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International Accounting Standards Board

This document is provided as a convenience to observers at Employee Benefits Working Group meetings, to assist them in following the Working Group'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 Employee Benefits Working Group Meeting. Paragraph numbers correspond to paragraph numbers used in the Employee Benefits paper. However, because these notes are less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

Meeting date:	**26 January 2009, London**
Meeting:	**Employee Benefits Working Group**
Paper:	**Financial Statement Presentation – Implications for post-employment benefits (Agenda paper 2A)**

Introduction

1. Many respondents to *Preliminary Views on Amendments to IAS 19 Employee Benefits* expressed concerns about how the financial statement presentation project would affect the presentation of pensions items. At the time the comment letters were written, the financial statement presentation discussion paper had not yet been published.

2. *Preliminary Views on Financial Statement Presentation* was published on 16 October 2008. The comment period ends on 14 April 2009. It is available at http://go.iasb.org/FSP-DP-document and is agenda paper 2 for this meeting. We will provide an overview of the proposals in the discussion paper, which include an analysis of the current issues in financial statement presentation, at this meeting.

3. A common theme in the comment letters to *Preliminary Views on Amendments to IAS 19 Employee Benefits* is that decisions about disaggregation of post-employment benefit cost should not be decided until the financial statement presentation project is completed. However, we continue to expect that the Board will complete this

project before the financial statement presentation project. Therefore, we expect that this project will reach conclusions on presentation in the context of IAS 1.

4. However, we acknowledge that the Board's decisions in this project should be consistent with the general direction of the financial statements presentation project. Accordingly, this paper discusses the consistency of the Board's preliminary views on presentation of pension cost with the proposals in the financial statements presentation discussion paper.

5. We see the following emerging issues:

   a. *Cohesiveness:* Many respondents would like to distinguish employment costs, which they would classify as business, and the costs of deferring payment of those costs, which they regard as financing. Such classification initially appears to be inconsistent with the cohesiveness principle in the financial statement presentation project.

   b. *Comparability of disaggregated information:* Many respondents, in particular users, tell us that they would prefer the Board to eliminate the ability for entities to choose whether they present some components of pension costs in business or financing. This would be inconsistent with the management approach in the financial statement presentation discussion paper.

   c. *Remeasurements:* Many respondents would like to be able to draw a subtotal in the statement of comprehensive income that could be described as "profit before tax and remeasurements". Unless the Board continues to permit recognition of some items in other comprehensive income, this does not appear possible under the financial statement presentation discussion paper.

6. These are discussed in paragraphs 7-22.

Discussion question
What other emerging issues do you see as a result of the interaction between this project and the financial statement presentation project?

Cohesiveness

7. Paragraphs 2.45 and 2.46 of the Financial Statements Presentation discussion paper describe the application of the cohesiveness principle to pensions, as follows.

> 2.45. Some users consider some or all elements of postemployment benefits, including pensions, part of an entity's financing activities and exclude related amounts in analyzing an entity's operating activities. Other users regard some or all elements of postemployment benefits as related to employee remuneration or compensation and include them in an analysis of an entity's operating activities. Because both IFRSs and U.S. GAAP require an entity to present plan assets and benefit liabilities on a **net** basis in its statement of financial position, the proposed presentation model requires an entity to classify its net postemployment benefit asset or liability in a single category in the statement of financial position. In other words, an entity could not classify the plan assets separately from the benefit liabilities. Because the **net** postemployment asset or liability relates to employee remuneration or compensation, an entity most likely would classify the net asset or liability in the operating category.
>
> 2.46. Following the cohesiveness principle, an entity should classify the related postemployment benefit expenses, including items such as service cost, interest cost, and return on plan assets, and cash flows in the same category as its net postemployment benefit asset or liability. Even though an entity would present all of the components of postemployment benefit expense in one category in its statement of comprehensive income, it could present those components on two or more lines in that category if that would assist users in predicting future cash flows. The IASB's Discussion Paper, *Preliminary Views on Amendments to IAS 19* Employee Benefits, suggests that disaggregating components of pension costs in the statement of comprehensive income provides useful information.

8. Thus, application of this principle as analysed in the financial statement presentation discussion paper would mean that all changes in the defined benefit obligation or in plan assets would be classified in one category in the statement of comprehensive income, split into one or more lines within that category if appropriate.

9. The staff observes that this result directly contradicts what we have heard from comment letters. However, the staff thinks that the disaggregation requested by respondents need not be inconsistent with the cohesiveness principle if the following analysis is applied.

10. When an employer receives service from employees in exchange for a postemployment benefit, the employer incurs:

    (a) a liability that will be settled on retirement. The classification of changes in the liability recognised in the income statement will depend on classification of the liability.

(b) an asset for employee service that is immediately consumed. The classification of the expense recognised when the asset is consumed will depend on the classification of the asset.

Thus, if an entity classifies the liability as financing and the asset as operating, then the service cost will be disaggregated from all other changes in the defined benefit obligation and plan assets. This is consistent with the view that changes in the defined benefit obligation other than service costs arise from deferred payment and are therefore are financing in nature.

11. This analysis would apply not only to post-employment benefit expense, but any operating expense that results in a liability. It is also consistent with the view that operating assets can be acquired using financing liabilities. For example, if an entity acquired a manufacturing facility using the proceeds of a bond issue, the manufacturing facility would be classified as an operating asset and the bond as a financing liability.

12. However, although we could use this analysis to allow for a business cost and a financing cost to arise for pensions and similar items whilst maintaining the idea of cohesiveness between the statement of financial position and statement of financial performance, it leaves open the question of how that idea could be extended to the cash flow statement. For example, if the post-employment benefit liability is classified as financing, this means that all cash flows that are paid to settle that liability would also be classified as financing. This would mean that there would be no operating cash flow associated with the operating post-employment benefit expense.

Discussion questions

Do you agree that there are operating and financing components to post-employment benefit expense?

Do you think that there must be an operating cash flow associated with the payment of post-employment benefits?

Comparability of disaggregated information

13. Some comment letters state that comparability will be enhanced if the Board specifies whether pension costs are operating or financing, rather than leaving it up to preparers to choose. For example:

"Key improvements on current standards include...a requirement to show pension-related items in a consistent category (or categories) in the statement of financial performance (for example, avoiding the choice entities currently have to show the financing components of pensions within operating profit or as a financial item). "[1]

14. The staff notes that mandated classification would contradict the principle set out in Chapter 2 of the Financial Statements Presentation discussion paper.

"An entity should classify its assets and liabilities in the business section and in the financing section in a manner that best reflects the way the asset or liability is used within the entity. This discussion paper refers to this as a *management approach* to classification."[2]

15. That discussion paper states that:

"The classification decision would reside with management and its classification rationale would be presented in the notes to financial statements as part of the accounting policy discussion. The board support a management approach to classification rather than a prescriptive approach because they believe it will result in financial statements that reflect how management views and manages the entity and its resources."

16. The issue of classification has been discussed at length in the financial statement presentation project and the financial statement discussion paper sets out the rationale for the Board's preliminary views on classification. The comment letters do not identify any reason to specify classification that would apply only to pensions.

Discussion question
Do you have any comments on the management approach to classification?

Remeasurements

17. The comment letters in response to *Preliminary Views on amendments to IAS 19* Employee Benefits indicated that many constituents think that disaggregated information about the components of pension cost provides decision-useful information to users of financial statements and reflects the management's view of pensions. The reason given is that the components of pension cost have different predictive values. Thus, comment letters argue that disaggregation is essential to provide a proper understanding of the reasons for changes in the post-retirement assets and obligations during the period.

[1] Fitch, similar view from CRUF
[2] paragraph 2.27, Preliminary Views on Financial Statement Presentation

18. Many comment letters explicitly state the view that pensions have a component that relates directly to employee costs and a component that relates to the deferred payment of those costs (usually referred to as financing). In addition, some constituents also believe that a component that arises from remeasurements should be separately identified. We think that disaggregation of a remeasurement component would help address some of the concerns about volatility in the statement of comprehensive income.

19. At present, IAS 1 permits entities to distinguish components such as employment costs, financing or remeasurements using additional line items. This can be achieved either by including the remeasurement component as a component of other comprehensive income, or by including it as a separate line item within either operating or financing. In either case, the use of separate line items and subtotals would allow entities to provide a figure representing 'profit before tax and remeasurements'. Therefore, we think that we might be able to reduce opposition to the Board's preliminary view that all changes in the defined benefit obligation and plan assets should be recognised in profit or loss by illustrating how entities can distinguish a remeasurement component from other components of pension cost. An example of such an illustration is:

Revenue	**X**
Operating expenses (including pensions employment expense)	(X)
Finance costs (including finance costs on pensions)	**X**
Profit before tax	X
Tax expense	**X**
Profit from continuing operations	X
Remeasurements arising from changes in pension assumptions (net of tax)	X
Post-tax gains or losses on discontinued operations	**X**
Profit or loss	**X**
Components of other comprehensive income	**X**
Total comprehensive income	**X**

20. If the financial statement presentation proposals are finalised as set out in the discussion paper, and subject to the discussion paragraphs 7-12, we think that an entity could present employment cost and financing components in separate categories within profit and loss. However, presentation of remeasurements as a separate item might be difficult.

21. In the formats proposed by *Preliminary Views on Financial Statement Presentation,* entities would only be able to identify remeasurements separately by including a separate line item within operating or financing, unless the Board permits remeasurements to be displayed in other comprehensive income. This is an example of how it might look:

BUSINESS	
Operating	
Sales	X
Expenses (including pension operating cost)	X
Total operating income	X
Investing	
Total investing income	X
TOTAL BUSINESS INCOME	X
FINANCING	
Interest income	X
Interest expense	X
Finance cost on pensions	X
Remeasurements arising from changes in assumptions for pensions	X
Total net financing expense	X
INCOME TAXES	X
NET INCOME	X
OTHER COMPREHENSIVE INCOME (after tax)	
Unrealised gain on derivatives (operating)	X
Foreign currency translation adjustment (operating)	X
TOTAL OTHER COMPREHENSIVE INCOME	X
TOTAL COMPREHENSIVE INCOME	X

22. We note that this format would not permit entities to show a subtotal representing total comprehensive income excluding tax and remeasurements. We think that some constituents might object as a result.

Discussion questions

Do you agree that pensions cost includes components representing employment costs, financing and remeasurements?

To what extent is it necessary to identify a figure representing 'profit before tax and remeasurements'?

Do you have any other comments on the emerging issues identified by the staff?