Project **Post-employment benefits**

Topic **Presentation of components of defined benefit cost**

Objective

1. This paper requests further clarification regarding the presentation of the remeasurements component of defined benefit cost.
2. This paper does not repeat the background and analysis in Agenda Paper 11C of November 2010. Board members should refer to Agenda Paper 11C for further background if required.
3. The staff recommends that:
   (a) if the Board wants to limit an entity's choice of presenting remeasurements in profit or loss, then the choice:
      (i) should be limited to cases when doing so eliminates or reduces an accounting mismatch in profit or loss.
      (ii) should apply to all of the remeasurements in all plans that meet the criteria in (i); and
      (iii) should be an accounting policy choice that the entity could revoke if IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* so permits;
   (b) if the Board **does not** want to limit an entity's choice of presenting remeasurements in profit or loss, then:
      (i) the choice should apply to all of the remeasurements in all of the entity's plans;

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.

(ii) the choice should be an accounting policy choice that the entity could revoke if IAS 8 so permits;

(iii) separate presentation of remeasurements in profit or loss should not be required.

(iv) the entity should disclose why it elected to present remeasurements in profit or loss.

Background

4. The objective of the proposals in the exposure draft *Defined Benefit Plans* (the ED) was to reduce the current options in IAS 19 of presenting the components of defined benefit cost in different parts of the statement of comprehensive income, thereby improving comparability and understandability.

5. As discussed in Agenda Paper 11C of November 2010, most of the respondents supported these objectives and the Board's proposal that an entity should present the remeasurements component in other comprehensive income (however some agreed, but added the caveat that these amounts should be recycled to profit or loss). However some noted the consequences of doing so, including the presentation mismatch that results due to unfunded plans, and hedging relationships. Some others did not support the Board addressing the presentation of defined benefit cost before a more fundamental review of the presentation of items in the statement of comprehensive income and the financial statement presentation project.

6. The Board discussed the presentation of the components of defined benefit cost at its meeting in November 2010 and tentatively decided:

   (a) to confirm the proposals in the ED that an entity should present the service cost and finance cost components in profit or loss;

   (b) to withdraw the proposal in the ED that an entity should present the finance cost component together with other finance costs as defined in IAS 1 *Presentation of Financial Statements.* Instead the Board

tentatively decided that an entity could present the components in profit or loss according to the requirements of IAS 1; and

(c) to withdraw the proposal in the ED that an entity should present the remeasurements component in other comprehensive income (OCI). Instead the Board tentatively decided that an entity could present the remeasurements component in either profit or loss or OCI.

7. In addition, in November 2010, the Board and the FASB discussed their project on the presentation of items in OCI. At that meeting, the boards tentatively decided:

(a) to proceed with the project as originally planned, as opposed to delaying the project until the boards can develop a consistent basis for determining which elements should be presented in OCI and when reclassification to net income is appropriate;

(b) to require entities to present net income and OCI either in a single continuous statement or in two separate, but consecutive, statements;

(c) the standards would be effective as of the beginning of a fiscal reporting year that begins after December 15, 2011 for US GAAP and for fiscal reporting years that begin on or after 1 January 2012 for IFRS;

(d) to affirm the tentative decision to require full-retrospective application for the final standard; and

(e) to affirm the tentative decision of the FASB to require reclassification adjustments to be presented in both OCI and net income, and by both boards to allow items of OCI to be presented either net of tax with details in the notes or gross of tax with each item's tax effect displayed parenthetically, and to retain the current calculation of earnings per share based on net income/(profit or loss).

(f) In addition, the IASB affirmed its tentative decision to require entities to present items of OCI that will be reclassified through profit or loss separately from items that will not be so reclassified.

8. The November meeting regarding the project on the presentation of items in OCI took place after the meeting on the presentation of components of defined benefit costs. This meeting provides an opportunity for the Board to reaffirm its tentative decision regarding presentation of the remeasurements component in the light of the tentative decision made in the project on presentation of OCI.

Staff analysis and questions for Board

9. The Board tentatively decided in November 2010 to allow an entity to present remeasurements either in profit or loss or in OCI. This paper seeks further clarification of this decision, in particular:

   (a) whether the option to present remeasurements in profit or loss or in OCI should be limited to specified circumstances;

   (b) whether an entity's election to present remeasurements in profit or loss or in OCI:

      (i) is a separate election for each plan or a single election for the entire entity;

      (ii) applies to all of the remeasurements;

      (iii) is irrevocable;

   (c) if the Board decides that the option is a free choice (not limited to specified circumstances), then:

      (i) whether an entity should be required to identify remeasurements as a separate line item if presented in profit or loss; and

      (ii) whether the entity should be required to explain the reasons for the presentation choice.

Whether the option to present remeasurements in profit or loss should be limited to specified circumstances

10. The ED's objective of improving comparability by reducing options for presenting defined benefit cost was well received by respondents to the ED. This section:

    (a) discusses whether the Board's tentative decision to allow an entity to present remeasurements in profit or loss or OCI should be a free choice or should be limited to specified circumstances; and

    (b) considers what circumstances should allow a choice of presentation.

Free choice vs under specified circumstances

11. Allowing a free choice of presentation of remeasurements would be consistent with the current requirements of IAS 19 relating to the presentation of actuarial gains and losses if actuarial gains and losses are recognised immediately.

12. 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.

13. Limiting the choice of presentation to specified circumstances would improve the comparability of financial statements when those circumstances do not apply. Such a limitation would address the concerns expressed by respondents that requiring entities to present remeasurements in OCI may have unintended consequences. Such a limitation may also reduce comparability less than a free choice would. However, limiting the choice to particular circumstances would require the establishment of criteria and would add complexity.

14. Such a limitation on the choice of presentation would be similar to the limitation in IFRS 9 *Financial Instruments* on the option to present in OCI changes in the fair value of an investment in equity instruments. That option is available **only if** that equity instrument is not held for trading (IFRS 9 paragraph 5.4.4). Paragraph BC89 of IFRS 9 expressed the Board's concern at the time of allowing an option for the presentation of some gains and losses.

> 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.

15. Limiting the choice of presentation would require the Board to decide whether the default presentation approach of remeasurements is in OCI or in profit or loss. On the basis of the ED and the responses to the ED as discussed at the November meeting, the staff thinks that presenting remeasurements in OCI should be the default presentation approach, with presentation of remeasurements in profit or loss being the exception.

16. The staff notes that the decision whether to allow a free choice or limit the choice to specified circumstances will have implications for the following issues discussed in paragraphs 28 – 35:

    (a) whether to apply the choice entity wide, or plan-by-plan;

    (b) whether to apply the choice to all remeasurements arising from the unit of account in (a);

    (c) whether the choice is revocable or irrevocable.

What would be the circumstances where choice is allowed?

17. Concerns about presenting remeasurements in OCI (other than the concerns about recycling) included:

    (a) the potential presentation mismatch in an unfunded plan between the remeasurement of the defined benefit liability and the assets held by the entity to fund that liability. In these cases, the returns on the assets may be presented in profit or loss, but the remeasurement of the liability would be presented in OCI.

    (b) the presentation mismatch that results when hedging part of a defined benefit obligation, a plan asset or a deficit or surplus. The

remeasurement of the hedging instrument would be presented in profit or loss, but the remeasurement of the liability would be presented in OCI.

(c) for small plans, the cost of disaggregating changes in defined benefit assets or liabilities would exceed the benefits.

18. The staff does not think that the concern in paragraph 17(c) should be addressed by allowing entities the option to present in profit or loss remeasurements based on a cost/benefit assessment. The staff thinks that establishing appropriate cost/benefit criteria would be difficult and would not result in improved comparability because entities with similar economic liabilities would present remeasurements differently based on cost/benefit. The staff thinks that the general materiality rules should apply, and therefore, if information about remeasurements for small plans is not considered material, then disaggregation and presentation of those amounts would not be required in the financial statements.

19. The concerns described in paragraphs 17(a) and 17(b) above relate to a presentation mismatch between amounts in profit or loss and amounts in OCI.

20. Regarding hedging part of a defined benefit obligation, a plan asset or a deficit or surplus as described in paragraph 17(b), the existing hedge accounting requirements of IAS 39 *Financial Instruments: Recognition and Measurement* would not apply because IAS 39 defines a hedging relationship as one in which the exposure to be hedged could affect profit or loss. Consequently, if the hedged exposure affects OCI without subsequent reclassification out of OCI into profit or loss, the hedged exposure would never ultimately affect profit or loss and so the entity cannot apply hedge accounting. The Board considered changing this requirement as part of its 2010 exposure draft *Hedge Accounting* as noted in paragraph BC23 of the Basis for Conclusions on that exposure draft:

> BC23 The Board considered whether it should amend the definition of a fair value hedge to state that the hedged exposure could affect either profit or loss or other comprehensive income, rather than always profit or loss.

> However, the Board had practical concerns. These related to the matching of the changes in the fair value of the hedging instrument with the changes in the value of the hedged item attributable to the hedged risk. Furthermore, the Board was concerned about how to account for any related hedge ineffectiveness.

21. Examples where IFRSs permit or require different accounting where the default method of accounting will result in an accounting mismatch include the fair value option in IFRS 9 *Financial Instruments* paragraphs 4.1.5, 4.2.2 and 5.7.7. The Board acknowledged this approach in IFRS 9 will introduce some additional complexity to financial reporting.

22. Paragraphs 4.1.5 and 4.2.2 apply to the classification of financial assets and financial liabilities and provide a fair value option that gives an entity the choice to classify a financial asset or financial liability as measured at fair value through profit or loss if doing so eliminates or reduces a measurement or recognition mismatch:

> 4.1.5 Despite paragraphs 4.1.1–4.1.4, an entity may, at initial recognition, irrevocably designate a financial asset as measured at fair value through profit or loss if doing so eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as an 'accounting mismatch') that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases (see paragraphs B4.1.29–B4.1.32).
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> 4.2.2 An entity may, at initial recognition, irrevocably designate a financial liability as measured at fair value through profit or loss when permitted by paragraph 4.3.5, or when doing so results in more relevant information, because either:
>
> (a) it eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as 'an accounting mismatch') that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases;
>
> …

23. Paragraph 5.7.7 applies to the presentation of gains and losses on financial liabilities for which an entity uses the fair value option. It requires the entity to present all changes in that liability in profit or loss if presenting the effects of changes in the liability's credit risk in OCI would create or enlarge an accounting mismatch in profit or loss:

> 5.7.7 An entity shall present a gain or loss on a financial liability designated as at fair value through profit or loss as follows:
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> (a) The amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability shall be presented in other comprehensive income (see paragraphs B5.7.13– B5.7.20), and
>
> (b) the remaining amount of change in the fair value of the liability shall be presented in profit or loss
>
> unless the treatment of the effects of changes in the liability's credit risk described in (a) would create or enlarge an accounting mismatch in profit or loss (in which case paragraph 5.7.8 applies). Paragraphs B5.7.5–B5.7.7 and B5.7.10–B5.7.12 provide guidance on determining whether an accounting mismatch would be created or enlarged.
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> 5.7.8 If the requirements in paragraph 5.7.7 would create or enlarge an accounting mismatch in profit or loss, an entity shall present all gains or losses on that liability (including the effects of changes in the credit risk of that liability) in profit or loss.

24. These requirements in IFRS 9 point to different criteria for determining whether an accounting mismatch exists. In the case of the requirements for classifying financial assets and financial liability, paragraph B4.1.29 states:

> B4.1.29 Measurement of a financial asset or financial liability and classification of recognised changes in its value are determined by the item's classification and whether the item is part of a designated hedging relationship. Those requirements can create a measurement or recognition inconsistency (sometimes referred to as an 'accounting mismatch') when, for example, in the absence of designation as at fair value through profit or loss, a financial asset would be classified as subsequently measured at fair value and a liability the entity considers

> related would be subsequently measured at amortised cost (with changes in fair value not recognised). In such circumstances, an entity may conclude that its financial statements would provide more relevant information if both the asset and the liability were measured as at fair value through profit or loss.

25. In the case of the requirements for presenting the gains and losses on financial liabilities for which an entity uses the fair value option, paragraphs B5.7.5 and B5.7.6 state [emphasis added]:

> B5.7.5 When an entity designates a financial liability as at fair value through profit or loss, it must determine whether presenting in other comprehensive income the effects of changes in the liability's credit risk would create or enlarge an accounting mismatch in profit or loss. An accounting mismatch would be created or enlarged if presenting the effects of changes in the liability's credit risk in other comprehensive income would result in a greater mismatch in profit or loss than if those amounts were presented in profit or loss.
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> B5.7.6 To make that determination, an entity must assess whether it expects that the effects of changes in the liability's credit risk will be offset in profit or loss by a change in the fair value of another financial instrument measured at fair value through profit or loss. <u>Such an expectation must be based on an economic relationship between the characteristics of the liability and the characteristics of the other financial instrument</u>.

26. Similar criteria could be specified to restrict the option of presenting remeasurements of defined benefit plans in profit or loss so that the option would be available only when using it eliminates or reduces an accounting mismatch in profit or loss. B4.1.29 allows the differing accounting treatment if it would provide more relevant information to users, whereas B5.7.6 is arguably more restrictive because it requires an economic relationship between the characteristics of the liability and the characteristics of the other instrument. Typically there is no economic relationship between the characteristics of the defined benefit obligation and the characteristics of the assets held by the entity to fund that obligation (unless the entity holds insurance assets that closely match the benefits in the defined benefit obligation). However both these assets

and the defined benefit obligation would be affected by changes in market discount rates, inflation and other assumptions in similar ways, which is how the presentation mismatch would arise. For example an increase in the discount rate would generally reduce both the fair value of the assets and the present value of the defined benefit obligation (albeit to a different extent depending on other characteristics of the assets and the obligation).

27. If the Board wishes to limit the choice of presenting remeasurements in profit or loss to particular circumstances, the staff recommend that these circumstances are when presenting remeasurements in profit or loss eliminates or reduces an accounting mismatch in profit or loss.

Applying choice to all plans and all remeasurements

28. Current IAS 19 paragraph 93A requires that if an entity adopts a policy of recognising actuarial gains and losses when they occur, it may present them in OCI provided it does so for:

    (a) all of its defined benefit plans; and

    (b) all of its actuarial gains and losses.

29. If the Board decides to limit the choice of presentation of remeasurements to limited circumstances, the staff recommends that paragraph 93A should be retained and applied to each plan. In other words, if an entity exercises the option, it would need to present in profit or loss all remeasurements arising on all plans that meet the criteria. An entity would not permitted to exercise the option for some, but not all, plans qualifying for the option.

30. If the Board decides not to limit the choice of presentation of remeasurements to limited circumstances, but to keep the existing free choice in IAS 19, the staff also recommends that the existing restrictions in paragraph 93A are retained.

Whether the choice is irrevocable or not

31. The option in current IAS 19 to present actuarial gains and losses in OCI is an accounting policy choice. An entity could change that accounting policy if criteria specified in IAS 8 are met. However, for IFRS 9 the Board made such choices irrevocable. In IFRS 9 the fair value option and the option to present in OCI changes in the fair value of an equity investment are irrevocable choices made at initial recognition.

32. The fair value option has consequences for measurement as well as presentation.

33. For the OCI presentation option for equity investments, the Board made the option irrevocable:

    (a) to provide discipline to its application (paragraph BC 86(d) of the Basis for Conclusions on IFRS 9); and

    (b) to address concerns about the resulting additional complexity (paragraph BC 89 of the Basis for Conclusions on IFRS 9).

34. The IFRS 9 OCI presentation option has consequences for presentation only, and therefore its consequences are similar to those of the option to present the remeasurements component of defined benefit costs.

35. In considering whether to make the option irrevocable, it is also worth considering the Board's decisions on the matters discussed in the preceding section regarding whether to apply the option to the entity as a whole or plan by plan:

    (a) If the option is to be applied entity wide, then the staff recommends retaining the existing IAS 19 treatment (that the option would be an accounting policy choice, and revocable when IAS 8 so permits). The staff think this conclusion is particularly compelling if the Board does not limit the choice to particular circumstances, because the requirements regarding the option would remain as in current IAS 19.

(b) If the option is to be applied plan by plan, then the staff recommends that the option should be irrevocable for the reasons set out in paragraph 33. The staff think this conclusion is particularly compelling if the Board limits the choice to particular circumstances: making the choice irrevocable would address concerns about additional complexity.

Presentation and disclosure if entity elects to present in profit or loss

36. If the Board decides not to limit the choice of presentation of remeasurements to limited circumstances, but to keep the existing free choice in IAS 19, the Board could consider further clarification of the presentation and disclosure requirements in order to meet the objectives of the ED to improve comparability and understandibility.

Presentation

37. Paragraph 13(c) of Agenda Paper 11C of November described the P&L Option approach as permitting a choice between presenting the remeasurement component in OCI and presenting it **separately** in profit or loss. However it is not clear whether the Board intended its tentative decision in November to **require** separate presentation if the entity elected to present remeasurements in profit or loss.

38. The staff do not think that this project is the appropriate place to define additional line items in IAS 1 *Presentation of Financial Statements*. In addition, current IAS 19 does not require separate presentation of actuarial gains and losses if they are presented in profit or loss. However, presenting remeasurements separately in profit or loss would help users identify an amount that other entities may elect to present in OCI.

Disclosure

39. If the Board decides in Question 1 not to limit the choice of presentation of remeasurements to specified circumstances, the Board could require additional disclosure of why the entity has elected to present remeasurements either in profit or loss, or in OCI. Such a disclosure could require an entity to disclose why it decided to deviate from any default presentation approach (such as the one described in paragraph 15) and how the selected presentation provides more relevant information than the default presentation.

Summary of staff recommendation and questions for the Board
The staff recommends that: (a) if the Board wants to limit an entity's choice of presenting remeasurements in profit or loss, then the choice: (i) should be limited to cases when doing so eliminates or reduces an accounting mismatch in profit or loss. (ii) should apply to all of the remeasurements in all plans that meet the criteria in (i); and (iii) should, if applied to all plans, be an accounting policy choice that an entity could revoke if IAS 8 so permits. However, if the choice is available plan by plan, it should be irrevocable; (b) if the Board does not want to limit an entity's choice of presenting remeasurements in profit or loss, then: (i) the choice should apply to all of the entity's plans; (ii) the choice should apply to all of the remeasurements; (iii) the choice should, if applied to all plans, be an accounting policy choice that the entity could revoke if IAS 8 so permits. However, if the choice is available plan by plan, it should be irrevocable; (iv) separate presentation of remeasurements in profit or loss should not be required. (Separate presentation would not be prohibited and separate disclosure would be required);

(v) the entity should disclose why it elected to present remeasurements in profit or loss.

Question 1. Does the Board wish to limit the choice of presenting remeasurements in profit or loss to particular circumstances?

Question 2. Does the Board agree with the staff recommendations? If not, what does the Board propose and why?