Project **Post-employment Benefits**

Topic **Disclosures - Alternative measures of defined benefit obligation**

Purpose of this paper

1. This paper asks the Board to determine whether the disclosure of an alternative measure of defined benefit obligation should be required.

Background

2. At its May 2009 meeting, the Board tentatively decided to align the disclosure requirements for post-employment benefits with those in IFRS 4 *Insurance Contracts* and IFRS 7 *Financial Instruments: Disclosures*.

3. At that meeting the Board noted that some UK companies disclose a buy-out amount as recommended by the UK Accounting Standards Board's (ASB) best practice Reporting Statement *Retirement Benefit -Disclosures*. The Board requested the staff to provide an analysis of whether the disclosure of any alternative measures of the defined benefit obligation, such as a buy-out amount, should be required.

Options for disclosure

4. Concerns have been raised about the measurement required by IAS 19 of the defined benefit obligation. The Board does not intend to address comprehensively the measurement of the defined benefit obligation in this stage of the project. In the meantime, the disclosure of an alternative measure of the defined benefit obligation may provide useful information and mitigate some of the concerns.

5. The Board's discussion paper *Preliminary Views on Amendments to IAS 19 Employee Benefits* noted that the following measurement methods could be considered as alternatives in the comprehensive review:

   (a) Settlement value (including buy-out amount)

   (b) Fair value

   (c) Accumulated benefit obligation[1]

   Hence, all the above are candidates if an alternative measure of the defined benefit obligation is proposed to be disclosed.

6. The settlement value(buy-out amount) and accumulated benefit obligation are recommended as additional disclosures by the ASB Reporting Statement and the discussion paper of Pro-active Accounting Activities in Europe (PAAinE) *The Financial Reporting of Pensions*. Also, fair value may allow the defined benefit obligation and plan assets to be compared in a more meaningful way because plan assets are already measured at fair value.

7. However, any required additional disclosures must meet the cost:benefit test. Also, if one of the three alternative measures is required for disclosure, some may perceive this as pre-empting the Board's discussions in the future comprehensive project.

Staff recommendations

8. The staff recommends that the Board should not require the disclosure of any alternative measures of the defined benefit obligation.

9. In reaching this recommendation, the staff has examined the following possible alternative measures of the defined benefit obligation:

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[1] According to the definition of SFAS 87, the accumulated benefit obligation is:

(a) the actuarial present value of benefits attributed by the pension benefit formula to employee service rendered before a specified date and based on employee service and compensation (if applicable) prior to that date and;

(b) different from the projected benefit obligation in that it includes no assumption about future compensation levels.

(a) settlement value, including buy-out amount (discussed in paragraphs 10-14)

(b) fair value (discussed in paragraphs 15-18)

(c) accumulated benefit obligation (discussed in paragraphs 19-20).

The staff does not think that the benefits of disclosing any of these alternative measures outweigh the costs. Also, the staff notes that any alternative measure required to be disclosed could be wrongly perceived by some as the Board's future direction in its comprehensive project.

Alternative measures

Settlement value

10. This paper notes that 'settlement' is a transaction that eliminates all further legal or constructive obligation for the benefits provided under a defined benefit plan as defined in paragraph 112 of IAS 19. A settlement value may include (a) lump-sum cash payments to plan participants in exchange for their rights to receive specified post-employments benefits and (b) the payment of cash (or other assets) to transfer to an insurance company the liability for some or all of the benefits. 'Buy-out', which is increasing among UK companies, is an example of settlement. Through a buy-out an entity can transfer its responsibility for a *closed* defined benefit plan to an insurance company.

11. Consequently, this paper defines settlement value as the amount that the entity would be required to pay in order to settle the defined benefit obligation as defined in IAS 19.

12. The possible benefits of disclosing a settlement value are:

(a) It could enhance the predictive value of the financial information. For example, it helps users forecast the gain or loss arising from an expected plan settlement.

(b) Voluntary disclosure of the buy-out amount by some UK companies indicates that the disclosure may have information content. Pension plan regulation[2] in the UK requires companies to disclose the buy-out amount to the members of the defined benefit plan and some companies disclose it in the annual report consistent with the recommendations in the ASB Reporting Statement.

13. On the other hand, the disclosure of the settlement value raises the following concerns:

    (a) In most cases, if not all, there is likely to be no observable evidence for settlement value. For example a buy-out amount may not be readily available where a buy-out market does not exist. In those cases, a settlement value will have to be estimated, resulting in additional costs for the entity.

    (b) Even in UK, where a buy-out market exists and the disclosure of the buy-out amount to plan members is already required by regulation, the settlement value calculated for regulatory purposes may not be suitable for general purpose financial statements because it may be biased towards prudence in order to protect plan members' rights.

14. The staff concludes that the costs of determining an unbiased settlement value outweigh the benefits of its disclosure.

***Fair value*[3]**

15. As stated earlier, the disclosure of the defined benefit obligation at fair value may allow the defined benefit obligation and plan assets to be compared in a more meaningful way because plan assets are already measured at fair value.

16. There are a few IFRSs that require or encourage the entity to disclose the fair value of an asset or liability when it is recognised and measured at an amount other than fair value. They are:

[2] Under relevant UK legislation, the trustees of defined benefit plans are required to obtain a valuation of the cost of winding up the plan determined on a full buy-out basis and to disclose the estimated amount to the members of the plan.

[3] In the context of IAS 19, fair value is differentiable from the settlement value discussed above. The main difference lies on the way to reflect the credit risk. The fair value of a liability reflects the effect of an entity's own credit risk, while the settlement value, eg buy-out amount, of the defined benefit obligation is determined on the basis of the transferee's credit risk. Therefore, the fair value of the defined benefit obligation can be considered distinctively of the settlement value.

(a) IFRS 7 *Financial Instruments; Disclosures* requires supplementary fair value disclosures when a financial asset or financial liability is not measured at fair value to assist users to compare entities on a consistent basis. (paragraph 25, BC36)

(b) IAS 16 *Property, Plant and Equipment* encourages the disclosure of the fair value of property, plant and equipment when this is materially different from the carrying amount determined using the cost model. (paragraph 79)

(c) IAS 40 *Investment Property* requires (with an exception) the disclosure of the fair value of investment property when those assets are measured using the cost model. (paragraph 79)

17. On the other hand, IFRS 4 does not require or encourage the entity to disclose the fair value of insurance liabilities although the exposure draft had proposed that the entity should do. The staff notes that:

(a) The proposal was intended to give useful information to users of an insurer's financial statements and some respondents supported the disclosure of fair value, arguing that it is important information for users.

(b) However, many respondents opposed the disclosure of fair value, arguing that the lack of guidance on how to determine fair value would lead to lack of comparability for users.

(c) The Board agreed with the opponents that requiring disclosure of fair value would not be appropriate at the stage.

18. In the staff's view the examples listed in paragraph 16 indicate that fair value is useful information in many cases. In particular, the disclosure of the fair value of the defined benefit obligation may assist comparability between the defined benefit obligation and plan assets. However, some constituents have more issues with fair value as a measurement objective for liabilities when compared to assets (eg issues relating the entity's own credit risks). Further, since there is generally no active market for the defined benefit obligation itself, its fair value will need to be estimated. This estimation is likely to be costly. The staff therefore concludes that the costs will outweigh the benefits of such disclosure.

Accumulated benefit obligation

19. As stated above, the disclosure of the accumulated benefit obligation (ABO) is recommended by the ASB Reporting Statement and the discussion paper of PAAinE. The reason is that the ABO may provide a solvency estimate for users of financial statements by removing the effect of future salary growth from plan liabilities. The ABO is also required under US GAAP (paragraph 5.e of SFAS 132(R)).

20. The staff notes that some may support the disclosure of the ABO as it is the least costly of the alternative measures discussed and it allows some comparability with US companies. The staff also acknowledges that some may support disclosure of the ABO because they think it is a better measure of the defined benefit obligation than that currently required by IAS 19. However, this project is not the place in which to debate whether the ABO is a better measure. Given that, the staff does not think it is an appropriate time to require its disclosure.

Disclosure when required by regulation

21. If the disclosure of an alternative measure of the defined benefit obligation is already required by regulation, some may argue that it could be disclosed in the financial statements without incurring additional costs. The staff notes that the ASB Reporting Statement only recommends disclosure of the buy-out amount where the cost of buying out benefits is made available to trustees (managers) and/or members of defined benefit plans. The ASB could find no justification that information made available to members of defined benefit plans and/or trustees (managers of schemes) should not be made available to users of the entity's financial statements.

22. However, the disclosure of an alternative measure of the defined benefit obligation only when it is required to be calculated by regulation is unlikely to provide useful information because:

    (i) Such regulatory amounts may be conservatively biased in order to protect employees' rights. Such prudence would not be suitable for general purpose financial statements.

(ii) It does not enhance comparability because not all jurisdictions require the calculation of the defined benefit obligation on an alternative measure. Also, for jurisdictions that do, there is likely to be inconsistency in what and how that alternative measure is calculated.

Conclusion

23. In staff's view:

(a) the benefits of disclosing any of the alternative measures discussed above would not exceed the costs.

(b) also, any alternative measure required to be disclosed could be wrongly perceived by some as the Board's future direction in its comprehensive project.

Hence, the staff does not recommend the mandatory disclosure of any alternative measures of the defined benefit obligation.

Staff Recommendation and Question for the Board	
1.	The staff recommends that the Board should not require the disclosure of any alternative measure. Does the Board agree?
2.	If the Board does not agree, which alternative measure should be required to be disclosed?