Project **Post-employment Benefits**

Topic **Analysis of the comments from ARG & EBWG**

Introduction

1. The purpose of this paper is to provide an analysis of the feedback obtained from the Analyst Representative Group (ARG) and the Employee Benefit Working Group (EBWG) on the appropriate disclosures for:

   (a) defined benefit pension plans

   (b) other defined benefit plans

   (c) defined contribution plans

   (d) multi-employer benefit plans.

   The paper presents background information to stimulate discussion on the questions discussed in Agenda papers 3 onwards.

2. At the ARG February 2009, the ARG were asked their opinion on post-employment benefit disclosures noted above. After that meeting, a questionnaire on post-employment benefit disclosures was sent to both the ARG and EBWG. The questions asked are set out in text boxes at the beginning of the relevant subsections below.

Question 1

Objective of post-employment benefits disclosures
What are the objectives of post-employment benefits disclosures?

3. A summary of the disclosures proposed in the PAAinE discussion paper *The Financial Reporting of Pensions*[1] accompanied the questionnaire sent to the ARG and EBWG. Many of the responses are consistent with the disclosure objectives in the PAAinE discussion paper. Accordingly, this section provides the analysis in line with PAAinE discussion paper.

4. The comments may be categorised on the basis of the objectives set out in the PAAinE discussion paper (highlighted in **bold**) as follows:

   (a) disclosure of the cost of providing pension benefits and any related gains, losses, asset and liabilities

      (i) the scale of the DB promises that they have made with a clear indication of what the present value of that liability amounts to

      (ii) transparency on asset coverage of liabilities

      (iii) information to allow the user to estimate the liabilities on a different basis

      (iv) information to allow the user to normalise the P&L account for the impact of the pension arrangements

   (b) a clear view of the risks and rewards arising from liabilities to pay pension benefits and the assets held to fund those benefits

      (i) a sense of how future expenses and cash requirements are likely to change

      (ii) disclosures related to the forecast of future benefit cost expenses

      (iii) the risks that management are running in their asset allocation strategy

[1] The overview of the proposed disclosures from the PAAinE discussion paper is referred to Agenda 2D.

(iv) information about how the entity manages its capital

(v) financial risks associated with the maintenance of the plan

(c) the funding obligations of the entity, in relation to liabilities to pay pension benefits, are clearly identified

No comments received consistent with this objective.

Also, a respondent noted that the disclosure objectives should be set out on the grounds that a pension plan is similar to an embedded insurance company.

Question 2

Defined benefit pension plans
Which IAS 19 disclosures are useful? Why? Which IAS 19 disclosures are not useful? Why? Are there circumstances which make certain disclosures more useful? If so, what circumstances and which disclosures? What additional disclosures to IAS 19 would you recommend? If so, to whom should these disclosures apply?

Which IAS 19 disclosures are useful or not useful?

5. On the usefulness of current disclosures in IAS 19, most of the respondents agreed that they are useful either by explicitly expressing positive views or by stating no negative views. However, a few respondents expressed some doubts on the following aspects:

(a) boilerplate narrative disclosures and lack of materiality override

(b) there is no need for additional 3 prior years besides current year and immediately prior year[2] of the DBO, plan assets and experience adjustments, because it just adds depth to already long notes

(c) disclosing experience adjustments (IAS 19.120A(p)) is not helpful

(d) expected rate of salary increases may be deleted–compensation strategies are usually very confidential, and putting them in the public

[2] The respondent said 'just look back at prior's year annual reports'.

domain may create expectations among employees and others which may not be fulfilled.

6. On why IAS 19 disclosures are useful, a respondent noted that 'the information about the gross obligation and the plan assets is important because there is no legal right of offset, even though a net liability/asset is presented on the balance sheet'. Another respondent specified reasons for each of the following disclosures:

   (a) policy for recognising actuarial gains and losses–fundamental impact on the financial statements

   (b) reconciliation of the DBO and plan assets–transparency

   (c) break down of the DBO into funded and unfunded amounts–important as far as risk management is concerned

   (d) disaggregation between amounts recognised in profit or loss and actuarial gains and losses recognised in other comprehensive income–transparency

   (e) information on plan assets and expected return on assets–transparency and some insight into risk assumptions

   (f) history (IAS 19.120A(p)) and projection (IAS 19.120A(q))–risk-informative data: the trends and the needs for cash in the near future

Circumstances that make certain disclosures more useful

7. One of respondents on this question indicated that if the pension plan is material:

   (a) It is important that the disclosure allows a reasonably sophisticated user to recast the calculation on the basis that they feel is relevant to their decision making around company.

   (b) A better understanding of the risk within the pension plan may also be helpful–ie more detailed disclosure of the nature of assets held and their risk characteristics.

Recommendation of additional disclosures

8. Many respondents recommended various disclosures. They can be grouped in accordance with the disclosure objectives set out in Question 1 (highlighted in **bold**) as follows:

(a) disclosure of the cost of providing pension benefits and any related gains, losses, asset and liabilities

(i) post-employment benefit cost as a percentage of payroll cost

(ii) accumulated liabilities (without projected salary increase) and projected service costs over the next 5 years

(iii) disclosure of other measures of the pension liability eg the buy-out amount and the deficit calculated for funding purposes

(iv) date for next actuarial review of the pension liability

(v) explanation of what the actuarial gains and losses relate to

(vi) amounts recognised in other comprehensive income related to (A) experience adjustments and (B) changes in assumptions, separately

(vii) explanation of gains and losses by item (eg change in discount rate, more increase in salaries than expected)

(viii) identification of the source of gains and losses over each of the past five years–identifying the portion due to changes in assumptions, DBO-related experience gains and losses and asset-related gains and losses[3]

(ix) the rationale underlying the choice of the main assumptions

(x) sensitivity to key assumptions

(xi) in an environment where compensation is rising, information related to the maintenance of coverage of plan assets on increasing liabilities

(xii) separation of discontinued operations if there is a substantial business withdrawal or sale

(b) a clear view of the risks and rewards arising from liabilities to pay pension benefits and the assets held to fund those benefits

[3] In particular, the DBO-related gains and losses are indicative of whether the company tends to be overly optimistic in its assumption setting.

(i) expected benefit payments and contribution

(ii) presenting some information (eg key assumptions, DBO, plan assets and cost) by geographic region would likely be worthwhile information about expected cash flow

(iii) mix of active employees, deferreds and pensioners

(iv) information about control of the pension plans

(v) investment policy and strategy[4]

(vi) more information about assets–‘equities vs bonds vs property vs other’ is inadequate when the pension assets are very material. For example, we may need more information about fixed income exposure, whether currency exposure is hedged, etc.

(vii) duration of fixed income assets (by asset class and at least in total)

(viii) asset mix with greater granularity–eg bonds is not enough. Government bonds, corporate bonds and asset-backed securities are materially different asset classes

(ix) volatility (asset class and at least in total)

(x) aligning some of the IAS 19 disclosure requirements with those in IFRS 4 and IFRS 7–eg liquidity (maturity) analysis

(c) the funding obligations of the entity, in relation to liabilities to pay pension benefits, are clearly identified

(i) cash funding information–focused on scheduled contributions and a brief commentary on how this schedule may change if a new valuation is underway

(ii) duration of the liabilities

(iii) development of the pension plan’s deficit during the year, and disclosure of lump-sum contribution per annum to

[4] The respondent noted that the disclosure enables stakeholders to understand who sets up the strategy, who are consulted, a broad contour of the strategy in terms of the nature of investment instruments and geographies in which the investments are to be made.

remove the deficit and period over which the deficit is expected to be removed

(iv) more information about pension funding–for example, in the UK it would be helpful to know the date of the next triennial review (used to be a SSAP 24 disclosure)

9. Also, some respondents recommended the following disclosures:

(a) major terms of the benefit–life annuity or lump-sum; eligibility; vesting; spouse's right; final salary, average or cash balance; etc

(b) deferred tax asset/liability on pension deficit/surplus–current IAS 12 disclosures often inadequate

Question 3

Other defined benefit plans
Which IAS 19 disclosures are useful? Why? Which IAS 19 disclosures are not useful? Why? Are there circumstances which make certain disclosures more useful? If so, what circumstances and which disclosures? What additional disclosures to IAS 19 would you recommend? If so, to whom should these disclosures apply?

10. There were few comments on the disclosures about other defined benefit plans. In general, the comments on the question 2 are also applicable to the question 3. A respondent noted that expected increases in medical costs and sensitivity to changes in the assumptions are particularly useful.

Question 4

Defined contribution plans
IAS 19 requires only the disclosure of the amount recognised as an expense for defined contribution plans. Is this disclosure useful? Why? Why not? What additional disclosures would you like to see disclosed? If so, to whom should these disclosures apply?

> PAAinE discussion paper's preliminary view is that defined contribution plans should be subject to the same disclosures, where applicable, as defined benefit plans. The PAAinE's discussion paper approach is to not draw a distinction between defined benefit and defined contribution schemes and considers principles applicable to both schemes. The only net asset or liability arising from defined contributions plans will be unpaid contributions, as under IAS 19. However, the disclosures would be considerably more extensive.
>
> Do you agree that the same disclosures should apply to defined contribution plans as defined benefit plans? Please explain your reasoning.

11. On the usefulness of the current disclosures, all the respondents agreed that they were useful either by explicitly expressing positive views or by stating no negative views. They noted the following reasons:

    (a) users are able to reconcile the pension cost in the staff cost note to the pension note and spot if there is some inconsistency

    (b) it facilitates transparency on the effect of DC plans on the profit or loss

    (c) it represents the cost to the entity of providing employee benefits.

12. Most of the respondents raised strong objections to the preliminary view of the PAAinE discussion paper. They noted that:

    (a) A fundamental feature of a pure defined contribution plan is that an entity will not carry any risk after it has made contribution payments, thus the presentation and disclosure of DC plan has to be set apart from DB plan

    (b) because DC plans do not create the same level of risk as DB plans, it may be sufficient to focus on the contributions paid, unpaid or to be paid

    (c) DC plans are no different from national insurance contributions.

13. As a consequence, most of the respondents believe that there is no need for additional disclosures in terms of DC plans. However, a few respondents recommended the followings as additional disclosures:

    (a) features associated with DC plan–eg certain features may permit the plan to convert to a DB plan

    (b) a projection of future contributions including the underlying assumptions and rationale–this will reflect the future need for cash payments.

Question 5

Multi-employer plans
IAS 19 requires the same disclosure for multi-employer plans as single-employer plans according to whether the multi-employer plans are classified as defined benefit or defined contributions, when the entity is able to obtain the required information. When sufficient information is not available to use defined benefit accounting for a multi-employer plan that is a defined benefit plan, an entity shall: a) account for the plan as if it were a defined contribution plan; b) disclose: i) the fact that the plan is a defined benefit plan; and ii) the reason why sufficient information is not available to enable the entity to account for the plan as a defined benefit plan; and c) to the extent that a surplus or deficit in the plan may affect the amount of future contributions, disclose in addition: i) any available information about that surplus or deficit; ii) the basis used to determine that surplus or deficit; and iii) the implications, if any, for the entity. Would you recommend any additional disclosures? Please give your reasons.

14. One respondent indicated that the current accounting requirements would encourage employers with these plans to say that information is not available. In contrast, other respondent noted ‘that an up-to-date liability figure might be hard to obtain, while surely assets are not so hard.’

15. Recommendations for additional disclosures, where sufficient information is not available to account for the multi-employer plans as DB plans, can be grouped as follows:

    (a) Information about the **financial position of multi-employer plans**

   (i) at least the amount of assets should be disclosed if known[5]

   (ii) data on the gross liability as well as the net position

(b) Information about **the entity's share** in multi-employer plans

   (i) the entity's obligation and how it may change especially if the plan is underfunded

   (ii) the entity's portion of the whole funded status, and also the portion of the contributions and potential for the portion to increase/decrease

(c) Information about **the risk arising on withdrawal of other sponsors** in multi-employer plans

   (i) information about the other employers who are in the plan to the extent that the participants have a joint and several liability to pay pensions

   (ii) the amount of exposure the entity may have

   (iii) the number of employees covered by the multi-employer plan(eg the number of all employees covered by the multi-employer plan as a whole, the number of the entity's own employees covered by the multi-employer plan)

(d) Others

   (i) risk associated with the multi-employer plan, for example whether benefits cannot be reduced

   (ii) the effect of the funded status on the amount of future contributions, eg when a minimum funding requirement exists

   (iii) the formula used to determine contributions under the plan

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[5] The respondent noted that at least the asset figure would not be so hard to obtain and added that thereby investors could tell if the deficit was mainly a liability of a largely unfunded plan or a deficit on a mainly funded plan.

Question 6

Level of disaggregation
When an entity has more than one defined benefit plan, IAS 19 currently permits disclosures to be presented using the following options: a) aggregated as a total b) separately for each plan c) disaggregated in groupings (eg by geographical location, by risk profiles). When an entity has more than one defined benefit plan, a) What level of aggregation/disaggregation would be useful for pension information? Are there circumstances which would influence your answer to this question? b) What types of information would be useful to be presented in aggregation or disaggregation?

16. Some respondents noted that the level of disaggregation should depend on the professional judgement in each occasion. They believe that, if it is material, users need to understand different plans where they have different funding situations and where the entity has differing levels of control[6].

17. Respondents recommended the followings as the levels of disaggregation:

    (a) geography, ie by country

    (b) split between funded and unfunded plans

    (c) distinguishing between surpluses and deficits[7]

    (d) disaggregating pension plans from non-pension plans

    (e) exposure to currency risk and to what extent currency risk hedged

    (f) inflation risk

    (g) when a business discontinuation or sale is a possibility or if a certain plan is under stress.

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[6] For example, British Airway Pilots scheme is very different to their other schemes.
[7] The focus is on understanding future funding requirements and that the funding requirements of individual plans are not transferable.