Project **Post-employment benefits**

Topic **Transition**

Objective

1. This paper provides:

   (a) an overview of the proposed transition requirements in the exposure draft *Defined Benefit Plans* (the 2010 ED) and of the responses to those proposals (paragraphs 7 - 11);

   (b) an overview of the proposed transition requirements in the exposure draft *Amendments to IAS 37* Provisions, Contingent Liabilities and Contingent Assets *and IAS 19* Employee Benefits (the 2005 ED) in respect of termination benefits (paragraphs 12 - 14); and

   (c) a staff analysis and recommendation (paragraphs 15 – 42).

2. Agenda Paper 7A includes a summary of the Board's tentative decisions to date and a comparison with the proposals in the ED, highlighting any changes from the ED.

3. This paper does not address the effective date which is considered in Agenda Paper 7C. However, the Board's decision on the effective date will have consequences on the transition requirements (discussed in paragraphs 16 – 17).

4. On 19 October 2010, the Board published a Request for Views to gather views from interested parties about the time and effort that will be involved in adapting to the several new IFRSs the IASB expects to issue in 2011 and about transition

requirements for these projects in general. The comment period for the Request for Views ended on 31 January 2011.

5. The staff analysis and recommendation below considers the transition requirements for this project in isolation, and therefore the Board should note that it still has the opportunity to review the transition requirements as part of its broader consideration of the feedback received from the request for views on effective dates and transition consultation.

6. In summary, the staff recommends:

(a) that for entities already applying IFRSs, the amendments to IAS 19 should be applied retrospectively in accordance with the general requirements of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, except that:

(i) the Board specify that the carrying amount of assets outside the scope of IAS 19 need not be adjusted for changes in employee benefit costs that were included in the carrying amount before the beginning of the financial year in which this Standard is first applied (ie previously unrecognised actuarial gains and losses and past service cost should be recognised by adjusting equity, not by adjusting the carrying amount of assets that include employee benefit costs); and

(ii) the Board specify that comparatives need not be presented for the disclosures for the sensitivity of the defined benefit obligation for the year of initial application of the amendments to IAS 19.

(b) that for entities adopting IFRSs for the first time, the amendments to IAS 19 should be applied retrospectively in accordance with the general requirements of IFRS 1 *First-time Adoption of International Financial Reporting Standards*, except that:

(i) the Board specify that the carrying amount of assets outside the scope of IAS 19 need not be adjusted for changes in employee benefit costs that were included in the carrying amount before the beginning of the financial year in which IFRSs are first applied (ie previously unrecognised actuarial gains and losses and past service cost should be recognised by adjusting equity, not by adjusting the carrying amount of assets that include employee benefit costs); and

(ii) the Board allows a temporary exemption for entities adopting IFRSs with a date of transition before the effective date of the amendments to IAS 19 that comparatives need not be presented for the disclosures for the sensitivity of the defined benefit obligation.

(c) the Board confirm the ED 2010 proposal to delete paragraphs 153-156 of IAS 19 and paragraph D10 of Appendix D of IFRS 1 (reproduced in Appendix A).

Proposed requirements in the 2010 ED

7. In developing the proposals in the 2010 ED, the Board concluded that it would not be unduly burdensome for entities to apply the proposed changes to IAS 19 retrospectively. Although some of the proposed amendments will change the amounts recognised, entities will not have to recalculate amounts for dates earlier than the beginning of the first period presented in the financial statements. The amounts depend solely on conditions at that date, not on assessments made on previous dates.

8. Accordingly, the Board proposed that entities should apply the proposed amendments to IAS 19 retrospectively, in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Responses to the proposals in the 2010 ED

9. Question 15 of the ED asked:

> **Question 15**
>
> Should entities apply the proposed amendments retrospectively? (Paragraphs 162 and BC97–BC101) Why or why not?

10. Most respondents agreed with the ED proposal that the amendments to IAS 19 resulting from the ED should be applied retrospectively in accordance with IAS 8.

11. However, some respondents raised the following concerns:

    (a) how to apply retrospective application where the cost of assets include amounts based on IAS 19, for example for manufacturing companies which allocate employee benefit costs to inventories, allocating adjustments to inventory and cost of goods sold in prior year financial statements might be very difficult. Some respondents suggested using the cost of those assets at the beginning of the first period presented in the financial statements as their deemed cost at that date;

    (b) that entities will be required to go back to the inception of the plan to calculate the adjustments required on first-time application of the amendments;

    (c) potential issues in the calculation of deferred tax balances, particularly since the US Financial Accounting Standards Board (FASB) rejected retrospective application of SFAS 158 *Employers' Accounting for Defined Benefit Pension and Other Postretirement Benefit Plans* and required prospective application due to issues with assessing valuation allowances against deferred tax assets on a retrospective basis.

    (d) the costs of implementing the changes proposed in the ED retrospectively would outweigh the benefits of retrospective application (particularly in relation to the proposals for other long-term employee benefits, but also in relation to the other amendments); and

(e) the costs of applying the some of the new disclosure requirements (such as information required by paragraphs 125E and 125F) retrospectively would outweigh the benefits of doing so. Accordingly, as for the transitional provisions of the March 2009 amendments to IFRS 7, these respondents believe comparative disclosures should not be required in the first year of application and in the first IFRS financial statements of a first-time adopter.

Proposed requirements for termination benefits in the 2005 ED

12. Paragraph 159D of the 2005 ED proposed that:

> 159D An entity shall apply the amendments in [draft] paragraphs 7 and 132-147 from the beginning of its first annual period commencing on or after [1 January 2007]. Comparative information shall not be restated. Earlier application is encouraged. However, an entity shall apply the amendments only from the beginning of an annual period commencing on or after [date the amendments are issued]. If an entity applies the amendments before the effective date, it shall disclose that fact.

13. The Basis for Conclusions in the 2005 ED did not elaborate why the Board proposed a prospective basis for transition to the new requirements for termination benefits, however the following was included regarding the proposed amendments to IAS 37:

> BC92 IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* requires a change in accounting policy upon initial application of a Standard to be applied retrospectively (ie to all periods presented). However, the Board noted that unless it set the effective date two or three years after issuing the revised IAS 37, an existing user of IFRSs would, in many instances, find it impracticable to apply the amendments retrospectively. This is because the Board believes that the most significant effect of the proposals in the Exposure Draft is to require entities to recognise, as non-financial liabilities, items that were not previously recognised (and, in some

cases, not considered to be liabilities). Thus, until the proposals are confirmed in a final Standard, entities would have had no reason to collect the necessary information to measure these items. Hence, requiring entities to recognise and measure such items as at dates before the final Standard is issued would, in many cases, require the inappropriate use of hindsight.

BC93 When it is impracticable to apply a new accounting policy retrospectively, paragraph 24 of IAS 8 requires an entity to apply the new policy to the carrying amount of assets and liabilities as at the beginning of the earliest period for which retrospective application is practicable, which may be the current period. The Board concluded that the earliest period for which it would be practicable to apply the revised IAS 37 would be periods beginning on or after the date the revised Standard is issued (expected to be in 2006). Because of this, and because the Board proposes the same effective date for the revised IAS 37 as for the revised IFRS 3 which it accompanies (ie 1 January 2007), the Board proposes to prohibit entities from applying the revised IAS 37 for accounting periods beginning before the date it is issued and from restating comparative information.

BC94 The Board noted that a similar question about impracticability would arise for any first-time adopter of IFRSs with a date of transition to IFRSs before the date the revised IAS 37 is issued. This is because, in the absence of any specific exemption in IFRS 1 *First-time Adoption of International Financial Reporting Standards*, a first-time adopter applies the IFRSs effective at its reporting date for its first IFRS financial statements. So, for example, a first-time adopter that has a first IFRS reporting period ending on 31 December 2007 and includes comparative information for two years would be required to apply the amended IAS 37 from 1 January 2005. Therefore, the Board decided to propose a new exemption in IFRS 1 that specifies the same transitional requirements for a first-time adopter of IAS 37 as for an existing user of IFRSs.

14. The staff notes that the proposals in the 2005 ED were developed with the other proposals related to IAS 37 in mind, and with the consideration that current IAS 19 allows entities to defer recognition of defined benefit cost.

Staff analysis and recommendation

15. This section considers:

    (a) interaction with effective date (paragraphs 16 – 17);

    (b) transition requirements for initial application of amendments for entities already applying IFRSs (paragraphs 18 – 36);

    (c) first-time adopters of IFRSs (paragraphs 37 – 41);

    (d) existing transition paragraphs in IAS 19 (paragraph 42);

Interaction with effective date

16. Agenda Paper 7C discusses the effective date of the amendments. However, the effective date and transition requirements are complementary. If the Board decides that a shorter effective date is appropriate, then the costs of implementing the proposals within a shorter time frame should be taken into account in the transition requirements. However if the Board decides that a longer effective date is appropriate then the costs of implementing the proposals becomes less of an issue.

17. The analysis below is based on the staff recommendation in Agenda Paper 7C of an effective date of 1 January 2012.

Initial application of amendments for entities already applying IFRSs

18. The initial application of the amendments to IAS 19 may result in a change in accounting policy.

19. IAS 8 states that entities apply a change in accounting policy resulting from the initial application of an IFRS retrospectively. When applying a new IFRS, IAS 8 requires the reporting entity to adjust the opening balance of retained earnings for the earliest period presented for any difference between the amounts recognised before and after the application of the new IFRS, as would be the case if the new IFRS had always been applied (IAS 8.22). A change in accounting policy is not applied retrospectively to the extent that it is

impracticable to determine either the period-specific effects or the cumulative effect of the change (IAS 8.23). IAS 8 sets out transition requirements that apply if retrospective application is impracticable and prohibits the use of hindsight when applying a new accounting policy to a prior period.

20. Agenda Paper 7A includes a summary of the Board's tentative decisions to date. The main amendments to IAS 19 include:

    (a) *Recognition* – including elimination of the option to defer recognition of defined benefit cost and amendments to the timing of recognition of termination benefits, plan amendments and curtailments (paragraphs 21 – 26);

    (b) *Presentation* – amendments to the presentation of defined benefit cost in the statement of comprehensive income (paragraph 27);

    (c) *Disclosure* - amendments to the disclosure for defined benefit plans (paragraphs 28 – 30);

    (d) *Termination benefits* – amendments to the definition of termination benefits (paragraphs 31 - 34); and

    (e) *Other* - other issues raised in the comment letters to the DP that the Board considered could be addressed in a short period of time (paragraphs 35 – 36).

Recognition

21. The staff thinks that the feedback received highlights four main concerns with retrospective application of the amendments:

    (a) whether an entity would be required to go back to the inception of the plan in order to recalculate the amounts for employee benefit assets and liabilities (paragraph 22)and cumulative amounts recognized in other comprehensive income (paragraph 23);

(b) whether an entity should be required to restate the amounts of other non-employee benefit assets and liabilities that are affected by the amounts determined by IAS 19 (ie inventories) (paragraph 24);

(c) the recognition of one-time transactions in profit or loss twice, or not at all (paragraph 25); and

(d) the use of hindsight for the recognition of transactions before the amendments to IAS 19 are issued (paragraph 26).

22. In the staff's view it would not be unduly burdensome for entities to apply the changes resulting from the elimination of deferred recognition retrospectively. Although some of the proposed amendments will change the amounts recognised, entities will not have to recalculate amounts for employee benefit assets and liabilities for dates earlier than the date of the beginning of the first period presented in the financial statements. The amounts depend solely on conditions at that date, not on assessments made on previous dates.

23. Some respondents requested further clarification regarding the presentation of previously unrecognised actuarial gains and losses in equity. In November 2010, the Board tentatively decided to permit, but not require, an entity to transfer within equity the cumulative amounts recognised in other comprehensive income. Because an entity is permitted to transfer within equity the cumulative amounts recognised in other comprehensive income, there is no specific equity balance that needs to be restated as a result of applying the changes to IAS 19.

24. Assets that could be affected by changes in the amounts of employee benefit costs include inventories and property, plant and equipment. The staff agree that restating the cost of these amounts may be difficult, for example in the case of inventories it may be difficult to determine the amount of restatement that should be allocated to inventory on hand and to cost of goods sold. The staff think that transition relief should be provided in respect of these amounts, so that an entity would be permitted, but not required to restate these amounts. The staff recommends that the Board specify that the carrying amount of assets

outside the scope of IAS 19 need not be adjusted for changes in employee benefit costs that were included in the carrying amount before the beginning of the financial year in which this Standard is first applied (ie previously unrecognised actuarial gains and losses and past service cost should be recognised by adjusting equity, not by adjusting carrying amount of assets that include employee benefit costs recognised under the existing IAS 19).

25. Some respondents noted that changing the timing of recognition for transactions (such as curtailments, termination benefits and plan amendments) might result in the recognition of those transactions in profit or loss twice (if the amendments to the timing of recognition result in recognition in a later period compared to current requirements) or not at all (if the amendments to the timing of recognition result in recognition in an earlier period compared to the current requirements). The staff thinks this is an unavoidable consequence of amending the timing of recognition. This may cause further confusion if the comparatives are not restated, as the transaction may appear both in the current profit or loss and the prior profit or loss.

26. Changing the recognition requirements may also result in the use of hindsight where an entity is required to recognise (and therefore measure) a plan amendment, curtailment, settlement or termination benefit or calculate a deferred tax asset and deferred tax liability (including associated valuation allowance) at a date before the Board issues the amendments to IAS 19. Until the Board issues the amendments to IAS 19, entities would have had no reason to collect the necessary information to measure these items. Hence, requiring entities to recognise and measure such items as at dates before the amendments to IAS 19 are issued would, in many cases, require the inappropriate use of hindsight. IAS 8 prohibits the use of hindsight when applying an accounting policy change to prior periods and contains requirements to be applied when retrospective application is impracticable. In such circumstances, an entity is required to apply a change in accounting policy from the earliest date practicable, which may be the current period.

Presentation

27. In the staff's view, the revised requirements for presentation do not require any information beyond that which entities would already have prepared to apply the existing version of IAS 19.

Disclosure

28. Some respondents to the 2010 ED requested some relief from preparing comparative disclosures for some of the new requirements, such as the sensitivity analysis on cost/benefit grounds. If the Board decides that an entity should apply other proposed amendments retrospectively, then the disclosures relating to restated amounts will have to be presented as well. The quantitative disclosures in addition to what IAS 19 currently requires include the new disclosure requirements for the sensitivity, disaggregation and maturity profile of the defined benefit obligation. The staff thinks that information required for the disclosure of a disaggregation and maturity of the defined benefit obligation should be available as part of the calculation of the defined benefit obligation, however until the Board issues the amendments to IAS 19, entities would have had no reason to collect the necessary information to disclose the sensitivity of the defined benefit obligation.

29. Given the recommended effective date provides a lead time of 2 years, the staff think that the Board may provide relief from requiring the sensitivity disclosure in the comparative period. This would allow entities time to implement the systems required to gather the new information. Therefore, the staff recommends that comparatives need not be presented for the disclosures for the sensitivity of the defined benefit obligation for the year of initial application of the amendments to IAS 19. If the Board decides that a longer lead time before the effective date is necessary, then the staff thinks that adequate time will be available for entities to implement new systems to gather the information for these disclosures and therefore no exemption from presenting comparatives for the year of initial application of the amendments to IAS 19 will be needed.

30. The staff also notes that these new disclosures may result in the use of hindsight if the disclosures are required as at dates before the amendments to IAS 19 are issued. As noted earlier, the staff thinks that the earliest period for which it would be practicable to apply the revised IAS 19 would be periods beginning on or after the date the amendments to IAS 19 are issued.

Termination benefits

31. The 2005 ED proposed that an entity should apply the amendments to IAS 19 for termination benefits from periods beginning 1 January 2007 and that an entity should not restate comparatives. However, the proposed requirements were not clear on the transitional arrangements for benefits that change classification from termination benefits to employee benefits (or vice versa), and the accounting for such benefits as at the effective date.

32. The staff thinks that the amendments to IAS 19 resulting from the 2005 ED should have the same effective date and transition requirements as the amendments resulting from the 2010 ED because of:

    (a) the interaction between the amendment to eliminate the option to defer recognition of defined benefit cost and the other amendments; and

    (b) the reclassification of benefits from termination benefits to employee benefits (and vice versa).

33. The amendments to the requirements for termination benefits may result in the reclassification of benefits from termination benefits to another one of the employee benefit categories when the amendments are first applied. This could have implications for the recognition of these benefits, and could result in the recognition of past service cost in the case of a benefit that was reclassified to one of the employee benefit categories from termination benefits. Paragraphs 25 – 26 address the changes to the timing of recognition for termination benefits.

34. The staff notes that the tentative decisions by the Board regarding the definition of termination benefits result in a closer match to the current definition (ie, termination benefits are provided in exchange for termination of employment,

employee benefits are provided in exchange for service) than the definition proposed in the 2005 ED (ie voluntary and involuntary termination benefits). Accordingly, we do not think that there is any reason why it would be difficult to apply the proposed amendments retrospectively.

Other changes

35. The other changes include clarification of the accounting for risk-sharing features, administration costs and taxes, and the classification of short-term and long-term employee benefits.

36. In the staff's view, these other changes do not require an entity to recalculate amounts for employee benefit assets and liabilities for dates earlier than the date of the beginning of the first period presented in the financial statements. The amounts depend solely on conditions at that date, not on assessments made on previous dates.

First-time adopters of IFRSs

37. Paragraph D10 of Appendix D of IFRS 1 deals with the application of the corridor approach for first-time adopters of IFRS. In the light of the Board's proposal to abolish the corridor approach, this paragraph is redundant.

38. Paragraph D11 of Appendix D of IFRS 1 allows prospective application of the 5 year disclosure requirements of IAS.19.120A(p). The allowance was made as this paragraph requires disclosure of amounts from dates prior to the date of transition to IFRSs and it was considered impractical for a first-time adopter of IFRSs to apply. We see no reason to change this exemption.

39. There are no other specific transitional provisions relating to IAS 19 or IFRIC 14. This means that first-time adopters would be required to apply the amended IAS 19 retrospectively, except for paragraph 120A(p).

40. The staff thinks that the same considerations discussed for initial application for entities already applying IFRSs apply to first time adopters as well. Consequently, the staff recommends that the Board require first-time adopters

apply the amendments to IAS 19 retrospectively in accordance with the general requirements of IFRS 1, except that:

(a) the Board specify that the carrying amount of assets outside the scope of IAS 19 need not be adjusted for changes in employee benefit costs that were included in the carrying amount before the beginning of the financial year in which IFRSs are first applied (ie previously unrecognised actuarial gains and losses and past service cost should be recognised by adjusting equity, not by adjusting the carrying amount of assets that include employee benefit costs); and

(b) the Board allows a short-term exemption for entities adopting IFRSs with a date of transition before the effective date of the amendments to IAS 19 that comparatives need not be presented for the disclosures for the sensitivity of the defined benefit obligation.

41. IFRS 1 places priority on achieving comparability over time within a first-time adopter's first IFRS financial statements and between different entities adopting IFRS for the first time at a given date. Therefore, the staff does not think that the Board should allow an exemption for entities adopting IFRSs from applying the revised IAS 19 to comparative information.

Existing transition paragraphs in IAS 19

42. Paragraphs 153 to 156 of the existing version of IAS 19 contain transitional provisions that would have applied when entities first adopted IAS 19 in 1999 and their effect expired after five years. These are no longer necessary as entities adopting IAS 19 for the first time in the future would be within the scope of IFRS 1. Therefore the 2010 ED proposed their deletion. There was no objection to this in the comment letters, therefore the staff recommends the Board confirm this proposal.

Question
Does the Board agree with the staff recommendation: **(a)** that for entities already applying IFRSs, the amendments to IAS 19 should be applied retrospectively in accordance with the general requirements of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, except that: (i) the Board specify that the carrying amount of assets outside the scope of IAS 19 need not be adjusted for changes in employee benefit costs that were included in the carrying amount before the beginning of the financial year in which this Standard is first applied (ie previously unrecognised actuarial gains and losses and past service cost should be recognised by adjusting equity, not by adjusting the carrying amount of assets that include employee benefit costs); and (ii) the Board specify comparatives need not be presented for the disclosures for the sensitivity of the defined benefit obligation for the year of initial application of the amendments to IAS 19. **(b)** that for entities adopting IFRSs for the first time, the amendments to IAS 19 should be applied retrospectively in accordance with the general requirements of IFRS 1 *First-time Adoption of International Financial Reporting Standards*, except that: (i) the Board specify that the carrying amount of assets outside the scope of IAS 19 need not be adjusted for changes in employee benefit costs that were included in the carrying amount before the beginning of the financial year in which IFRSs are first applied (ie previously unrecognised actuarial gains and losses and past service cost should be recognised by adjusting equity, not by adjusting the carrying amount of assets that include employee benefit costs); and (ii) the Board allows a temporary exemption for entities adopting IFRSs with a date of transition before the effective date of the amendments to IAS 19 that comparatives need not be presented for the disclosures for the sensitivity of the defined benefit obligation. **(c)** to confirm the ED 2010 proposal to delete paragraphs 153-156 of IAS 19 and paragraph D10 of Appendix D of IFRS 1 (reproduced in Appendix A). If not, what does the Board propose and why?

Appendix A

A1. Relevant paragraphs proposed to be deleted from IAS 19:

153 This section specifies the transitional treatment for defined benefit plans. Where an entity first adopts this Standard for other employee benefits, the entity applies IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

154 On first adopting this Standard, an entity shall determine its transitional liability for defined benefit plans at that date as:

(a) the present value of the obligation (see paragraph 64) at the date of adoption;

(b) minus the fair value, at the date of adoption, of plan assets (if any) out of which the obligations are to be settled directly (see paragraphs 102–104);

(c) minus any past service cost that, under paragraph 96, shall be recognised in later periods.

155 If the transitional liability is more than the liability that would have been recognised at the same date under the entity's previous accounting policy, the entity shall make an irrevocable choice to recognise that increase as part of its defined benefit liability under paragraph 54:

(a) immediately, under IAS 8; or

(b) as an expense on a straight-line basis over up to five years from the date of adoption. If an entity chooses (b), the entity shall:

(i) apply the limit described in paragraph 58(b) in measuring any asset recognised in the statement of financial position;

(ii) disclose at the end of each reporting period: (1) the amount of the increase that remains unrecognised; and (2) the amount recognised in the current period;

(iii) limit the recognition of subsequent actuarial gains (but not negative past service cost) as follows. If an actuarial gain is to be recognised under paragraphs 92 and 93, an entity shall recognise that actuarial gain only to the extent that the net cumulative unrecognised actuarial gains (before recognition of that actuarial gain) exceed the unrecognised part of the transitional liability; and

(iv) include the related part of the unrecognised transitional liability in determining any subsequent gain or loss on settlement or curtailment.

If the transitional liability is less than the liability that would have been recognised at the same date under the entity's previous accounting policy, the entity shall recognise that decrease immediately under IAS 8.

156 On the initial adoption of the Standard, the effect of the change in accounting policy includes all actuarial gains and losses that arose in earlier periods even if they fall inside the 10% 'corridor' specified in paragraph 92.

A2. Relevant paragraphs from Appendix D of IFRS 1:

D10 In accordance with IAS 19 Employee Benefits, an entity may elect to use a 'corridor' approach that leaves some actuarial gains and losses unrecognised. Retrospective application of this approach requires an entity to split the cumulative actuarial gains and losses from the inception of the plan until the date of transition to IFRSs into a recognised portion and an unrecognised portion. However, a first-time adopter may elect to recognise all cumulative actuarial gains and losses at the date of transition to IFRSs, even if it uses the corridor approach for later actuarial gains and losses. If a first-time adopter uses this election, it shall apply it to all plans.

D11 An entity may disclose the amounts required by paragraph 120A(p) of IAS 19 as the amounts are determined for each accounting period prospectively from the date of transition to IFRSs.