

Snapshot: Defined Benefit Plans: proposed amendments to IAS 19

Some companies provide benefits to their employees through defined benefit plans, eg pensions or post-employment medical care.

This snapshot provides a brief overview of proposed changes to the accounting for defined benefit plans, as published for public comment by the International Accounting Standards Board (IASB).

Project objectives: The IASB aims to make fundamental improvements to the recognition, presentation and disclosure of defined benefit plans by mid-2011.

These improvements will make it easier for users of financial statements to understand how defined benefit plans affect a company's financial position, financial performance and cash flows.

Project stage: In April 2010 the IASB published an exposure draft (ED) containing proposals on recognition, presentation and disclosure of defined benefit plans.

Comment deadline: The ED is open for public comment until 6 September 2010.

Next steps: The IASB will undertake further outreach during the comment period to ensure that the views of all interested parties are taken into consideration.



Why is the IASB undertaking this project?

Defined benefit plans give rise to large and highly uncertain costs for many companies and estimating those costs can be extremely complex.

Investors, analysts and others need relevant information about those items that is easy to understand and permits comparison between companies.

However, the accounting for those items under the current standard, IAS 19 *Employee Benefits*, is complex and needs a comprehensive review. This project aims to address the following deficiencies in IAS 19:

- companies do not have to account for changes in their defined benefit plans immediately. This 'deferred recognition' of gains and losses makes it difficult to understand the amounts relating to defined benefit plans in financial statements.
- companies may choose different options for recognising gains and losses. This makes it difficult to compare the effects of defined benefit plans on different companies.
- disclosures are voluminous but do not highlight risks arising from these defined benefit plans.

Defined benefit plans define the benefits that employees will receive, such as pensions or post-employment medical care.

Project scope and context

The exposure draft proposes improvements to the recognition, presentation and disclosure of defined benefit plans.

The proposals have been developed following a rigorous and comprehensive due process. A discussion paper *Preliminary Views on Amendments to IAS 19* was published for public comment in 2008. The IASB then met on 13 occasions to consider the responses and further refine the proposals, seeking input from a broad range of interested parties, including the IASB's Employee Benefits Working Group.

The ED does not address measurement of defined benefit plans or the accounting for contribution-based benefit promises. The IASB will consider after 2011 whether to address these topics.

What is the IASB proposing?

The ED proposes improvements in the following areas:

1. Immediate recognition of defined benefit cost
2. Presentation
3. Disclosure

1. Immediate recognition of defined employee benefit cost

The issue

As users of financial statements and others have pointed out, if companies do not recognise gains and losses in the period when they arise, the amount reported in the statement of financial position (balance sheet) may be confusing or misleading.

In particular:

- a company might recognise an asset in the statement of financial position, even when a plan is in deficit.

- some gains or losses might be recognised in the statement of comprehensive income even though they arise from economic events that occurred in previous periods.
- two companies might have identical defined benefit obligations but report different amounts because gains and losses have arisen in different sequences.

The IASB proposal

The IASB proposes to remove from IAS 19 options that allow a company not to recognise some gains and losses that arise when the company changes its estimate of a defined benefit obligation, or when there are changes in the fair value of its plan assets. Instead, the ED proposes that companies should recognise these items immediately.

The response to the IASB's 2008 discussion paper indicated general support for immediate recognition.

Example

A plan has assets of 100 million currency units (CU) and a defined benefit obligation of CU120 million. The expected average remaining working life of the employees participating in the scheme is 10 years.

Suppose that, in the current year, a loss of CU20 million arises in the plan as a result of both changes in the estimated cost of providing benefits already earned by employees and changes in the value of plan assets. IAS 19 currently permits the employing company to recognise only a portion of that loss in the current year. This is calculated as follows:

	CU million
Loss in current year	20
Losses of prior periods (assumed to be nil)	0
less the corridor*	(12)
Excess	8
Minimum amount that the company must recognise	0.8

*the corridor is the greater of 10% of CU120 million and 10% of CU100 million

The company would be required to recognise at least CU0.8 million loss in the period. Depending on its accounting policy, the company could recognise the remaining CU19.2 million either in the period or smoothed out over the next nine years.

What is the IASB proposing? continued

2. Presentation

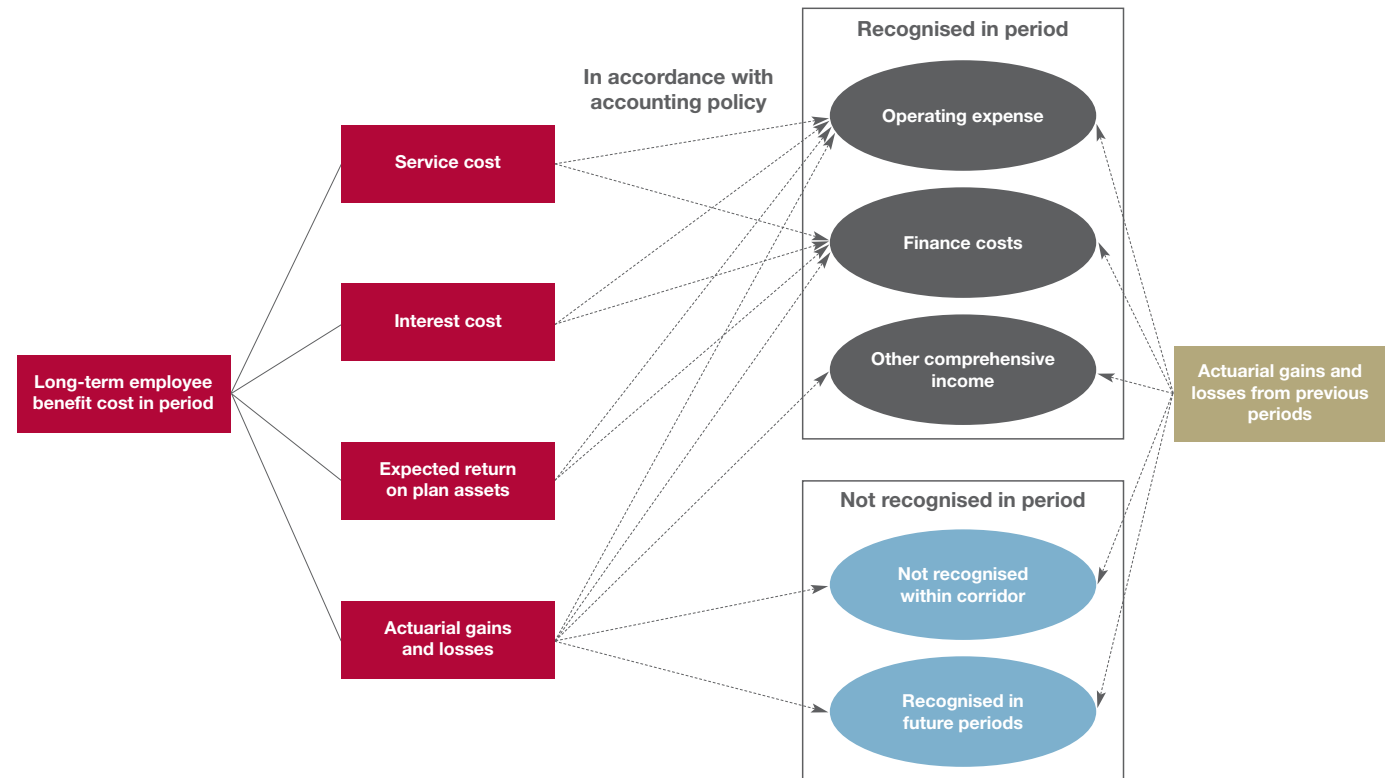
The issue

As well as permitting options for recognition, IAS 19 permits companies to present the components of the recognised amounts in many different ways. This makes it difficult to compare companies with similar obligations.

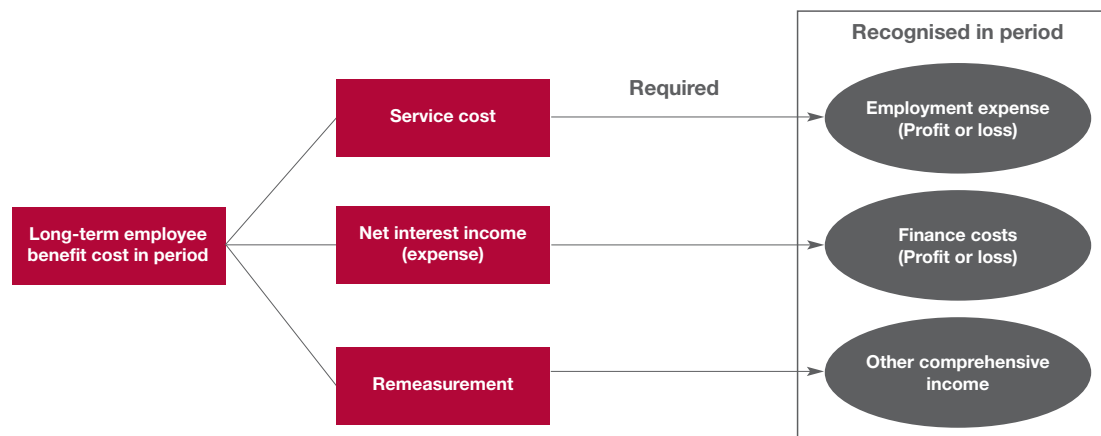
This creates the following problems:

- costs can be recognised in different categories. For example, interest cost can appear in different positions making operating profit difficult to compare.
- actuarial gains and losses are sometimes recognised in the period when they occur and sometimes not.
- gains and losses from previous periods can be recognised in the current period, preventing a clear picture of the gains and losses that arose in the current period.

Presentation – current requirements in IAS 19



Presentation – proposed requirements



The IASB proposal

The ED proposes a new presentation approach that will improve the visibility of the different types of gains and losses arising from defined benefit plans.

Specifically, the ED proposes that companies should present:

- service cost – in profit or loss.
- finance cost – as part of finance costs in profit or loss.
- remeasurement – in other comprehensive income.

The proposal complements more general improvements that the IASB will propose in its forthcoming exposure draft on the presentation of items of other comprehensive income, expected in May 2010.

What is the IASB proposing? continued

3. Disclosure

The issue

The disclosure requirements in IAS 19 have drawn a number of criticisms. In particular, that:

- the volume of disclosures about defined benefit plans in many financial statements risks reducing understandability and usefulness by obscuring important information.
- the disclosures in IAS 19 do not provide users of financial statements with an adequate basis to enable them to understand how defined benefit plans affect the financial statements as a whole.
- IAS 19 does not highlight information about the risks arising from participation in defined benefit plans.

The IASB proposal

The ED proposes improved disclosure requirements about matters such as:

- the characteristics of the company's defined benefit plans.
 - the amounts recognised in the financial statements.
 - risks arising from defined benefit plans.
 - participation in multi-employer plans.
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What would be the benefits of the proposals?

The IASB believes that the proposals in the ED would significantly improve the reporting for defined benefit plans.

If, after considering the responses to this consultation, the IASB confirms the proposals in the ED, financial reporting will be improved because:

- changes in the carrying amounts of defined benefit obligations and changes in the fair value of plan assets will be reported in a more understandable way.
 - some presentation options currently allowed by IAS 19 will be eliminated, thus improving comparability.
 - requirements that have resulted in diverse practices will be clarified.
 - companies will provide improved information about the risks arising from a company's involvement in defined benefit plans.
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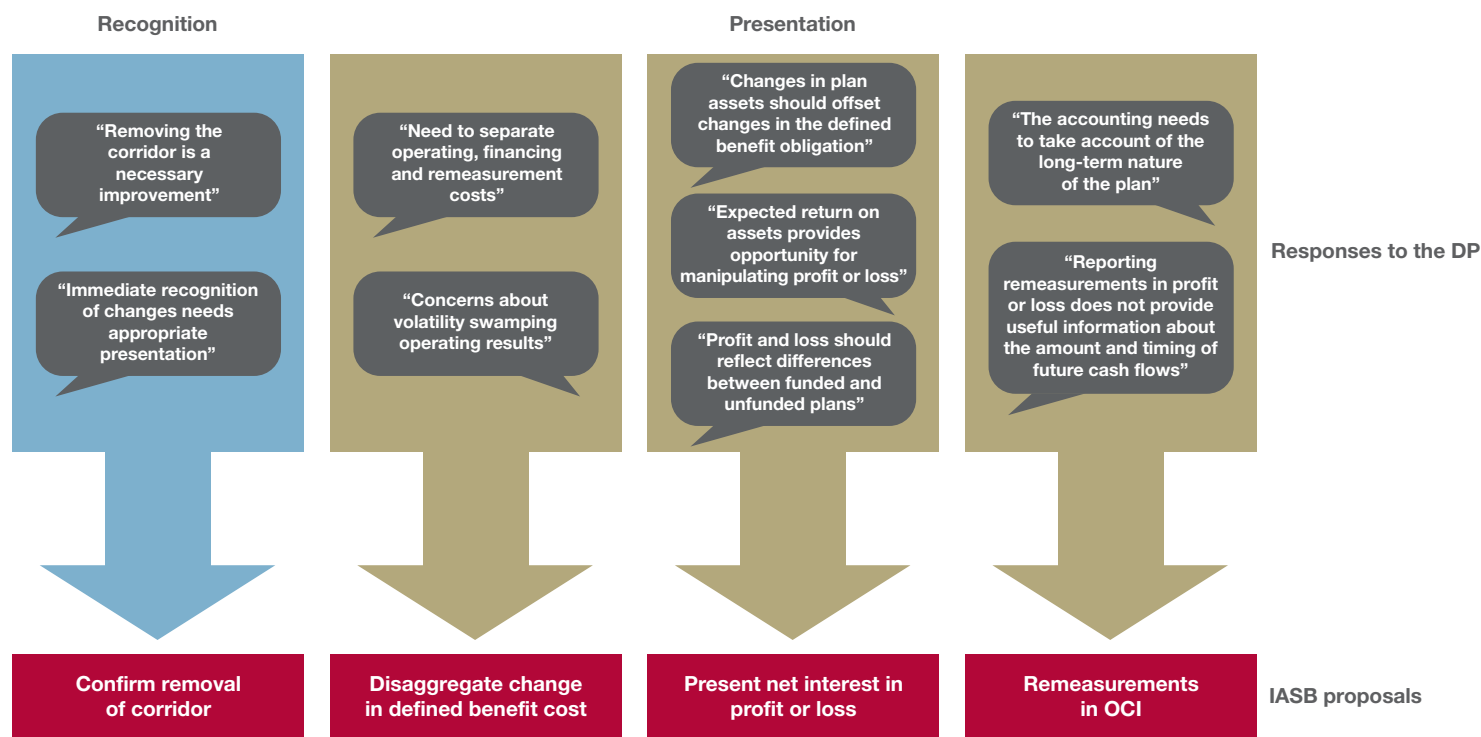
Response to previous consultation

The IASB developed the proposals in the ED considering the input received on the IASB’s 2008 discussion paper *Preliminary Views on Amendments to IAS 19*.

That discussion paper contained proposals on recognition and presentation for all defined benefit plans, as well on the accounting for contribution-based promises.

The ED develops the proposals on recognition and presentation, but does not address contribution-based promises.

The diagram indicates some of the main themes on recognition and presentation in the responses to the DP, which the IASB now proposes to address by splitting changes in defined benefit cost and the fair value of plan assets into service cost, finance cost and remeasurement components.



The IASB's long term plan

Interested parties have urged the IASB to review comprehensively the accounting for employee benefit promises.

The IASB agrees that there is a need for a comprehensive review of the accounting for employee benefits but will not begin any further work on the defined benefit accounting before mid-2011.

The IASB would consider conducting such a review together with the US Financial Accounting Standards Board.

In the meantime, the IASB thinks that the targeted improvements proposed in the ED would yield significant improvements to the transparency and comparability of pension obligations.

Furthermore, the IASB expects to retain this project's fundamental conclusion that a company must account for its obligation to provide benefits as a result of services already rendered by employees.

Therefore, the IASB believes its proposals on recognition and presentation are independent of any future work on measurement that it may decide to undertake.

What happens now?

During the consultation period the Board and the project team will undertake outreach activities to discuss the proposals with a wide range of interested parties.

These outreach activities will include:

- discussions with representative groups and the national standard-setters.
- discussions with other interested parties.
- webcasts and presentations.

The IASB will discuss responses to the proposals in public meetings and will announce the date of those meetings on the IASB website.

To stay up to date about the project progress, you can subscribe to email alerts about the project.

To do so, visit the “subscribe to email alerts” section on our website:
<http://www.iasb.org/IASB+Registration.htm>

The ED includes questions on the proposals including questions on:

- recognition.
- presentation.
- disclosures.

Respondents are invited to comment on any or all of those questions and to comment on any other issue that the IASB should consider in finalising the proposals.

The deadline for comments on the ED is 6 September 2010.

To view the ED and submit your comments, visit www.iasb.org

The IASB plans to finalise amendments to IAS 19 in mid-2011.

Notes

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