Project **Post-employment benefits**

Topic **Presentation: Presenting the components**

Objective

1. This paper provides a staff analysis and recommendation for:

   (a) the presentation of the service cost and finance cost components (paragraphs 3 – 11)

   (b) the presentation of the remeasurements component (paragraphs 12 – 25)

2. The staff recommends that the Board:

   (a) confirms the proposals in the ED that an entity should present:

      (i) the service cost and finance cost components in profit or loss; and

      (ii) the remeasurements component in other comprehensive income.

   (b) does not specify where in profit or loss an entity should present the service cost and finance cost components.

Staff analysis and questions for Board

Presenting the service cost and finance cost components

3. Other than general concerns about addressing presentation within a limited scope project, there was little opposition to presenting the service cost and finance cost components in profit or loss. However respondents were concerned

about the Board requiring the finance cost component to be part of the finance cost line item of IAS 1 *Presentation of Financial Statements*.

4. IAS 1:

   (a) requires entities to present, amongst other line items, amounts for revenue and finance cost (paragraph 82). However IAS 1 does not define what revenue and finance costs are.

   (b) requires entities to present an analysis of expenses in profit or loss based on either their nature or their function, whichever is reliable and more relevant (paragraph 99).

   (c) permits entities to provide disaggregated information on the face of the performance statements or in the notes if the entity considers it appropriate and furthermore specifies that entities should present additional line items where it is relevant to an understanding of the entity's financial performance (paragraph 85).

5. The staff do not believe that this project is the appropriate place for the Board to further define finance costs in IAS 1. Other current projects, including *Revenue from Contracts with Customers*, also propose that entities separately identify the financing effect of transactions. The Board needs to consider whether entities should present such financing effects together with other IAS 1 finance costs, or whether they should be distinguished from both the service cost component and other IAS 1 finance costs. Amounts that other IFRSs have prescribed to be finance costs include:

   (a) IFRIC 1 *Decommissioning, restoration and similar liabilities* – Paragraph 8 requires the periodic unwinding of the discount for a decommissioning, restoration or similar liability to be recognised in profit or loss as a finance cost as it occurs.

   (b) IFRS 7 *Financial Instruments: Disclosure* – Paragraph IG 13:

   > IG13 Total interest expense disclosed in accordance with paragraph 20(b) is a component of finance costs, which paragraph 82(b) of IAS 1 requires to be presented

> separately in the statement of comprehensive income. The line item for finance costs may also include amounts associated with non-financial liabilities.

6. The problem is magnified because the finance cost component is not always a cost – if there is a net defined benefit asset, the finance cost is income. In *Improvements to IFRSs* issued in May 2008, the Board amended paragraph IG13 of IFRS 7 and removed 'total interest income' as a component of finance costs. This amendment removed an inconsistency with paragraph 32 of IAS 1, which precludes the offsetting of income and expenses (except when required or permitted by an IFRS).

7. The staff have indentified three alternatives for presenting the finance cost component:

   (a) Relying on the requirements of IAS 1, and staying silent on whether the finance cost component should be presented together with other finance costs in IAS 19.

   (b) Requiring finance cost to be presented in the finance cost line item of IAS 1. This was the approach proposed in the ED.

   (c) Amending IAS 1 to require separate presentation of a line item for the finance cost component or to require presentation of a pensions line item combining service cost and finance cost.

8. To the staff's knowledge, practice varies on how the unwinding of the discount rate on the defined benefit obligation in current IAS 19 is presented and it appears that some entities currently include this as part of finance cost and some do not. These different treatments could be valid depending on how the requirements of IAS 1 are applied, since the unwinding of the discount rate will have a different relevance to each entity. If IAS 19 is silent on where the finance component should be presented, it would be reasonable to assume that this practice would continue.

9. If the Board confirms the approach in the ED, then it would need to consider whether this requirement will apply when the finance cost component represents

income. The Board will also need to consider whether it should apply a consistent treatment to amounts related to finance in other projects. If the Board confirms this approach, the staff recommend that the finance cost component should be part of finance costs only when the component represents an expense.

10. Some would prefer the Board require separate presentation of amounts related to post-employment benefits on the face of profit or loss, either an amount in aggregate or the disaggregated amounts displayed separately from other line items. However, the staff do not believe that adding mandatory line items to IAS 1 would be relevant if the entity presents its expenses by function.

11. We recommend that the Board does not require mandatory disaggregation of information on the face of the performance statements for the following reasons:

    (a) although material to many entities, there is no reason to single post-employment benefits out for special treatment on the face of the performance statements.

    (b) the staff do not think that the arguments presented justify the inclusion of additional mandatory line items in IAS 1.

    (c) if an entity and the users of its financial statements think that information about pensions is sufficiently important to that entity, IAS 1 already permits that entity to provide disaggregated information on the face of the performance statements.

Question 1
Does the Board agree with the staff recommendation to: (a) confirm the proposals in the ED that an entity should present the service cost and finance cost components in profit or loss; and (b) not specify where in profit or loss an entity should present the service cost and finance cost components? If not, does the Board wish to confirm the proposal in the ED that an entity should present the finance cost component with the finance cost line item of IAS 1?

Presenting the remeasurements component

12. Many respondents supported the proposal to present the remeasurements component in OCI. However a number of concerns were raised about the use of OCI. In generating alternative approaches, the staff has considered the current presentation options in IAS 19 and the Board's recent conclusions regarding presentation of items in OCI in IFRS 9. The current presentation options in IAS 19 are based on a different disaggregation to what the Board has tentatively decided at its October meeting. Maintaining the current IAS 19 options, or limiting the presentation to one of the two options will not result in the same presentation that exists to day because of the different disaggregation.

13. The staff have indentified four alternatives for the Board to consider for presenting the remeasurements component:

    (a) **P&L Approach –** require presentation of the remeasurement component separately in profit or loss.

    (b) **OCI Approach –** require presentation of the remeasurement component in OCI.

    (c) **P&L Option Approach –** permit a choice between presenting the remeasurement component in OCI or presenting it separately in profit or loss.

    (d) **P&L Mismatch Approach –** require presentation of the remeasurements component in OCI unless presenting it in OCI would create a mismatch in profit or loss, in which case the entity would present it in profit or loss.

The P&L Approach

14. This approach is similar to one of the two current options in IAS 19 that are available if the entity recognises actuarial gains and losses immediately. The arguments in favour of the P&L Approach are well developed, and were articulated in paragraphs BC42 and BC43 of the Basis for Conclusions on the ED (refer Agenda Paper 11B Appendix A). This approach results in fewer items

presented in OCI and avoids the need for the Board to consider whether items in OCI should be reclassified to profit or loss at some future date. Users of financial statements would be able to see the amount related to remeasurements and could make their own decisions about whether to use it in their analyses. However, most respondents agreed with the proposal in the ED that remeasurements should not be presented in profit or loss because they believe it would be inappropriate to present in profit or loss short-term fluctuations in an item that is long-term in nature. Many also agreed with the Board's view that information about remeasurements have a different predictive value (see paragraph 16). Very few comment letters supported presenting remeasurements in profit or loss.

The OCI Approach

15. This is the approach proposed in the ED and is also similar to one of the two current options in IAS 19 that are available if the entity recognises actuarial gains and losses immediately. The OCI approach is consistent with the majority of the views expressed in the comment letters that remeasurements should not be presented in profit or loss. It would present in a separate section an amount that provides useful information about the uncertainty of cash flows but less useful information about their amount and timing (BC38).

16. Paragraph BC42 acknowledges that 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. In developing the proposals in the ED, the Board considered the proposals in its exposure draft P*resentation of Items of Other Comprehensive Income*. That ED did not set a principle to distinguish what items entities should present in profit or loss and in OCI, and therefore individual projects are required to determine what the best presentation solution is. In the light of those proposals, the Board concluded that 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.

17. At its October meeting, the Board discussed a comment letter summary for the exposure draft *Presentation of Items of Other Comprehensive Income*. At that meeting the Board decided to focus on whether profit or loss and OCI should be presented in one or two statements. The staff will continue to monitor that project for any decisions which may affect the Board's thinking in this project.

The P&L Option Approach

18. The P&L Option Approach maintains the existing presentation options in IAS 19 and therefore does not expand the use of OCI. It would allow entities with small plans to keep the accounting simple and would allow entities to eliminate accounting mismatches caused when items are recognised in different parts of the statement of comprehensive income (for example, in an unfunded plan where the entity holds assets where the changes in the assets go through profit and loss). Both these features would address concerns expressed by the comment letters. However the Board stated in paragraph BC 41 of the Basis for Conclusions on the ED that perpetuating the options in IAS 19 would not improve financial reporting. Moreover, to the staff's knowledge, the extent of use of the current IAS 19 option to present actuarial gains and losses in profit or loss is limited.

19. In finalising IFRS 9 *Financial Instruments* the Board decided that an entity could make an irrevocable election to present in other comprehensive income changes in the value of any investment in equity instruments that is not held for trading (IFRS 9 paragraph 5.4.4). If an entity makes this election it would recognise in profit or loss dividends from that investment (IFRS 9 paragraph 5.4.5); it would recognise realised and unrealised gains in OCI (with no subsequent recycling). The reasons for permitting this election are as follows:

> BC83 …the Board noted arguments that presenting fair value gains and losses in profit or loss for some equity investments may not be indicative of the performance of the entity, particularly if the entity holds those equity instruments for non-contractual benefits, rather than primarily for increases in the value of the investment.

> BC84 The Board also noted that, in their valuation of an entity, users of financial statements often differentiate between fair value changes arising from equity investments held for purposes other than generating investment returns and equity investments held for trading. Thus, the Board believes that separate presentation in other comprehensive income of gains and losses for some investments could provide useful information to users of financial statements because it would allow them to identify easily, and value accordingly, the associated fair value changes.
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> BC89 The Board noted that permitting an option for entities to present some gains and losses in other comprehensive income is an exception to the overall classification and measurement approach and adds complexity. However, the Board believes that the requirement that the election is irrevocable, together with the additional disclosures required, addresses many of those concerns.

20. The P&L Option Approach is similar to the approach for equity instruments in IFRS 9. If the Board were to adopt this approach, it would alleviate some of the concerns about inconsistency in the treatment of items presented in OCI. Under IFRS 9, if an entity elects to present changes in equity instruments in OCI, the entity is required to present in profit or loss dividends received. In this project an entity is required to present in profit or loss a notional finance income as part of the finance cost component. The Board's reasoning for presenting part of the return in profit or loss are similar under both projects, ie to present a portion of income so that it matches the interest expense used to fund the assets. However the determination of this amount differs between the two projects.

The P&L Mismatch Approach

21. One disadvantage of the OCI approach is that it could result in a mismatch for entities that hold assets that do not qualify as plan assets. In that case, the changes in the DBO would be presented in OCI, while for many such assets, the changes would be presented in profit or loss. If the Board were to require that entities present the remeasurement component in OCI unless it results in a mismatch in profit or loss, the Board could eliminate this mismatch and would not effect comparability to the extent that the P&L option approach does.

22. This approach would be similar to the Board's current thinking in IFRS 9 where, for a financial liability designated as at fair value through profit or loss, the effects of changes in the liability's credit risk are presented in OCI unless that treatment would create or enlarge a mismatch in profit or loss. The reasons for that thinking are as follows:

    (a) users and others have told the Board that changes in a liability's credit risk ought not to affect profit or loss unless the liability is held for trading. That is because an entity generally will not realise the effects of changes in the liability's credit risk unless the liability is held for trading. To respond to that long-standing and widespread concern, the Board proposed that the effects of changes in a liability's credit risk should be presented in other comprehensive income.

    (b) However, the Board discussed whether such treatment would create or enlarge an accounting mismatch in profit or loss in some limited cases. The Board acknowledged that this might be the case if an entity holds large portfolios of financial assets that are measured at fair value through profit or loss and there is an economic relationship between changes in the fair value of those assets and the effects of changes in the credit risk of the financial liabilities designated under the fair value option. To address potential mismatches, the Board concluded that the effects of changes in the liabilities' credit risk would be presented in other comprehensive income unless such treatment would create or enlarge an accounting mismatch in profit or loss (in which case, the entire fair value change would be presented in profit or loss). The determination about potential mismatches would be made when the liability is initially recognised and would not be reassessed. The Board acknowledged this approach in IFRS 9 will introduce some additional complexity to financial reporting because not all liabilities designated under the fair value option will be treated the same.

23. If the Board were to pursue the P&L mismatch approach it would need to develop criteria similar to the criteria in IFRS 9 to determine whether presenting

remeasurements in OCI will create or enlarge an accounting mismatch in profit or loss. The staff does not expect to be able to prepare a paper to discuss what the criteria should be until the January meeting. This would mean that we may need to delay the interim reporting and transition papers until the January meeting too. However, we do not expect that a one month's delay in redeliberations would necessarily lead to a delay in publication.

Recommendation

24. In summary:

(a) The P&L Approach does not use OCI and therefore the Board does not need to address other issues relating to the use of OCI. However very few respondents supported this approach.

(b) The OCI Approach presents separately amounts with different predictive value and is therefore more understandable. However this would require the Board to address other issues relating to the use of OCI. A majority of respondents supported this approach.

(c) The P&L Option Approach maintains, to some extent, the status quo in IAS 19 (the Board has tentatively decided to disaggregate the components on a different basis to IAS 19). This approach also addresses some of the concerns about limiting the presentation of remeasurements to OCI. However perpetuating options will not improve comparability. The staff is also concerned about perpetuating options, however the P&L Option Approach could be considered a short-term solution until the Board completes its project on presentation of items in OCI. Some respondents supported maintaining the current options in IAS 19.

(d) The P&L Mismatch Approach addresses some of the concerns about limiting the presentation of remeasurements to OCI and would result in more comparability than the P&L Option Approach because it would limit the circumstances in which the remeasurement component is presented in profit or loss. However the Board will still need to address other issues relating to the use of OCI and will need to further develop the criteria used to determine a mismatch.

25. On balance, the staff believes the views of the Board in developing the ED have not been invalidated by the concerns raised by respondents. Despite the concerns raised, the majority of respondents still agreed with the Board's views and supported the proposal. Therefore the staff agree with the majority of the comment letters and recommend the Board confirm the proposals in the ED that the remeasurements component should be presented in OCI (the OCI Approach). The staff notes the concerns raised about the OCI Approach but believes that these do not prevent the Board finalising amendments based on that approach. We discuss those issues in Agenda Paper 11D.

Question 2
Does the Board confirm the proposals in the ED that an entity should present the remeasurements component in other comprehensive income? If not, what do you propose and why?