Project	**Post-employment benefits**
Topic	**Presentation: Background and overview of responses to the ED**

Objective

1. At the Board's October meeting, the Board tentatively confirmed the proposals in the exposure draft *Defined Benefit Plans* (the ED) that:
   (a) an entity should disaggregate changes in the net defined benefit liability (asset) into service cost, finance cost and remeasurement components.
   (b) the service cost component should exclude gains and losses arising from changes in the assumptions used to measure the service cost.
   (c) the finance cost component should comprise net interest on the net defined benefit liability (asset), determined by applying the rate used to measure the defined benefit obligation to the net defined benefit liability (asset).
2. The objective of this meeting is to discuss the presentation of the disaggregated components in profit and loss and in other comprehensive income.
3. This paper provides:
   (a) an overview of the proposals in the ED relating to the presentation of the service cost, finance cost and remeasurement components in profit or loss and other comprehensive income (paragraphs 5 - 8).
   (b) an overview of responses to the ED on those proposals (paragraphs 9 – 19).

(c) the relevant extracts of the Basis for Conclusions on the ED for the proposals on presentation in Appendix A.

4. This paper is for information only, the staff analysis and recommendation can be found in:

   (a) Agenda Paper 11C – for presentation of the service cost, finance cost and remeasurements components.

   (b) Agenda Paper 11D – for other presentation issues.

The ED proposals

5. The ED proposed that an entity should present:

   (a) service cost in profit or loss;

   (b) net interest on the net defined benefit liability (asset) as part of finance costs in profit or loss; and

   (c) remeasurements in other comprehensive income.

6. In finalizing the proposals in the ED, the Board concluded that although the changes included in the remeasurement component may provide information that helps with an assessment of the uncertainty of future cash flows, many regard those changes as not providing useful information about the likely amount and timing of future cash flows. Therefore, to separate the remeasurement component from service cost and finance cost in an informative way, the ED proposed that entities should present the remeasurement component as an item of other comprehensive income. This would remove from IAS 19 the option for entities to recognise in profit or loss all changes in defined benefit obligations and in the fair value of plan assets.

7. Other approaches to presentation considered by the Board in developing the proposals in the ED are detailed in paragraphs BC39 to BC44 of the Basis for Conclusions reproduced in Appendix A.

8. In developing the proposals in the ED the Board considered whether entities should reclassify or 'recycle' amounts from OCI to profit or loss in later periods. IAS 19 does not permit recycling. The reasons why IAS 19 does not permit recycling and the reasons the Board retained that conclusion in the ED are set out in paragraph BC45 of the Basis for Conclusions reproduced in Appendix A

Overview of comments received on the ED

9. Question 6 of the ED asked:

> **Question 6**
>
> Should entities present:
>
> (a) service cost in profit or loss?
>
> (b) net interest on the net defined benefit liability (asset) as part of finance costs in profit or loss?
>
> (c) remeasurements in other comprehensive income?
>
> (Paragraphs 119A and BC35–BC45) Why or why not?

Views from the comment letters

10. The majority of respondents agreed with the Board's views and the proposals in the ED. Respondents that disagreed with the presentation proposals of the ED in general did so for the following reasons:

    (a) Some believe presentation should not be part of the scope of the project and would like to keep the existing presentation requirements in IAS 19. These respondents would prefer the Board to wait for the outcome of the financial statement presentation (FSP) project before changing presentation in IAS 19.

    (b) Some respondents believe the Board should maintain the current options in IAS 19 that allow an entity to select how to present amounts relating to defined benefit plans in a way that the entity considers as best reflecting the performance of the particular entity and how the entity manages the defined benefit plan.

(c) Some believe that amounts relating to defined benefit plans should be shown in aggregate, as a single net amount arising from personnel or employment expense, consistent with the presentation on the balance sheet of a single net amount.

11. Very few respondents disagreed with the proposal to present the finance cost and service cost components in profit or loss. However some respondents disagreed with the proposal to present the finance cost component together with other finance costs in profit or loss. These respondents believe that the finance cost component should be either presented together with service cost, or distinguished from both service costs and other finance costs in a separate category similar to the 'operating finance cost' category envisaged in the financial statement presentation (FSP) project.

12. Respondents that did not support presenting the finance cost component together with other finance costs regard finance costs arising from defined benefit plans as different from finance costs arising from normal financing activities, such as loans. Responses from financial services companies in particular noted the potential effect of the proposals on their 'net interest margin', which is considered a key performance metric in that industry.

13. Respondents that support presenting the finance cost component together with the service cost component consider that aggregate amount to be an employee expense. In other words, they consider the finance cost to arise because of the service cost. In addition, some respondents that supported defining the finance cost component based on the expected return approach believed that superior returns on assets had the effect of reducing service cost, and therefore believed that the two components should be presented together.

14. Responses to questions 6(a) and 6(b) also expressed concerns about:

(a) the departure from normal IFRS practice not to prescribe the caption within profit or loss in which items should be presented;

(b) presenting finance income arising from a net defined benefit asset together with finance costs; and

(c) how the presentation approach would apply to entities that present expenses by function in the statement of comprehensive income.

15. In response to the proposal to present remeasurements in OCI, respondents expressed the following concerns:

(a) *Remeasurements in profit or loss* – A small number of respondents did not support the proposal in the ED because they believe there is no conceptual basis for presenting amounts in OCI. These respondents consider it more appropriate to present changes in the net defined liability (asset) in profit or loss, despite the different predictive values of the individual components. The fact that the remeasurement component's predictive value is different from that of other components should not lead to a conclusion that this component should be presented in other comprehensive income, but to the need to separate this component as a separate line item in profit or loss.

(b) *Remeasurements option* – Some respondents believe the Board should maintain the option to present remeasurements in profit or loss:

(i) because they believe it is the conceptually best method;

(ii) to keep the accounting simple for entities with small plans; or

(iii) because presenting remeasurements in other comprehensive income will lead to an accounting mismatch (for example, for an unfunded plan where the entity holds assets where the changes in the assets go through profit and loss).

(c) *Recycling* - Some respondents are concerned that amounts presented in OCI are not reclassified to profit or loss in subsequent periods, including:

(i) the lack of conceptual basis for deciding whether items should be reclassified to profit or loss from OCI.

(ii) that the amounts in OCI would never be recognized in net profit.

(iii) divergence from US GAAP, since amounts in OCI under US GAAP are recycled.

(iv) the requirement to transfer immediately to retained earnings amounts recognized in OCI.

(d) *Inclusion in cost of asset* - whether and how remeasurements should be included in the cost of an asset. Many manufacturers responded that all three components represent costs associated with the manufacture of assets and should therefore form part of the cost of the asset.

Views from the EBWG

16. The EBWG met on 27 September 2010. Amongst other topics, the EBWG discussed the presentation proposals, and responses to those proposals. The staff specifically asked working group members their views on:

(a) whether the finance cost component should be presented together with other finance costs; and

(b) whether presentation of the remeasurements component in profit and loss should be permitted or required under specified circumstances.

17. EBWG members' views were mixed regarding the finance cost component. Members with a preparer background were more inclined toward not requiring presentation of the finance cost component together with other finance costs, while other members had difficulty distinguishing the finance cost component from other finance costs on a conceptual basis and would prefer them being presented together. EBWG members were also concerned to maintain consistency across projects. A number of other projects, such as the ED *Revenue from Contracts with Customers*, require the time value of money to be

presented separately, and EBWG members believed the Board should try an achieve a consistent treatment of finance costs across IFRSs.

18. EBWG members' views were less mixed regarding whether the Board should permit presentation of the remeasurements component in profit or loss. Some EBWG members believed that requiring remeasurements to be presented in OCI would improve comparability while providing options for the presentation of the remeasurements would reduce comparability. Some EBWG members had concerns about the accounting mismatch that could arise and were more sympathetic to the view that the Board should permit presentation of remeasurements in profit or loss. Some noted that this option currently exists and has not reduced comparability because only a handful of entities use the option.

19. EBWG members also shared their views on subsequent reclassification of remeasurements to profit or loss from OCI. Very few EBWG members supported reclassification. One member noted that the proposal to present remeasurements in OCI is like separating the noise from a signal, and permitting an entity to reclassify remeasurements to profit or loss would be like re-introducing the noise to the signal. EBWG members noted that subsequent reclassification would confuse users since the amounts in profit or loss would include amounts that relate to changes occurring in prior periods. Other EBWG members noted that a consistent approach to recycling across projects should be the Board's objective.

Appendix A – Basis for Conclusions

This appendix reproduces the section on presentation from the Basis for Conclusions on the ED Defined Benefit Plans.

Presentation of changes in the net defined benefit liability (asset)

BC35 The Board considered how entities should present the service cost, finance cost and remeasurement components.

BC36 The discussion paper did not express a preliminary view on this topic, but described three possible approaches to the presentation of information about those components. One approach proposed that entities should present all gains and losses in profit or loss. The other approaches proposed that entities should present some gains and losses in other comprehensive income.

BC37 Although responses to the discussion paper showed no clear consensus that any one of the approaches described in that paper would provide more useful information than the others, many expressed the view that the Board should consider retaining the presentation of some gains and losses in other comprehensive income. The reasons given were:

(a) Presentation of all gains and losses in profit or loss would combine items of different predictive value.

(b) Some components of defined benefit cost are conceptually different from other items in profit or loss and should be clearly demarcated.

(c) This presentation helps to reflect risk clearly. The apparent increased risk that results from measuring plan assets and defined benefit liabilities at current value is not a faithful representation of the risk relative to other assets and liabilities. Thus, special consideration should be given to the presentation of the changes in those assets and liabilities.

(d) Reporting all changes in defined benefit cost in profit or loss would result in volatile swings in profit or loss that are not related to the entity's underlying operations. These swings in profit or loss do not have the same characteristics as income and expenses arising from transactions that are completed over the short term of a typical operating cycle.

BC38 After discussing all aspects of the proposal, the Board concluded that entities should disaggregate changes in the defined benefit obligation and in plan assets into service cost, finance cost and remeasurement components. This is because these components have different characteristics and so they need to be distinguished. Furthermore, although the changes included in the remeasurement component may provide information that helps with an assessment of the uncertainty of future cash flows, many regard those changes as not providing useful information about the likely amount and timing of future cash flows. In the light of the Board's forthcoming exposure draft on the presentation of items of other comprehensive income, and to separate the remeasurement component from service cost and finance cost in an informative way, the exposure draft *Defined Benefit Plans* proposes that entities should present the remeasurement component as an item of other comprehensive income. This would remove from IAS 19 the option for entities to recognise in profit or loss all changes in defined benefit obligations and in the fair value of plan assets.

BC39 The discussion paper discussed one approach that would have presented finance costs in other comprehensive income. However, respondents said that there was no basis to present finance costs for long-term employee benefits in one section of the statement of comprehensive income and finance costs for other liabilities in a different section of that statement. The Board agreed with this view and proposes that entities should present the finance cost component in the profit or loss section of the statement of comprehensive income.

Other approaches to presentation

The presentation options in IAS 19 consistent with immediate recognition

BC40 Many respondents to the discussion paper suggested that the Board should deal only with recognition in this project, retaining both presentation options currently in IAS 19 that are consistent with immediate recognition. This approach would permit entities to recognise actuarial gains and losses, as defined in IAS 19, either in profit or loss or in other comprehensive income.

BC41 However, the presentation options in IAS 19 would 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 that entities currently recognise in profit or loss or in other comprehensive income. The Board believes that an entity's expectations about the return on plan assets are less relevant than the actual return on plan assets. In addition the Board sees a possible danger that the subjectivity inherent in determining the expected rate of return could provide entities with an opportunity to manage profit or loss. Accordingly, the Board concluded that entities should not divide the return on assets into an expected return and an actuarial gain or loss (see paragraph BC26(a)). Some of the presentation options in IAS 19 would not be consistent with this conclusion. Furthermore, perpetuating options in IAS 19 would not improve financial reporting.

Presentation of all components in profit or loss

BC42 The Board considered whether to distinguish components that have different predictive values or risk profiles within profit or loss, rather than use other comprehensive income for some items. Some argue that entities should present in other comprehensive income items that are different because of their long-term nature. However, the Framework and IAS 1 Presentation of Financial Statements do not describe a principle identifying the items to be recognised in other comprehensive income rather than in profit or loss. Currently, entities present some changes in the carrying amounts of such long-term items in profit or loss and some outside.

BC43 It would be possible to disaggregate components of defined benefit cost without presenting remeasurements in other comprehensive income, for example, by using additional line items in profit or loss. Such a presentation would avoid the need to consider whether items presented initially in other comprehensive income should be 'recycled' at some future date from other comprehensive income to profit or loss. However, the Board concluded that in the light of the improved presentation of items of other comprehensive income proposed in its forthcoming exposure draft, the most informative way to disaggregate the components of defined benefit cost with different predictive values is to present the remeasurement component in other comprehensive income. Doing so is consistent with the view that although the remeasurement component provides useful information about the uncertainty of cash flows, it is less useful than the items presented in profit or loss for predicting their likely amount and timing.

BC44 Although future projects on financial statement presentation could result in refinements to the display of items in other comprehensive income, the Board would not expect to revisit its conclusion that entities should present the remeasurement component in other comprehensive income.

Recycling of amounts presented in other comprehensive income to profit or loss (paragraph 119A(c))

BC45 The proposed approach presents some components of long-term employee benefit cost outside profit or loss. This prompts questions about whether entities should reclassify or 'recycle' any such amounts to profit or loss in later periods. IAS 19 does not permit recycling. In the Basis for Conclusions on IAS 19, the Board noted 'there is not a consistent policy on recycling in IFRSs', that 'the question of recycling … remains open in IFRSs' and that the Board 'does not believe that a general decision on the matter should be made in the context of [amendments to IAS 19]. The decision …not to recycle ... is made because of the pragmatic inability to identify a suitable basis'. The Board remains convinced by this logic.