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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: Section 27 issues presented to the Board in November 2008
(Agenda paper 5, Attachment 3)

Section 27 Employee Benefits

Issue 27.1: Pensions – options for recognising actuarial gains and losses

- Reason for revisiting issue.** At the May 2008 meeting, the Board decided that, in general, the accounting policy options in full IFRSs should be available to private entities. However, as an exception to this, at the July 2008 meeting the Board decided all actuarial gains and losses should be recognised immediately in profit or loss, as proposed in the ED. At the September 2008 meeting, some Board members suggested that the Board should revisit their decision on recognition of actuarial gains and losses at a future meeting.
- Comment letters.** Allow other options for actuarial gains and losses, in particular recognition outside profit or loss, such as in equity or in other comprehensive income. Give private entities all of the options that an entity has using full IFRSs.

3. **Field tests.** Only a few field test entities commented but those who did noted that expensing all actuarial gains and losses only had a small effect on profit or loss. Therefore, these entities were indifferent to whether or not alternative options were allowed for actuarial gains or losses and they considered the approach in Section 27 the easiest.
4. **WG recommendation.** WG members would allow all options for actuarial gains and losses that are permitted by IAS 19 *Employee Benefits*.
5. **Staff comment.** Currently Section 27 requires immediate recognition in profit or loss of all actuarial gains and losses. IAS 19 allows the following four options for recognising actuarial gains and losses (IAS 19.92–19.93A):
 - a. Immediate recognition in profit or loss.
 - b. Immediate recognition in other comprehensive income and presentation in a statement of other comprehensive income.
 - c. The so-called ‘corridor approach’ in IAS 19.92, briefly summarised as recognition in profit or loss of the amortisation, over the average working life of the employees participating in a plan, of (a) the excess of (i) 10% of the defined benefit obligation and (ii) 10% of plan assets over (b) cumulative unrecognised actuarial gains and losses.
 - d. Any other systematic method of amortisation that results in faster amortisation than the corridor approach.
6. **Staff recommendation.** Many of the comment letters that proposed allowing private entities more options for recognition of actuarial gains and losses, agreed that immediate recognition is the simpler option. However, their main concern was that immediate recognition in profit or loss would lead to volatility. Out of those respondents wanting more options for recognition of actuarial gains and losses, over half of them indicated that it is only important to include the IAS 19 option that allows immediate recognition in other comprehensive income. Paragraph BC 89 in the Basis for Conclusions notes that immediate recognition in other comprehensive income was not provided as an option in the ED since it “*requires preparation of a financial statement that most SMEs do not normally prepare*” (this would be the case if such entities presented other components of comprehensive income in the statement

of changes in equity). In May 2008, the Board decided the final standard should incorporate the requirements of IAS 1 *Presentation of Financial Statements* (as revised in 2007). Under IAS 1 (revised) there is no option to present other components of comprehensive income in the statement of changes in equity. Instead, a statement of comprehensive income is required. Therefore, following requirements based on IAS 1(revised) would mean that immediate recognition of actuarial gains or losses in other comprehensive income would be feasible and not more burdensome for private entities than immediate recognition in profit or loss.

7. Of the four methods allowed in IAS 19 (see paragraph 42 above), immediate recognition in profit or loss or in other comprehensive income are the simplest methods for private entities to implement as they do not require tracking of data over many years and annual calculations. Immediate recognition also more faithfully presents the entity's pension obligation because it does not require deferral of actuarial gains and losses that do not meet the definitions of assets or liabilities. In addition, financial statement users generally have told the Board that they find immediate recognition provides the most understandable and transparent information. Staff also note that in March 2008, the IASB published for comment a Discussion Paper *Preliminary Views on Amendments to IAS 19 Employee Benefits* and one of the Board's preliminary views in this paper is to recognise all changes in the value of plan assets and in the post-employment benefit obligation in the financial statements in the period in which they occur. This would mean removing the options for deferred recognition of actuarial gains and losses in defined benefit plans.
8. Staff do not propose introducing in the IFRS for Private Entities the options in IAS 19 that allow deferred recognition of actuarial gains and losses. Staff believe that not having the deferral options would improve the information available to users, whilst also simplifying requirements for preparers. Therefore a departure from full IFRSs can be justified both on a cost-benefits basis and a user-needs basis. However, the same argument cannot be used for prohibiting immediate recognition in other comprehensive income, provided that a statement of comprehensive income must be presented. Hence, staff

propose that private entities should have the option to recognise actuarial gains and losses immediately in other comprehensive income.

Question 27.1

Does the Board agree with the staff recommendation that the ED should be amended to allow two methods for recognising actuarial gains and losses in the IFRS for Private Entities: immediate recognition in profit or loss and immediate recognition in other comprehensive income?

Issue 27.3: Pensions – measurement at current termination amount

9. **Reason for revisiting issue.** At the July 2008 Board meeting, the Board discussed whether, and in what circumstances, private entities might be allowed to measure the defined benefit obligation at a current termination amount, eg if information to apply the projected unit credit method as proposed in the ED was not available without undue cost. No decisions were made. The Board asked the staff to present a proposal at a future meeting that specifically sets out when a current termination amount might be used (ie when the undue cost and effort exemption could be used) and exactly how the current termination amount would be calculated, because current practice varies.
10. **Comment letters.** Measure as if all employees would retire as of the reporting date (that is, at a current termination amount) based on current salaries.
11. **Field tests.** Several field test entities have defined benefit plans. Some of these entities use outside specialists to value the plans so they did not encounter any problems. A few entities noted that use of outside specialists would be needed, but would be too costly. Another problem raised was the entities were unable to gather enough data to make estimates about demographic and financial variables as required by ED paragraph 27.16 for defined benefit plans.
12. **WG recommendation.** Most WG members would encourage the Board to simplify the calculation of defined benefit obligations. Some WG members

suggested that the calculation could be simplified by measuring the obligation on the basis that all employees would retire at the reporting date.

13. **Staff recommendation.** Staff recommend that an ‘undue cost or effort’ exemption should be added to the requirement to apply defined benefit accounting when determining the defined benefit obligation of a defined benefit plan for private entities (similar to that used for fair value measurement of biological assets in ED paragraph 35.1). Staff propose that Section 27 should state that in either of the following cases the entity should measure the defined benefit obligation of a defined benefit plan at the current termination amount using current salary information:

- when sufficient information is not available without undue cost or effort for an entity to determine the present value of its defined benefit obligation and related current service cost using the projected unit credit method; or
- if using the projected unit method to determine the defined benefit obligation would not give meaningful information. For example, this may be the case if the plan has only a very small number of employees.

This method would maintain the principles of recognising pension cost during the employees’ periods of service and recognising an obligation for vested benefits, while simplifying the calculation. Since this exemption applies to the determination of the defined benefit obligation only, the entity would determine the fair value of plan assets in the usual way.

14. The current termination amount would be the vested benefit obligation at the balance sheet date assuming all employees were to terminate their employment as of that date, ie the present value of the payment stream that the pension scheme would have to pay current participants and their survivors if all employees were to leave on the reporting date. Hence, the current termination amount assumes that the plan continues and benefits are settled as they fall due. The requirements should make clear that the current termination amount is not the cost of settling the defined benefit obligation on the reporting date under an assumption that the plan is wound up.

15. The change in the current termination amount during the year would be recorded as the current year's pension expense. Calculating the current termination amount does not involve most of the complexity of needing to make actuarial assumptions of future variables that will affect the value of the pension obligation, eg future salary and benefit levels, and rates of employee turnover. However, the calculation would still require the use of mortality tables, appropriate discount rates, and an estimate of inflation for any index-linked benefits. It also would include the impact of legislation enacted prior to the reporting date. Furthermore, as the calculation simplification only applies to the defined benefit obligation, determination of the expected rate of return on assets would still be required (see Issue 27.6 below).
16. Guidance should be provided to ensure the 'undue cost or effort' exemption is applied appropriately. Section 27 should provide an explanation that the 'undue cost or effort' exemption can only be used in relation to the cost of obtaining information, e.g. costs of hiring specialists, if the cost is significant in relation to the entity's other operating costs (note, an outside specialist would not be needed every year and significance should be judged in this context – see Issue 27.4 which proposes that a roll forward of the valuation may often be appropriate if actuarial assumptions are relatively constant).
17. Staff propose the 'undue cost or effort' exemption would apply on a plan by plan basis. However, an entity would not be allowed to apply the exemption in some years and not others (ie frequent changing between the two methods would not be allowed). If, in the past, the entity has used the 'undue cost or effort' exemption for a particular plan, and then has later moved back to applying defined benefit accounting for the defined benefit obligation of that plan, the entity would not be then be allowed to use the 'undue cost or effort' exemption again for that particular plan.
18. Recognition and measurement of defined benefit pension obligations provides useful information for users of financial statements. Staff do not favour or propose a disclosure only requirement for defined benefit plans due to concerns about off balance sheet obligations. However, staff feel that defined benefit accounting can be complex and costly for private entities and may not be applied correctly unless costly specialists are used. Staff also note that if

the private entity only has very few employees, an assessment using the projected unit credit method would often not be appropriate. Staff believe that the current termination amount is an appropriate measurement simplification that provides users with useful information. If the exemption is taken, adequate disclosure about the defined benefit plan should be provided to explain the basis for determining the current termination amount.

Question 27.3

Does the Board agree with the staff recommendation to amend the ED to state that if sufficient information is not available without undue cost or effort to determine the present value of the defined benefit obligation and related current service cost under a defined benefit plan using the projected unit credit method, or determining the obligation that way would be of questionable usefulness because of the small number of employees involved, an entity should measure the defined benefit obligation of that plan at the current termination amount, defined as the vested benefit obligation at the balance sheet date assuming all employees were to terminate their employment as of that date using current salary information, and give supplementary disclosures?

Issue 27.4: Pensions – allow choice of actuarial method

19. **Reason for revisiting issue.** This issue has not yet been discussed by the Board as the outcome of the discussion on Issue 27.3 may affect Issue 27.4.
20. **Comment letters.** Do not require a specific actuarial method (projected unit credit). Also clarify that even if a specific method is required, an actuarial valuation performed by an outside actuary is not required to be done every year. Clarify that updating prior period valuations for changes in circumstances can result in reasonable measurements.
21. **Field tests.** See Issue 27.3.
22. **WG recommendation.** Most WG members would encourage the Board to seek simplify the calculation of defined benefit obligations.
23. **Staff recommendation.** If the Board agrees with the staff recommendation in Issue 27.3 to allow use of the current termination amount either if sufficient

information is not available without undue cost or effort to apply defined benefit accounting for the defined benefit obligation or determining the defined benefit obligation that way would be of questionable usefulness because of the small number of employees involved, then staff do not feel there is any need to provide further simplification by allowing actuarial methods other than the projected unit credit method to be used.

24. Staff recommend clarifying the following where defined benefit accounting is applied to determine the defined benefit obligation (ie in the case where the undue cost or effort exemption is not appropriate in the staff recommendation for Issue 27.3):
 - a. An actuarial valuation performed by an outside actuary is not required every year since often a roll forward of the valuation would be appropriate if actuarial assumptions are relatively constant. Staff recommend providing guidance for private entities on when a roll forward is appropriate and how it should be performed.
 - b. For group plans, subsidiaries should be permitted to recognise a charge based on a reasonable allocation of the group charge if the parent prepares consolidated financial statements in accordance with either the IFRS for Private Entities or full IFRSs since accounting for group plans can be complex and may add little informational value if the obligation is shared by many group entities. The basis of allocation should be disclosed.

Question 27.4A

If the Board agrees with the staff recommendation in Issue 27.3 above, does the Board also agree with the staff recommendation that there is no need to provide further simplification by allowing actuarial methods other than the projected unit method to be used for defined benefit accounting?

Question 27.4B

Does the Board agree with the staff recommendation that additional clarification should be added to the ED to state that under defined benefit accounting, an actuarial valuation performed by an outside actuary is not required to be done every year and that guidance should be added on when a roll forward is appropriate and how it should be performed?

Question 27.4C

Does the Board agree with the staff recommendation that additional clarification should be added to the ED to state that subsidiaries are permitted to recognise a charge based on a reasonable allocation of the group charge if the parent prepares consolidated financial statements under either the IFRS for Private Entities or full IFRSs and the basis of allocation is disclosed?

Issue 27.5: Pensions – treat all multi-employer as defined contribution

25. **Reason for revisiting issue.** This issue has not yet been discussed by the Board as staff felt it was more appropriate to discuss the remaining Section 27 issues together.
26. **Comment letters.** Treat all multi-employer plans as defined contribution.
27. **Field tests.** No related comments.
28. **WG recommendation.** Most WG members would encourage the Board to seek simplify the calculation of defined benefit obligations. Some WG members would simplify calculations by treating all multi-employer plans as defined contribution.
29. **Staff comment.** The ED proposes that multi-employer plans be classified as defined contribution or defined benefit based on their terms. However, if

sufficient information is not available to use defined benefit accounting, then a private entity can use defined contribution accounting, with disclosure. This requirement is consistent with IAS 19 *Employee Benefits*.

30. **Staff recommendation.** Staff recommend allowing all multi-employer plans to be treated as defined contribution plans with appropriate disclosure (ie the nature of the plan and its funding arrangements) for cost benefit reasons, unless information on the underlying assets and liabilities of the plan is readily available to the entity. Effectively the staff recommendation is just to modify slightly the proposed wording in the ED by replacing ‘available’ with ‘readily available’ to clarify that the entity need not make any considerable effort to try to obtain such information if it does not already have the information to hand. The staff recommendation acknowledges that in many cases it is difficult to obtain the information necessary to apply defined benefit accounting in the financial statements of the participating employers (or even to determine the current termination amount, proposed as a simplification in special cases under Issue 27.3) since many multi-employer arrangements effectively share the obligation amongst participating employers without providing detailed information about underlying assets and liabilities. In particular the cost and difficulty of obtaining this information may be significant for smaller private entities.

31. Staff also recommend adding the following based on IAS 19.32A

There may be a contractual agreement between the multi-employer plan and its participants that determines how the surplus in the plan will be distributed to the participants (or the deficit funded). A participant in a multi-employer plan with such an agreement that accounts for the plan as a defined contribution plan shall recognise the asset or liability that arises from the contractual agreement and the resulting income or expense in profit or loss.

Question 27.5

Does the Board agree with the staff recommendation that the ED should be amended to state that all multi-employer plans should be treated as defined contribution plans with appropriate disclosure unless information on the underlying assets and liabilities of the plan is readily available to the entity?

Issue 27.6 (new): Expected rate of return on assets

32. **Additional staff issue.** Like IAS 19, the ED requires entities to recognise the expected return on assets in profit or loss in measuring the defined benefit obligation. The difference between the actual and expected return on assets forms part of the actuarial gains and losses. Staff believe that private entities should not be required to divide the return on assets into an expected return and an actuarial gain or loss.
33. **Comment letters.** No related comments.
34. **Field tests.** No related comments.
35. **WG recommendation.** Not discussed.
36. **Staff comment.** Both Section 27 of the ED and IAS 19 require entities to recognise in profit or loss an expected return on assets. The difference between the actual and expected return on assets forms part of the actuarial gains and losses.
37. In March 2008, the IASB published for comment a Discussion Paper *Preliminary Views on Amendments to IAS 19 Employee Benefits*. One of the Board's preliminary views in this paper is that entities should not divide the return on assets into an expected return and an actuarial gain or loss. Paragraph 2.15 of the Discussion Paper states "*the Board is concerned that the subjectivity inherent in determining the expected rate of return provides entities with an opportunity to choose a rate with a view to manipulating profit or loss. Accordingly, the Board's preliminary view is that entities should not divide the return on assets into an expected return and an actuarial gain or loss.*"

38. **Staff recommendation.** Some users feel that dividing the actual return on plan assets into an expected return and an actuarial gain or loss provides information that is more relevant than a single item representing the actual return. However, staff note that determining the expected rate of return is subjective, and smaller private entities generally have less expertise and may not apply such judgment properly, meaning the number will be less useful for users.
39. For cost-benefit reasons staff propose that entities should not divide the return on assets into an expected return and an actuarial gain or loss. If the Board agrees with the staff recommendation in Issue 27.1 to require immediate recognition of actuarial gains and losses in full during the period, either within profit and loss or in other comprehensive income, then the impact of the staff's proposal here is limited to the presentation of the components of the change in the defined benefit liability. Use of an expected rate only has an impact on the measurement of the defined benefit liability if actuarial gains and losses are deferred.

Question 27.6

Does the Board agree with the staff recommendation that the ED should be amended to state that entities should not divide the return on assets into an expected return and an actuarial gain or loss?