Project **Post-employment benefits**

Topic **Presentation: Other issues**

Objective

1. This paper provides a staff analysis and recommendation for other issues that were raised by respondents as noted in Agenda Paper 11B, including:
   (a) Components to be included in the cost of an asset (paragraphs 3 – 25); and
   (b) issues that are relevant only if the Board decides to present the remeasurements component in other comprehensive income (OCI), ie:
      (i) Subsequent reclassification of amounts presented in OCI (paragraphs 25 – 28)
      (ii) Transfer of amounts in OCI to retained earnings (paragraphs 29 – 33)
2. The staff recommends that the Board:
   (a) permits an entity to include only the service cost component in the cost of an asset when another standard so requires.
   (b) prohibits subsequent reclassification of the remeasurement component from other comprehensive income to profit or loss.
   (c) align the requirements for transfer of cumulative amounts recognised in OCI with IFRS 9.

This paper has been prepared by the technical staff of the IFRS Foundation for discussion at a public meeting of the IASB.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the IASB.

Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretations Committee or the IASB can make such a determination.

The tentative decisions made by the IASB at its public meetings are reported in IASB *Update*. Official pronouncements of the IASB, including Discussion Papers, Exposure Drafts, IFRSs and Interpretations are published only after it has completed its full due process, including appropriate public consultation and formal voting procedures.

Staff analysis and questions for Board

Components to be included in the cost of an asset

3. Paragraph 61 of the ED proposed that changes in the net defined benefit liability (asset) should be recognized in the statement of comprehensive income except to the extent that another Standard requires or permits their inclusion in the cost of an asset.

4. One of the concerns expressed by respondents about the proposal to present remeasurements in OCI is whether and how remeasurements should be included in the cost of an asset. Many manufacturers believe that all three components represent costs associated with the manufacture of assets and should therefore form part of the cost of the asset.

5. This section considers whether the components of defined benefit cost might meet the requirements in other IFRSs for inclusion in the cost of an asset. The following issues are considered:

   (a) Whether amounts presented in OCI can be included in the cost of an asset (paragraphs 6 – 8)

   (b) The current requirements in IAS 19 (paragraphs 9 – 11)

   (c) Whether the components of defined benefit cost meets the definition of "cost" for the purpose of determining the cost of an asset (paragraphs 12 – 18)

   (d) Whether IAS 19 should specify what components can be capitalised (paragraphs 21 – 24)

Can amounts in OCI be included in the cost of an asset?

6. IFRSs do not specify whether amounts that can be capitalised are limited to expenses that the entity would otherwise recognise in profit or loss. This raises the question of whether costs can be capitalised if they would otherwise be presented in OCI.

7. The staff thinks that it may be possible for entities to capitalise costs that would otherwise be presented in OCI because IFRSs do not include any principle that prohibits it. Additionally, IFRSs do not specify whether an entity can capitalise items that are recycled from OCI to profit or loss, except in the context of cash flow hedge accounting.

8. In the staff's view, the nature of each item that would otherwise be presented in OCI determines whether that item meets the definition of cost in the relevant IFRS for the asset in question.

Current requirements in IAS 19

9. Some interpret the requirements in IAS 19 as preventing an entity from including in the cost of an asset actuarial gains and losses recognised in OCI. They believe that IAS 19 requires all such gains and losses to be recognised in OCI because paragraph 93A of IAS 19 states:

> If, as permitted by paragraph 93, an entity adopts a policy of recognising actuarial gains and losses in the period in which they occur, it may recognise them in other comprehensive income, in accordance with paragraphs 93B–93D, providing it does so for:
>
> (a) all of its defined benefit plans; and
>
> (b) **all of its actuarial gains and losses**.
>
> (emphasis added)

10. Those with this view also argue that the requirements in IAS 19 relating to whether employee benefit costs may be capitalised only refers to costs recognised in profit or loss:

> 61 An entity shall recognise the net total of the following amounts in **profit or loss**, except to the extent that another Standard requires or permits their inclusion in the cost of an asset:
>
> (a) …
>
> (d) actuarial gains and losses, **as required in accordance with the entity's accounting policy** (see paragraphs 92–93D);

(e) …

62 Other Standards require the inclusion of certain employee benefit costs within the cost of assets such as inventories or property, plant and equipment (see IAS 2 and IAS 16). Any post-employment benefit costs included in the cost of such assets include the appropriate proportion of the components listed in paragraph 61.

(emphasis added)

11. Others argue that actuarial gains and losses do not meet the definition of costs in IFRS, regardless of whether these actuarial gains and losses would otherwise be recognised in profit or loss or in OCI. They believe that employee benefit costs should be disaggregated for the purpose of determining which cost components can be included in the cost of an asset.

Do the components of defined benefit cost meet the definition of costs?

12. IFRSs generally[1] define cost as follows [emphasis added]:

> The amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction or, where applicable, the **amount attributed** to that asset **when initially recognised** in accordance with the specific requirements of other IFRSs, eg IFRS 2. (IAS 16.6, IAS 38.8 and IAS 40.5)

13. In addition, IFRSs require that a financing element should be recognised as interest and not capitalised, unless that financing element meets the requirements for capitalisation in IAS 23 *Borrowing costs* [emphasis added]:

> The cost of an item of property, plant and equipment is the cash price equivalent at the recognition date. If payment is deferred beyond normal credit terms, the difference between the cash price equivalent and the total payment is recognised as interest over the period of credit unless such interest is capitalised in accordance with IAS 23. (IAS 16.23)

[1] IAS 2 *Inventories*, requires costs of inventory to include costs directly related to the units of production such as direct labour, but does not expand on this requirement.

> An entity may purchase inventories on deferred settlement terms. When the arrangement effectively contains a financing element, that element, for example a difference between the purchase price for normal credit terms and the amount paid, is recognised as interest expense over the period of the financing. (IAS 2.18)

14. If the financing element meets the requirements for capitalisation in IAS 23 *Borrowing costs*, the amount should be included in the cost of the asset in question. IAS 23 defines borrowing costs as:

> … interest and other costs that an entity incurs in connection with the borrowing of funds. (IAS 23.5)

15. The staff believes that the service cost component meets the definition of 'costs' as it represents the amount IAS 19 attributes to an asset when that asset is initially recognized. In the staff's view, the amount attributed to service during the period the asset is constructed is the 'cash price equivalent' at the recognition date of the asset.

16. IFRIC 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities* addresses whether changes in the measurement of a existing decommissioning, restoration or similar liability should be recognised in current period profit or loss, or added to (or deducted from) the cost of the related asset.

17. The IFRIC reached a consensus in IFRIC 1 that:

    (a) changes in an existing decommissioning, restoration or similar liability that result from changes in the estimated timing or amount of the outflow of resources embodying economic benefits required to settle the obligation, or a change in the discount rate, should be added to or deducted from the cost of the related asset and depreciated prospectively over its useful life.

    (b) the periodic unwinding of the discount shall be recognised in profit or loss as a finance cost as it occurs, because the unwinding of the discount rate used to measure a decommissioning liability does not meet the requirements of IAS 23 for the capitalization of interest since it does not reflect funds (ie cash) borrowed.

18. The staff believes that the finance cost component is similar to the unwinding of the discount rate for a liability within the scope of IFRIC 1 and the remeasurements component is similar to changes in the estimated timing or amount of the outflow of resources embodying economic benefits required to settle the obligation, or a change in the discount rate, for a liability within the scope of IFRIC 1.

19. Applying the reasoning of the IFRIC to whether the finance cost component meets the definition of borrowing costs as defined in IAS 23 would result in the conclusion that the finance cost component does not meet the definition of borrowing costs and should be recognised in profit or loss. This view would be consistent with the requirements in IAS 16.23 and IAS 2.18 to recognise finance elements as interest unless the finance element meets the requirement for capitalisation in IAS 23.

20. Applying the reasoning of the IFRIC to whether the remeasurements component meets the definition of costs in IAS 16 would result in the conclusion that changes in the defined benefit obligation that result from changes in the estimated timing or amount of the outflow of resources embodying economic benefits required to settle the obligation, or a change in the discount rate, should be added to or deducted from the cost of the related asset.

Should IAS 19 specify what components can be capitalized?

21. The Board can either:

    (a) Limit in IAS 19 what components of defined benefit cost can be capitalised in accordance with another standard, or

    (b) Not specify in IAS 19 what components of defined benefit cost can be capitalised in accordance with another standard.

22. The staff believes that the costs that qualify for capitalisation as part of an asset should be determined on the basis of an entity's accounting policy for determining the costs of the asset in accordance with IFRSs, including IAS 2, IAS 11, IAS 16 and IAS 38. Not specifying the components that can be

capitalised will future proof the standard from changes in the definition of costs in subsequent revisions of the relevant standards for the assets or the introduction of new standards.

23. Limiting the components of defined benefit cost would clarify the requirements and address concerns about whether amounts in OCI are eligible for capitalisation. If the Board decides to specify the components of defined benefit cost that can be capitalised, the staff recommends that capitalization of the finance cost component should be prohibited for the reasons set out in paragraphs 12 – 20. However, this analysis is based on the current definitions of cost in IFRSs, and any subsequent revision to these IFRSs or introduction of another standard may require the Board to revisit its conclusion.

24. The staff recommends that the Board confirms the proposal in the ED that an entity shall recognise the service cost, finance cost and remeasurements component in the statement of comprehensive income unless another Standard requires or permits their inclusion in the cost of an asset.

Question 1
Does the Board agree with the staff recommendation to confirm the proposal in the ED that an entity shall recognise the service cost, finance cost and remeasurements component in the statement of comprehensive income unless another Standard requires or permits their inclusion in the cost of an asset? If not, what do you propose and why?

Subsequent reclassification of amounts presented in OCI to profit or loss ('reycling')

25. Some believe the deferred recognition approach in IAS 19 (the corridor) supports the reclassification of actuarial gains and losses from OCI to profit or loss over the average service period. They argue that the Board should eliminate deferred recognition by requiring entities to recognise the unrecognized actuarial gains and losses in OCI but maintaining the mechanism of presenting those actuarial gains and losses in profit or loss over the average employee service

period. This would maintain the result for entities that currently use the corridor that all changes are presented in profit or loss eventually.

26. However, IAS 19 prohibits subsequent reclassification of actuarial gains and losses presented in OCI if they are recognized immediately. The ED did not propose to change this treatment.

27. The Board has previously acknowledged that it needs to address general issues relating to OCI, including what the objective for presenting items in OCI is and whether amounts in OCI should be reclassified to profit or loss (and if so, when). However, in the absence of an objective for presenting items in OCI, the staff does not believe there is a justification for modifying the immediate recognition approach currently permitted by IAS 19. Furthermore, that approach is also consistent with the Board's recent conclusions in issuing IFRS 9 to prohibit recycling for:

    (a) investments in equity instruments that are measured at fair value with changes presented in OCI, and

    (b) financial liabilities measured at fair value with the effect of changes in credit risk of the liability presented in OCI.

28. The Board has previously stated that reclassifying amounts from OCI to profit or loss is inappropriate because gains and losses should be recognised once in the statement of profit or loss and other comprehensive income. The staff believe that there is no justification for reaching a different conclusion for the remeasurement component. Therefore the staff recommend that the Board confirm the proposal in the ED that reclassification of the remeasurement component from OCI to profit or loss should be prohibited.

Question 2
Does the Board agree with the staff recommendation to confirm the proposal in the ED to prohibit subsequent reclassification of remeasurements from OCI to profit or loss? If not, what do you propose and why?

Transferring amounts in OCI to retained earnings

29. Paragraph 93D of IAS 19 requires actuarial gains and losses that are recognized immediately in OCI to be transferred immediately to retained earnings. The ED did not propose to amend this requirement.

30. The Board notes in paragraph BC48W of the Basis for Conclusions on current IAS 19 that:

> In IFRSs, the phrase 'retained earnings' is not defined and the IASB has not discussed what it should mean. In particular, retained earnings is not defined as the cumulative total of profit or loss less amounts distributed to owners. As with recycling, practice varies under IFRSs. Some amounts that are recognised outside profit or loss are required to be presented in a separate component of equity, for example exchange gains and losses on foreign subsidiaries. Other such amounts are not, for example gains and losses on available-for-sale financial assets.

31. The Board's current thinking in recent projects is to permit but not require entities to transfer the cumulative amounts recognized in OCI within equity. IFRS 9 paragraph B5.12 states:

> … Amounts presented in other comprehensive income shall not be subsequently transferred to profit or loss. However the entity may transfer the cumulative gain or loss within equity.

32. As noted in BC87 of IFRS 9:

> An entity may transfer the cumulative gain or loss within equity. In the light of jurisdiction-specific restrictions on components of equity, the Board decided not to provide specific requirements related to that transfer.

33. The staff recommends that, for consistency, entities should also be permitted, but not required, to transfer the remeasurement component within equity.

Question 3
Does the Board agree with the staff recommendation to permit but not require transfer of cumulative amounts recognised in OCI within equity? If not, what do you propose and why?