IFRS

IASB Meeting | Agenda reference **11C**

Staff Paper | Date **September 2010**

Project **Post-employment benefits**

Topic **Summary of outreach activities**

Background and objective of this paper

1. The comment period for the Board's exposure draft *Defined Benefit Plans* ends on 6 September 2010. At the time of writing this paper we had received around 30 comment letters and we plan to bring a comment letter summary to the Board in October.

2. To complement the formal consultation provided by comment letters, the staff and some Board members undertook an extensive program of outreach activities during the exposure period. Activities included live webcasts (conducted by the IASB and in partnership with other organisations), Q&A sessions, meetings, talks, conference presentations, conference calls, articles and email correspondence with a wide range of preparers, users, actuaries, auditors and other pensions professionals from a wide variety of geographic backgrounds.

3. The objective of this paper is to summarise, in very broad terms, the feedback received during these activities in order to provide the Board with an overview of the main issues raised by respondents. This paper reflects both formal and informal feedback received.

4. This paper does not provide a review or analysis of comment letters received and does not contain staff views or recommendations.

Summary of significant comments and issues

Overall

5. While interested parties express different views about specific aspects or details of the ED, the overall objectives and direction is well supported. However in many cases, this support is based on the assumption that the Board will perform a comprehensive review in the future, and, if the Board decides not to perform such a review, then the response could have been different. Some do not support the limited scope of the project and suggest that effort would be better spent on proceeding directly to a comprehensive review.

6. There was some concern about the behavioural implications of the proposals including concerns about the effects the proposals would have on the closure of defined benefit plans, on entities' decision to continue to offer defined benefits and about the implications for public policy. Others are concerned about the effect of the proposals on investment allocation within plans, for example, that the proposals may reduce the incentive to invest in equities.

7. Many are also concerned about divergence from US generally accepted accounting principles (US GAAP), particularly regarding presentation. While most acknowledge that removing the corridor will result in comparable statements of financial position for entities reporting in IFRSs and US GAAP, some propose that the IASB adopt the presentation requirements in US GAAP, specifically the recycling from other comprehensive income (OCI) to profit and loss based on the corridor method, as an interim step until such time as the Board undertakes a comprehensive review.

8. Regarding benefits and costs, some agree with the assessment in the Basis for Conclusions that the benefits to users of improved comparability, understandability, disclosures and reduction in diverse practices will exceed the costs to preparers of adopting and continuing to apply the changes. However some believe that the cost of the additional disclosures will be greater than the benefits and would favour scaling back the disclosure requirements.

9. Further comments on the main areas of the ED:

   (a) Recognition (Paragraphs 10 - 11)

   (b) Disaggregation and presentation (Paragraphs 12 - 20)

   (c) Disclosures (Paragraphs 21 - 24)

   (d) Other issues in the ED (Paragraphs 25 - 40)

   (e) Other issues not in the ED but coming up regularly in outreach (Paragraphs 41)

   (f) Transition (Paragraphs 42)

Recognition

10. The ED proposed that entities should recognise all changes in defined benefit obligations and in the fair value of plan assets when those changes occur. IAS 19 already permits entities to recognise all gains and losses when they occur, but also permits another option: to leave actuarial gains and losses unrecognized if they are within a 'corridor' and to defer recognition of actuarial gains and losses outside the corridor. The ED would remove that option.

11. There appears to be strong support for the removal of the corridor, both amongst users and preparers of financial statements. However, some would prefer to keep the corridor until measurement and other aspects of accounting for post-employment benefits have been addressed as part of a comprehensive review. Those who hold this view would prefer the Board to turn its attention to the comprehensive review now, rather than proceeding with the proposals.

Disaggregation and presentation

12. The ED proposed a new presentation approach for changes in defined benefit obligations and the fair value of plan assets. Entities would split changes in the defined benefit obligation and the fair value of plan assets into service cost, finance cost and remeasurement components and present:

(a) the service cost component in profit or loss.

(b) the finance cost component, ie net interest on the net defined benefit liability or asset, as part of finance costs in profit or loss.

(c) the remeasurement component in other comprehensive income.

13. While many support the removal of options for presenting changes in defined benefit assets or liabilities, there are mixed views on the particular disaggregation and presentation proposals in the ED. The views expressed can be divided as follows:

(a) Convergence supporters – prefer adopting the presentation in US GAAP, including recycling of gains and losses, as an interim step to a comprehensive review.

(b) EROA supporters – support retaining the use of the expected return on assets (EROA) and prefer the existing option for presenting actuarial gains and losses in OCI.

(c) Net interest supporters – support the proposal in the ED.

14. In many cases, the discussion of the presentation proposals in the ED focused on performance reporting and the distinction between OCI and net profit. Some constituents are concerned about the lack of a theoretical basis underlying the presentation of OCI items. Others consider the proposed use of OCI as a pragmatic approach that can be supported until the Board addresses performance reporting in the Conceptual Framework or another IASB project (such as Financial Statement Presentation).

15. Some feedback noted the inconsistency of the presentation model in the ED compared with the Board’s recent conclusions in financial instruments. Some commentators note that the proposed net interest approach is inconsistent with the Board’s conclusions in IFRS 9, in which an entity can elect to present gains and losses in the value of an equity instrument through OCI and present dividends from that equity instrument in profit or loss if the equity instrument is not held for trading.

16. Many believe that gains and losses should be reclassified from OCI to profit or loss. The basis for this could be one of a variety of reasons, including the current local GAAP recycling all OCI components (ie North America), other regulatory factors (such as the issue of distributable profits and whether OCI is part of retained earnings or part of another ‘reserve’ that is not distributable). However when pressed to suggest a basis for recycling, those with this view usually advocate an arbitrary mechanism, such as keeping the existing corridor method in a way similar to US GAAP.

17. Many preparers (and some users of financial statements) would like the Board to retain the EROA. They argue that the net interest approach proposed in the ED does not represent the underlying economics of the plan assets, and therefore provides an artificial comparability that ignores the differences between investments in bonds and investments in equities. However many of these same individuals also believe that the underlying economics would not be reflected if the actual return on assets were presented in profit or loss because the actual return would be too volatile to provide meaningful information. Those with the view acknowledge that presenting only the EROA in profit or loss may be subjective and propose that concerns over the use of management’s judgment could be addressed through improved disclosure.

18. Supporters of the net interest approach in the ED argue that it is a reasonable compromise and a pragmatic solution to a complex problem. They acknowledge that it is not an ideal solution, however they believe it removes a bias towards risky assets that has resulted from the existing EROA approach. Those with this view do not see that any additional benefit would arise from introducing recycling.

Settlements and curtailments

19. The ED proposed that gains and losses on routine and non-routine settlements are actuarial gains and losses and should be included in the remeasurement component, and that curtailments should be treated in the same way as plan amendments, with gains and losses presented in profit and loss.

20. Many disagreed with the ED proposal to treat non-routine settlements differently to curtailments. Many commented that non-routine settlements and curtailments usually happen at the same time, therefore requiring different accounting treatments for each component will introduce practical difficulties in determining the amount to allocate to each and will introduce structuring opportunities. Instead of the proposals in the ED, some advocated the same accounting for plan amendments, curtailments and non-routine settlements. However they did acknowledge that defining non-routine settlements and distinguishing them from routine settlements may present technical difficulties.

Disclosures

21. The ED proposed an objectives-based approach to disclosures, articulating disclosure objectives and proposing new requirements to support those objectives.

22. There was a mixed response to the disclosure proposals. While users of financial statements support the overall objectives and requirements proposed, there was concern about how the proposals would be implemented. In particular, many users of financial statements expressed concerns that the proposed disclosure requirements were broadly written and very high level. Preparers were concerned about the amount of disclosure proposed and the additional cost burden that this would impose. Many preparers expressed the view that an appropriate balance between cost and benefits had not been achieved.

23. There is concern that the disclosure requirements would be applied using a ‘checklist’ mentality, and therefore the disclosures specified by the standard would not be considered in the light of the financial statements as a whole, leading to excessive, voluminous disclosure.

24. Individual concerns about specific requirements have been noted, in particular the requirement to disclose information about factors that could cause contributions to differ from service cost and the sensitivity analysis for risk.

These concerns will be discussed in the analysis of the responses to the proposed disclosures.

Other issues in the ED

25. The Board proposed amendments to IAS 19 for other issues raised by respondents to the discussion paper *Preliminary Views on Amendments to IAS 19* that:

    (a) can be addressed expeditiously,

    (b) do not require a fundamental review of defined benefit obligation measurement, and

    (c) would lead to a worthwhile improvement in the reporting of defined benefit plans.

26. These proposals related to:

    (a) Administration costs (paragraphs 27 - 29)

    (b) Risk sharing (paragraphs 30 - 32)

    (c) Multi-employer plan exemption and disclosures (paragraphs 33- 35)

    (d) Merging of the post-employment and other long term employment benefit categories (paragraphs 35 - 38)

    (e) Other miscellaneous (paragraphs 39 - 40)

Administration costs

27. The ED proposed that the return on plan assets should be reduced by administration costs only if those costs relate to managing plan assets. However, it did not propose guidance regarding what administration costs should be included in the measurement of the DBO or how they should be allocated to service periods.

28. Many pensions professionals commented on the Board's proposals on the treatment of admin costs and noted that these costs could be significant. Some

estimate that the Board's proposals would cause an increase in the DBO of 5-6%. Many disagree with the ED's underlying conceptual assumption that admin costs should be included in the DBO if they represented part of the ultimate cost of providing the benefits and would prefer to expense such admin costs as incurred.

29. Regardless of the conceptual merits of the proposals, many raise concerns about how entities should estimate such costs and allocate them to current, past and future service. Difficulties include:

    (a) identifying the costs to include – this might be straightforward for some plans. However for an in-house administered plan, determining what should be included becomes less clear (ie the staff administering the plan, staff supervising them, a portion of the rent, CEO's salary and so forth).

    (b) allocating the costs between current service, past service and future service. This would be straightforward for closed plans, but difficult to do for the majority of open plans.

Risk sharing

30. Some defined benefit plans include features that share the benefits of a surplus or the cost of a deficit between the employer and plan participants. Similarly, some defined benefit plans provide benefits that are conditional to some extent on there being sufficient assets in the plan to fund them. Such features share risk between the entity and plan participants.

31. The ED proposed to amend paragraphs 64A and 85(c) to require explicitly that features that reduced the ultimate cost of the entity meeting its obligation be considered in determining the best estimate of the DBO. Those amendments were intended to provide greater clarity and reduce diversity in practice regarding the accounting for risk-sharing and conditional indexation features.

32. While those working with plans that have such features acknowledge that the proposals provide some welcome clarity, they do not think that the proposals go

far enough. Some state that the ED did not provide an optimal solution and left concerns about how the proposals will be implemented. The staff is continuing to work with interested parties to identify how best to resolve this issue.

Multi-employer plan exemption and disclosures

33. Users have welcomed the proposed disclosures for multi-employer plans (MEPs). Preparers have provided little feedback, but those that did comment were concerned about the requirement to quantify a withdrawal liability:

(a) the additional cost that the withdrawal liability disclosure will entail; and

(b) whether the disclosure would provide useful information if there was very little probability of withdrawal.

34. The US Financial Accounting Standards Board (FASB) soon intends to publish an exposure draft proposing to expand disclosures about an employer's participation in a multiemployer plan. The proposed disclosures in the FASB exposure draft are similar to the proposals in the Board's ED and we will continue to monitor the FASB's progress and feedback they receive.

35. The ED also asked respondents to describe any situations in which a defined benefit multi-employer plan has a consistent and reliable basis for allocating the obligation, plan assets and cost to the individual entities participating in the plan. We have received very little feedback regarding this issue.

Merging of the post-employment and other long term employment benefit categories

36. The exposure draft proposed to remove any difference between the accounting for post-employment benefits and the accounting for other long-term employee benefits. This would result in entities applying the net interest approach and the proposed disclosures to other long-term employee benefits. Currently, gains and losses arising from other long-term employee benefits are recognised in the period in which they occur and presented in profit or loss.

37. Most entities that would be affected by this proposal expressed strong opposition to merging the post-employment and long term employment benefit categories. Many noted that accounting for other long term employee benefits is not problematic, and believe there is no proven benefit in disaggregating and presenting the gains and losses in the way proposed for defined benefit plans.

38. Although the exposure draft identified this change in paragraph BC77, we believe that there may have been limited awareness of this change because it had been a consequential amendment, and not explicitly discussed by the Board before the ED was published. Some have commented that this change could have been better communicated.

Other miscellaneous

39. The ED proposed the following other amendments to IAS 19:

    (a) Taxes payable by the plan should be included in the return on plan assets or in the measurement of the defined benefit obligation, depending on the nature of the tax.

    (b) Clarification that expected future salary increases should be considered in determining whether a benefit formula expressed in terms of current salary allocates a materially higher level of benefit in later years.

    (c) The requirements in IFRIC 14 *IAS 19-The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*, as amended in November 2009, are incorporated without substantive change.

    (d) ‘Minimum funding requirement’ is defined as any enforceable requirement for the entity to make contributions to fund a post-employment or other long-term defined benefit plan.

    (e) Clarification that the mortality assumptions used to determine the defined benefit obligation are current estimates of the expected mortality rates of plan members, both during and after employment.

40. We received little feedback on these proposals during our outreach activities. To the extent there were any comments, they were brief and supportive of the proposals.

Other issues not in the ED but coming up regularly in outreach

Interim reporting

41. The outreach activities highlighted an existing issue related to interim reporting. The ED did not propose any change to this area. The issue is how net interest and actuarial gains and losses should be calculated in interim and annual reports and whether that calculation should be based on the assumptions and amounts at the beginning of the year or updated periodically during the year.

Transition

42. We received some questions on the transition requirements. These questions mostly relate to how entities should adjust cumulative retained earnings and other comprehensive income on transition if they had been either applying the corridor method, or presenting all changes in profit and loss, and whether they need to go back in time to work out what the cumulative amounts would have been.