iasb.org

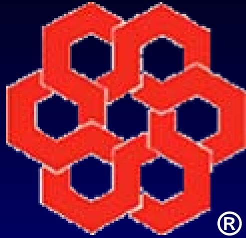
International Accounting Standards Board

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 6A)*



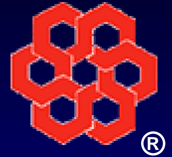
International
Accounting Standards
Board

Post-employment benefits

Anne McGeachin

Senior project manager

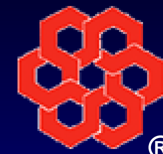
The views expressed in this presentation are those of the presenter, not necessarily those of the IASB.



Two phase project

- Phase 1
  - IASB project
  - Identifies the urgent issues in the accounting for certain pension plans
  - Consults with the public on possible solutions
  - Completion aimed for 2011
- Phase 2
  - Full comprehensive review in conjunction with FASB

Where are we in the Due Process for Phase I?



Q1 2008

2011

Discussion Paper Post-employment benefits

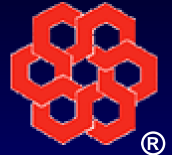
Public Consultation

Exposure Draft

Public Consultation

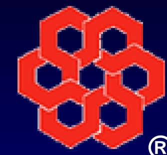
Interim Standard

Additional input from:
Advisory Council, Working Group, Analysts, Preparers
Audit technical partners, Special interest groups, Local standard setters, Regulators, Political groups



Issues in Phase I

1. Deferred recognition – the corridor method
2. Presentation for DB plans – expected asset return and actuarial gains and losses
3. Definitions of benefit promises
4. Measurement of the liability for cash balance and similar plans
5. Presentation for cash balance and similar plans



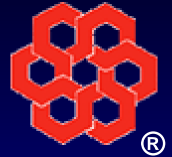
(1) Deferred recognition

Current requirements

- Option to defer actuarial gains and losses through use of corridor method

Consequences

- Deficits = Assets?
- Surpluses = Liabilities?
- Lack of comparability
- Complex accounting
- Important information relegated to the notes

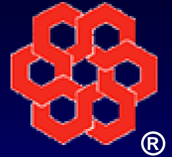


Proposed solution

- Immediate recognition of all gains and losses
- Removal of corridor

Expected impact

- Surpluses will be assets and deficits will be liabilities
- Greater transparency and comparability
- Greater simplicity
- No change in the balance sheet for those using the existing OCI approach



(2) Presentation

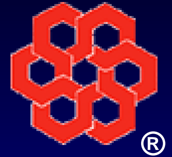
- How should pension gains and losses be presented?
- Board has not reached a preliminary view

Three approaches put forward

i. All gains and losses presented in profit or loss

ii. Service cost in P/L, everything else outside P/L

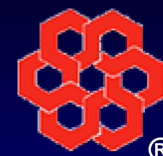
iii. Service cost, interest cost and interest on plan assets in P/L, other items (remeasurements) outside P/L



Interest on plan assets

Three possible ways of approximating the interest on plan assets

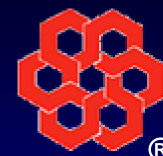
- Expected return on assets
- Dividends received on equity assets and current interest earned on debt assets
- Imputed interest determined by current yield on high quality corporate bonds



Three approaches – effect in P/L

	Current IAS 19	Approach (i)	Approach (ii)	Approach (iii)
Service cost	**600**	**600**	**600**	**600**
Interest cost	**1,800**	**1,800**		**1,800**
Return on assets[1]	**(2,000)**	**(7,000)**		**(1,500)**
Actuarial (gains) and losses[2]	**-**	**2,900**	**1,500**	**1,500**
Expense recognised in profit and loss	400	(1,700)	2,100	2,400

1. Current IAS 19 (i) expected return, Approach (i) actual return, Approach (iii) interest on plan assets
2. For approach (i) total gains and losses on liabilities, for approach (ii) and (iii) gains and losses on liabilities except those arising from the change in discount rate

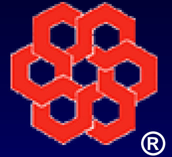


… and the effect in OCI

	Current IAS 19	Approach (i)	Approach (ii)	Approach (iii)
Interest cost	**-**	**-**	**1,800**	**-**
Actual Return on assets	**-**	**-**	**(7,000)**	
Actuarial (gains) and losses[3]	**(2,100)**	**-**	**1,400**	**(4,100)**
Total OCI	(2,100)	-	(3,800)	(4,100)
Profit and Loss Expense	*400*	*(1,700)*	*2,100*	*2,400*
Total Expense	(1,700)	(1,700)	(1,700)	(1,700)

3. Current IAS 19 - total gains and losses on assets and liabilities, Approach (ii) liability gains and losses due to discount rate, Approach (iii) liability gains and losses due to discount rate plus asset gains and losses given imputed return.

So….



Approach 1

Most volatile for earnings – everything goes through.

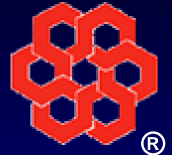
Approaches 2 & 3

Lower volatility for earnings but still increased due to gains and losses on service cost

Approach 2 takes all finance effects including actual asset return outside P/L

Approach 3 includes interest cost and interest income in P/L

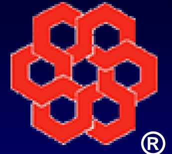
Help us to find the best possible solution – Comment on the DP



Is immediate recognition the right way to go?

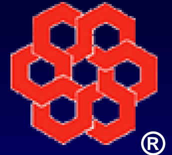
Which presentation approach shall we take?

(3) Definitions of benefit promises



Current requirements

- In IAS 19, plans are:
  - Defined Contribution (DC) or;
  - Defined Benefit (DB)
- All promises fall into one or the other category

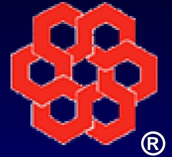


But what about …

… **the following promise?**

- contributions of 5% of salary
- return on a specified equity index
- minimum guaranteed return of 2% per annum
- lump sum at retirement

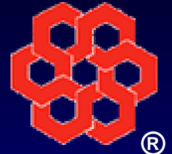
- Sounds like DC plus a guarantee
  - but the value of the guarantee is ignored if classified as DC
- Sounds like DB because there is risk to the employer
  - But projection at expected index return and discounting at bond rate over-states the liability



Proposed solution

- A new category of *contribution-based* promises:
  - Actual or notional contributions
  - Can be expressed independently of future salary
  - Any return is linked to the change in the value of an asset or group of assets or the change in value of an index
- Some plans that were formerly DB would now be contribution-based
- All DC plans classified as contribution-based
  - No significant impact

Examples of contribution-based promises

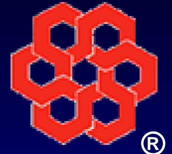


- Lump sum equal to contributions of 5% of current salary for each year of service plus the return on an equity index
- Lump sum equal to contributions of 5% of current salary plus the actual return on assets, with a guaranteed minimum return of 4%.
- Lump sum equal to contributions of 5% of career average salary for each year of service
- Annual pension of 50% of career average salary

Examples of defined benefit promises

- Annual pension of 50% of final salary
- Lump sum of 2.5% of the average of the final three years’ salary for each year of service
- Post-retirement medical costs

(4) Measurement of contribution-based promises



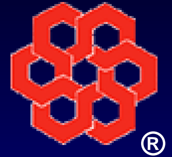
Current requirements

- Projected Unit Credit method as most are currently DB
- Project forward and discount back
- Application to promises linked to equity returns is problematic
- Application to promises with a higher of option also problematic

Possible solution – measurement of contribution-based promises

<u>New measurement attribute: fair value assuming the benefits do not change</u>

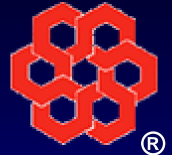
- Principles, not detailed guidance
- Current estimates
- Use observable market inputs, where they exist
- Time value of money
- Adjustment for risk



Adjustment for risk

- Include
  - asset-based risk
  - demographic risk
- Exclude
  - risk that benefit promise may change
  - General question of non-performance risk will be decided in the FVM project

Putting the blocks together Example



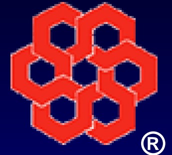
Example

- lump sum at retirement
- contributions of 5% of salary
- return on a specified equity index.

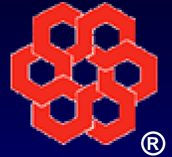
Q: After five years the accumulated contributions and returns on equity index equal 1,000. What is the value of the liability?

A: 1,000 adjusted for risk that employee may exit and not receive benefit. 1,000 would be the amount that is consistent with observable market prices.

(5) Presentation of contribution-based promises



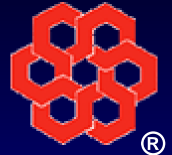
- Change in the value of the liability for a contribution-based promise disaggregated into:
  - a service cost and
  - other value changes
- All changes in liability and plan assets presented in profit or loss



Priorities for the future

- Completion of Phase 1 by 2011
- Phase II comprehensive review as a joint project with the FASB
- Consistency with Conceptual Framework and other IFRSs
- Interaction with Financial Statements Presentation project

Help us to find the best possible solution – Comment on the DP



Is immediate recognition the right way to go?

Which presentation approach shall we take?

Did we target the right plans for contribution-based promises?

Are there other measurement attributes for contribution-based promises?