Project	**Post-employment benefits**
Topic	**Interim reporting**

Objective

1. The objective of this paper is to provide the Board with staff analysis and recommendation on the issues that respondents to the exposure draft *Defined Benefit Plans* (the ED) raised in relation to the remeasurement of net defined benefit liability (defined benefit obligation less plan assets) for interim reporting purpose.

2. The staff recommends that the Board not make any additional amendments to address issues raised by respondents regarding interim reporting, because these are sufficiently addressed by IAS 34 *Interim Reporting*, the current IAS 19 *Employee Benefits* or the amendments proposed in the ED.

3. This paper includes:

   (a) Background, including feedback on the proposals in the ED

   (b) Staff analysis

   (c) Staff recommendation

Background

4. The ED did not propose any change to the interim reporting of defined benefit plans. However, respondents have raised issues as to:

(a) how often the net defined benefit asset or liability needs to be remeasured, ie whether it is to be remeasured at each interim reporting date or only when a significant event occurs such as a settlement or curtailment etc;

(b) if remeasurement were

(i) judged by the entity to be necessary during an interim reporting period; or

(ii) required by IAS 34 at each interim reporting date,

whether the assumptions underlying the calculation of current service cost and net interest for the next interim period should be fixed at the beginning of the year or updated to the assumptions used at the interim remeasurement date; and

(c) whether the base on which net interest is determined, ie the net defined benefit liability that is multiplied by the discount rate should be

(i) remeasured at each interim reporting date and the remeasurement used as an updated base for net interest for the next interim period; or

(ii) averaged over the period between the beginning of the annual period and the end of the reporting period.

5. Those respondents suggest that the Board should address those issues by spelling out the relevant guidance.

Cause of the issues

6. Currently, it is not always required for the entity to remeasure net defined benefit liability for interim reporting purposes. Paragraph B9 of IAS 34 *Interim Financial Reporting*, as adjusted by the consequential amendments proposed in the ED, states [emphasis is added in bold, new text is underlined and deleted text is struck through]:

> Pension cost for an interim period is calculated on a year-to-date basis by using the actuarially determined pension cost rate at the end of the prior financial year, **adjusted for significant market**

> **fluctuations since that time and** for ~~significant curtailments, settlements, or other~~ significant one-time events**, such as plan amendments, curtailments and non-routine settlements**.

7. The issue is how the proposals in the ED regarding immediate recognition interact with the phrase 'significant market fluctuations' in paragraph B9 of IAS 34:

   (a) Under current IAS 19 if the entity defers recognition of actuarial gains and losses (ie uses the corridor approach), market fluctuations would be less likely to be significant than if the entity recognised actuarial gains and losses immediately. This is because any actuarial gains and losses exceeding the corridor would be recognised over the average remaining working lives of the employees in subsequent periods.

   (b) In contrast, under the ED where the entity is required to recognise remeasurements in the period in which they arise, a market fluctuation is more likely to be significant to the entity than if it was applying the corridor approach in current IAS 19.

   Consequently, respondents think that the proposals in ED for immediate recognition imply that remeasurement for an interim period becomes more likely to be required.

Staff analysis

Whether to remeasure for interim reporting purpose

8. Paragraph B9 of IAS 34 (quoted above) may be read in conjunction with paragraph 56[1] of IAS 19, as adjusted to the amendments proposed by the ED, which states [emphasis is added in bold, new text is underlined and deleted text is struck through]:

[1] Paragraph 56 of IAS 19 was renumbered as 50A in the ED.

> An entity shall determine the net defined benefit liability (asset) ~~the present value of defined benefit obligations and the fair value of any plan assets~~ with sufficient regularity that the amounts recognised in the financial statements do **not differ materially from the amounts that would be determined at the end of the reporting period**.

9. Both paragraphs indicate that the entity needs to exercise a degree of judgment as to whether there has been a change in circumstances that might result in a significant difference between the amounts recognised in financial statements and the amounts that would be determined if remeasured at the end of the (interim or annual) reporting period.

10. The staff acknowledges that the judgment may become more inclined towards remeasurement for interim reporting purpose given that the Board decided to prohibit the 'corridor approach' and require the entity to recognise remeasurements in the period in which they arise.

11. However, the staff thinks that the exercise of the judgment should remain with the entity because how to apply paragraph B9 of IAS 34 and paragraph 56 of IAS 19 depends on the facts and circumstances specific to the entity and its defined benefit plans. The staff also thinks that it might end up detracting from the representational faithfulness of financial statements or imposing excessive burden on the entity to set a uniformed measurement frequency in disregard of the facts and circumstances specific to the entity and its defined benefit plans.

12. As for remeasurement for interim reporting purposes in US GAAP, paragraphs 30-36-65 and 66 of FASB ASC Topic 715 *Compensation – Retirement Benefit* provide guidance as follows:

> 35-65 Unless an entity remeasures both its plan assets and benefit obligations during the fiscal year, the funded status it reports in its interim-period statement of financial position shall be the same asset or liability recognized in the previous year-end statement of financial position adjusted for both of the following:
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> a. Subsequent accruals of net periodic pension cost that exclude the amortization of amounts previously recognized in other comprehensive income (for example, subsequent accruals of

service cost, interest cost, and return on plan assets)

b. Contributions to a funded plan, or benefit payments.

35-66 Paragraph 715-30-25-5 notes that, sometimes, an entity remeasures both plan assets and benefit obligations during the fiscal year, for example, when a significant event such as a plan amendment, settlement, or curtailment occurs that calls for a remeasurement.

13. In addition, paragraph B102 of the superseded FAS 158, from which the abovementioned paragraphs were imported, provided basis for that guidance:

> Because the primary objective of the first phase of the project was recognition of the funded statuses of an employer's postretirement benefit plans, the Board considered whether the status of each plan should be measured each interim reporting period or whether interim-period recognition could be based on a limited remeasurement approach. Limited remeasurement might involve updating certain, but not all, assumptions and other valuation shortcuts. The Board decided not to require that plan assets and benefit obligations be remeasured for interim-period reporting because:
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> a. There would be additional costs to implement that change.
>
> b. It would raise additional issues not addressed by Statement 87 or 106.
>
> c. It would represent a fundamental change in the measurement of net periodic benefit cost, and measurement issues were beyond the scope and objectives of this Statement.

14. The staff believes that the US GAAP guidance is consistent with paragraph B9 of IAS 34 and thus there is no need for additional efforts to secure consistency with US GAAP regarding this issue.

15. Therefore, the staff thinks that no additional amendment needs to be made by the Board regarding this issue.

Whether to update assumptions when remeasuring for interim reporting purpose

Cases in which remeasurement were required at each interim reporting date

16. The staff notes that issues of this kind are already addressed in IAS 34.

    (a) Paragraph 28 of IAS 34 states [emphasis added]:

    > An entity shall apply the same accounting policies in its interim financial statements as are applied in its annual financial statements, except for accounting policy changes made after the date of the most recent annual financial statements that are to be reflected in the next annual financial statements. However, **the frequency of an entity's reporting (annual, half-yearly, or quarterly) shall not affect the measurement of its annual results. To achieve that objective, measurements for interim reporting purposes shall be made on a year-to-date basis.**

    (b) Paragraph 29 of IAS 34 further states [emphasis added]:

    > Requiring that an entity apply the same accounting policies in its interim financial statements as in its annual statements may seem to suggest that interim period measurements are made as if each interim period stands alone as an independent reporting period. However, **by providing that the frequency of an entity's reporting shall not affect the measurement of its annual results, paragraph 28 acknowledges that an interim period is a part of a larger financial year.** Year-to-date measurements may involve changes in estimates of amounts reported in prior interim periods of the current financial year. But the principles for recognising assets, liabilities, income, and expenses for interim periods are the same as in annual financial statements.

17. If assumptions for each interim reporting period were updated to the most recent remeasurement date (mostly, the previous interim reporting date), the measurement of the entity's annual results would be affected by how frequently the entity reports, ie whether the entity reports quarterly, semi-annually or with no interim period. This consequence is obviously out of line with the abovementioned guidance.

18. The staff believes that the assumptions underlying the calculation of current service cost and net interest for the next interim period should not be updated to the previous interim reporting date but fixed at the beginning of the year in accordance with current IAS 34.

19. Therefore, the staff thinks that no additional amendment needs to be made by the Board regarding this issue.

Cases in which remeasurement is judged by the entity to be necessary during an interim reporting period

20. Paragraph B9 of IAS 34 suggests that assumptions should be updated during an interim period when curtailments or settlement occur. In this regard, the same guidance is provided in paragraph 110 of IAS 19, which states:

> Before determining the effect of a curtailment or settlement, an entity shall remeasure the obligation (and the related plan assets, if any) using current actuarial assumptions (including current market interest rates and other current market prices).

21. Respondents to the ED question, in the context of both IAS 19 and IAS 34, whether:

    (a) updated assumptions are used only

        (i) for the purpose of determining the effect of a curtailment or settlement (ie identifying the difference between the amount of net defined benefit liability calculated using current actuarial assumptions after taking into account a curtailment or settlement and the amount of net defined benefit liability calculated using current actuarial assumptions before taking into account a curtailment or settlement); but

        (ii) *not* for the purpose of determining current service cost and net interest for the post-curtailment or settlement period within an (annual or interim) period; or

    (b) updated assumptions are used both

        (i) for the purpose of determining the effect of a curtailment or settlement; and

        (ii) for the purpose of determining current service cost and net interest for the post-curtailment or settlement period within an (annual or interim) period.

22. Currently, there is no explicit guidance on this question.

23. Nonetheless, the staff believes that updated assumptions should not be used for the purpose of determining current service cost and net interest for the post-curtailment or settlement period within an (annual or interim) period in the light of the definitions of current service cost and net interest in the ED, which states [emphasis added]:

> *Service cost* comprise:
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> (a) ***current service cost***, which is the increase in the present value of a defined benefit obligation **resulting from employee service** in the current period; and
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> (b) past service cost, which is the change in the present value of the defined benefit obligation for employee service in prior periods, resulting from the introduction of, or changes to, long-term employee benefits.
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> ***Net interest on the net defined benefit liability (asset)*** is the change during the period in the net defined benefit liability (asset) that **arises from the time value of money**.

24. In the staff's opinion, there is no reason to distinguish between a pre-curtailment or settlement period and post-curtailment or settlement period in determining current service cost and net interest, ie determining how much service the employee has rendered to date and how much time value of money accrued to date. Rather, the staff thinks that the assumptions underlying the calculation of current service cost and net interest for the post-settlement period (including the next interim period) should remain fixed at the beginning of the year.

25. Therefore, the staff thinks that no additional amendment needs to be made by the Board regarding this issue.

Whether to update the base on which net interest is determined

26. This issue was raised by respondents who were concerned about paragraph 119B of the ED, which states [emphasis added]:

> Net interest on the net defined benefit liability (asset) shall be determined by multiplying the net defined benefit liability (asset) **throughout the period** by the discount rate specified in paragraph 78 as determined at the start of that period, **taking account of any material changes in the net liability (asset)**.

27. In particular, they were concerned that the wording, 'throughout the period … taking account of any material changes in the net liability (asset)' could be taken to imply a need to carry out a full remeasurement of net defined benefit liability and recalculate net interest at each interim reporting date if, for example, there is a significant market movement during the interim period.

28. The staff notes that paragraph 119B of the ED is adaptation from paragraph 82 of the current IAS 19, which states [emphasis added]:

> Interest cost is computed by multiplying the discount rate as determined at the start of the period by the present value of the defined benefit obligation **throughout that period**, **taking account of any material changes in the obligation**. The present value of the obligation will differ from the liability recognised in the statement of financial position because the liability is recognised after deducting the fair value of any plan assets and because some actuarial gains and losses, and some past service cost, are not recognised immediately. [Part A of the implementation guidance accompanying this Standard illustrates the computation of interest cost, among other things.]

29. The staff notes that there is no perceived change to the context of paragraph 82 of IAS 19, except that interest cost and the defined benefit obligation are replaced by 'net interest' and 'net defined benefit liability' respectively. The staff thinks that this issue does not relate to the amendments proposed in the ED but is the matter of interpretation of current IAS 19.

30. Therefore, the staff thinks that no additional amendment needs to be made by the Board regarding this issue.

Staff recommendation

31. As for the three issues on interim reporting that were identified in paragraph 4, the staff recommends that the Board make no additional amendment, because these are sufficiently addressed by IAS 34, the current IAS 19 or the amendments proposed in the ED.

Summary of Issues and Question

Does the Board agree to make no additional amendment on the following issues:

(a) how often the net defined benefit asset or liability needs to be remeasured, ie whether it is to be remeasured at each interim reporting date or only when a significant event occurs such as a settlement or curtailment etc;

(b) if remeasurement were

(i) judged by the entity to be necessary during an interim reporting period; or

(ii) required by IAS 34 at each interim reporting date,

whether the assumptions underlying the calculation of current service cost and net interest for the next interim period should be fixed at the beginning of the year or updated to the assumptions used at the interim remeasurement date; and

(c) whether the base on which net interest is determined, ie the net defined benefit liability that is multiplied by the discount rate should be

(i) remeasured at each interim reporting date and the remeasurement used as an updated base for net interest for the next interim period; or

(ii) averaged over the period between the beginning of the annual period and the end of the interim period?