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IASB Amends Accounting for Postemployment Benefits

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Introduction

On June 16, 2011, the IASB issued amendments to IAS 19[1] that change the accounting for defined benefit plans and termination benefits.

The objective of this limited scope project was to improve the financial reporting of employee benefits by:

- Requiring changes in defined benefit obligations and in the fair value of plan assets to be reported in a more understandable way.
- Eliminating some presentation options allowed under the previous version of IAS 19, thus improving comparability.
- Clarifying requirements that have resulted in diverse practices.
- Enhancing disclosure about the risks arising from defined benefit plans.

The Amendments

Elimination of the Corridor Approach

The most significant amendment requires an entity to recognize changes in defined benefit obligations and plan assets when they occur, thus eliminating the "corridor approach" permitted under the previous version of IAS 19.

All actuarial gains and losses must be recognized immediately through other comprehensive income (OCI) (the option to recognize actuarial gains and losses in profit or loss has also been removed) for the net pension asset or liability recognized in the statement of financial position to reflect the full value of the plan deficit or surplus.

Editor's Note: Upon making the transition to the amended standard, an entity currently using the corridor method may have to recognize a larger liability (or a smaller asset) in the statement of financial position, which could affect its compliance with debt covenants and impair its ability to pay dividends.

On an ongoing basis, there will be greater volatility in the statement of financial position and in OCI as a result of immediate recognition of actuarial gains and losses, but profit or loss will no longer be affect by amortizing actuarial gains and losses.

[1] IAS 19 (Revised 2011), *Employee Benefits*.

Change in Presentation Approach

The amendments introduce a new approach for presenting changes in defined benefit obligations and plan assets in the statement of profit or loss and OCI. Entities will need to segregate changes in the defined benefit obligation and in the fair value of plan assets into those associated with (1) service costs, (2) net interest on the net defined benefit liability (asset), and (3) remeasurements, as follows:

- *Service cost component* — Service costs are recognized in profit or loss and include current service cost, vested and unvested past service cost (together with gains and losses from curtailments), and gains or losses on settlements. The distinction between past service cost and curtailments in the previous version of IAS 19 is no longer necessary because both of these items are now recognized immediately.

- *Net interest component* — Net interest is recognized in profit or loss and calculated by applying the "discount rate by reference to market yields at the end of the reporting period on high quality corporate bonds" (or government bonds when no deep market for bonds exists) to the net defined benefit liability or asset at the beginning of each reporting period. The difference between the actual return on plan assets and the change in plan assets resulting from the passage of time will be recognized in OCI as part of the remeasurement component.

  Editor's Note: In many cases, using the rate representing the market yields on high-quality corporate bonds to calculate the net interest will reduce net profit or loss because the net interest will not reflect the benefit from the expectation of higher returns on riskier investments.

The amendments outline objectives for improving the understandability and usefulness of disclosures.

- *Remeasurement component* — Changes associated with remeasurement are recognized in OCI and comprise actuarial gains and losses on the defined benefit obligation, the actual return on plan assets net of the interest on plan assets included in the net interest component, and any changes in the effect of the asset ceiling. Actuarial gains and losses include experience adjustments and the effects of changes in actuarial assumptions. Remeasurements are never reclassified to profit or loss but may be transferred within equity (e.g., to retained earnings).

Disclosures

The amendments outline objectives for improving the understandability and usefulness of disclosures so that users of financial statements are better able to evaluate the financial effect of liabilities and assets arising from defined benefit plans. In accordance with the objectives, disclosures should:

- Explain the characteristics and related risks of defined benefit plans.
- Identify and explain the amounts in the financial statements.
- Describe how defined benefit plans may affect the future cash flows.

In addition, entities would be required to provide the following additional disclosures:

- A narrative description of the risks the entity determines to be significant or unusual (e.g., plan assets are invested primarily in a single class of investments when a concentration risk arises).
- Actuarial gains and losses arising from changes in demographic assumptions.
- Actuarial gains and losses arising from changes in financial assumptions.
- The fair value of plan assets (1) divided into classes that distinguish the nature and risks of those assets and (2) subdivided into assets that do and do not have a quoted market price.
- Significant actuarial assumptions used to determine defined benefit obligations.

- How a reasonably possible change to the significant actuarial assumptions would affect the defined benefit obligation (sensitivity analysis).
- A narrative description of asset-liability matching strategies, such as annuities or longevity swaps.
- The expected contribution for the next annual reporting period and the weighted average duration of the defined benefit obligations.

The amendments also add disclosure requirements to multiemployer defined benefit plans by requiring qualitative information about any agreed deficit or surplus allocation on windup of the plan or on the entity's withdrawal from the plan. If an entity accounts for a multiemployer defined benefit plan as if it were a defined contribution plan, disclosures of the level of participation in the plan and the expected contribution for the next reporting period are required.

Editor's Note: Entities will often be required to use judgment to determine the significant actuarial assumptions to be disclosed, which actuarial assumptions have a material effect if they are changed, and the range of reasonably possible change for the sensitivity analysis.

While the amendments made no fundamental change to the definition of a termination benefit, they added guidance to help entities distinguish between benefits payable in exchange for termination of employment and benefits payable in exchange for service.

Other Amendments

Classification of Employee Benefits

The amendments define short-term employee benefits as employee benefits that are "expected to be settled wholly before twelve months after the end of the annual reporting period." In addition, the amendments define other long-term benefits as all employee benefits other than short-term employee benefits, postemployment benefits, and termination benefits.

Editor's Note: In the definition of a short-term benefit plan, the amendments changed "due to be settled" to "expected to be settled wholly." This change may result in more plans being classified as long-term employee benefit plans that require the use of actuarial assumptions in their measurement.

Termination Benefits

While the amendments made no fundamental change to the definition of a termination benefit, they added guidance to help entities distinguish between benefits payable in exchange for termination of employment and benefits payable in exchange for service. For example, if an entity makes an offer to an employee of benefits that are available for more than a short period, or there is more than a short period between the offer and the expected date of actual termination, the offer is less likely to be deemed a termination benefit.

To align the timing of recognizing amounts resulting from plan amendments, curtailments, termination benefits, and restructuring, the amendments require that:

- If a plan amendment is linked to a restructuring or termination benefit, the gain or loss should be recognized as of the earlier of either of the following:
  - When the plan amendment or curtailment occurs.
  - When the related restructuring costs or termination benefits are recognized.
- If a termination benefit is linked to a restructuring, the termination benefit should be recognized as of the earlier of either of the following:
  - When the entity can no longer withdraw an offer of the benefits.
  - When the related restructuring costs are recognized under IAS 37.[2]

All of these amounts are recognized at the same time if they are related to each other.

[2] IAS 37, *Provisions, Contingent Liabilities and Contingent Assets.*

Other Changes

The amendments also clarify a number of practical issues. For example, the amendments make clear that a settlement is a "transaction that eliminates all further legal or constructive obligations for part or all of the benefits provided under a defined benefit plan, other than a payment of benefits to, or on behalf of, employees that is set out in the terms of the plan and included in the actuarial assumptions." Therefore, settlements that are recognized in profit or loss are limited to payments that are not in accordance with the terms of the plan. The amendments also clarify that only tax paid by the plan and costs related to the management of the assets are deducted from the return on plan assets.

Effective Date and Transition

The amendments are effective for annual periods beginning on or after January 1, 2013. Earlier application is permitted.

Retrospective application is required in accordance with IAS 8,[3] with two exceptions:

- When benefit costs are included in the carrying amount of assets outside the scope of IAS 19 (e.g., inventories), these assets do not need to be adjusted on adoption.
- In financial statements for periods beginning before January 1, 2014, comparative information does not need to be presented for the disclosures related to the sensitivity of the defined benefit obligation.

Editor's Note: Because the projects under the FASB's and IASB's Memorandum of Understanding are nearing completion,[4] and given the recent SEC staff paper on incorporating IFRSs into the U.S. reporting system,[5] the FASB may consider adding stand-alone projects that would further align U.S. GAAP with IFRSs. In addition, because the amendments to IAS 19 may have created further differences between the accounting requirements under ASC 715[6] and IAS 19, defined benefit and contribution plan accounting may become an area of focus for the FASB.

The amendments are effective for annual periods beginning on or after January 1, 2013.

[3] IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors.*

[4] See Deloitte's May 2011 *Accounting Roundup — Special Edition* for information on the progress the FASB and IASB have made on convergence projects.

[5] See Deloitte's June 1, 2011, *Heads Up* for information on the SEC's recently issued staff paper. The staff paper explores a possible framework for incorporating IFRSs into the U.S. financial reporting system.

[6] FASB Accounting Standards Codification Topic 715, *Compensation — Retirement Benefits.*

Appendix A — Key Differences Between U.S. GAAP and IFRSs Under the Amendments

The table below compares the accounting for defined benefit plans and termination benefits under U.S. GAAP (ASC 715) and IAS 19 as amended.

Subject	U.S. GAAP (ASC 715)	IFRSs (IAS 19 Revised)
Recognition of prior service cost	Prior service costs are amortized over the remaining service period (or life expectancy if all or almost all of the participants are inactive).	Immediately recognized in profit or loss as part of service cost component.
Remeasurement component	Not applicable.	Remeasurement component includes (1) actuarial gains and losses on defined benefit obligation, (2) difference between the actual return on plan assets and interest on plan assets included in the net interest component, and (3) any changes in the effect of the asset ceiling.
Recognition of actuarial gains and losses	An entity may adopt either (1) the deferral method (i.e., corridor approach) and recycle amounts in excess of the corridor through net periodic benefit cost over an amortization period or (2) a systematic method that results in faster recognition.	Immediately recognized through OCI as part of the remeasurement component.
Calculation of the "corridor"	If an entity applies the deferral method and therefore recognizes actuarial gains and losses outside of the corridor, the lower and upper limits of the corridor are calculated as 10 percent of the greater of the projected benefit obligation or the market-related value of plan assets, which is either the fair value or a calculated value that incorporates asset-related gains and losses over a period of no more than five years.	The corridor approach has been eliminated. All changes in defined benefit obligations and plan assets are immediately recognized when they occur.
Expected return on plan assets	Measurement is based on the market-related value of the plan assets, which is either fair value or a calculated value that incorporates asset-related gains and losses over a period of no more than five years.	Not applicable (implicitly determined by net interest component calculation).
Recognition of gains/losses on a curtailment	A curtailment loss is recognized when it is probable that a curtailment will occur and the effects are reasonably estimable. A curtailment gain is recognized when the relevant employees are terminated or the plan suspension or amendment is adopted, which could occur after the entity is demonstrably committed and a curtailment is announced. The significance test is based on the number of years of service eliminated, not the number of employees.	Gains/losses are recognized as of the earlier the date of curtailment occurs or related restructuring costs or termination benefits are recognized. Amounts are included in past service cost as part of the service cost component.
Disclosure objectives	Not specifically defined.	Disclosures should: • Explain the characteristics and related risks of defined benefit plans. • Identify and explain the amounts in the financial statements. • Describe how defined benefit plans may affect the future cash flows.

Appendix B — Illustration of Effect of Amendments on Financial Statements

An entity with a defined benefit plan has a financial period that ends on December 31. The table below provides information about the plan. Assume there are no actuarial gains or losses in prior periods and no contributions to the plan or benefits paid in 20X2. The average remaining life of the employees participating in the plan is assumed to be 10 years.

	January 1, 20X2	December 31, 20X2
Present value of defined benefit obligation	$ 70	$105
Fair value of plan assets	$ 40	$ 45
Net defined benefit liability	$ 30	$ 60

Service cost	$ 15
Discount rate (high-quality corporate bond yield)	2%
Expected rate of return on plan assets	4%

The tables below compare how the entity's financial statements are affected by:

- Applying each of the three accounting policies for recognition of actuarial gains and losses (immediately in profit or loss, immediately in OCI, or deferred under the corridor method) under the previous version of IAS 19.
- Applying the revised standard.

Statement of Financial Position as of December 31, 20X2

	Before the Amendments			
	P&L	OCI	Corridor	After the Amendments
Net defined benefit liability	$ 60	$ 60	$ 44.8	$ 60

Under the corridor approach, the actuarial loss of $15.2 arising in the period is not recognized in the statement of financial position but would begin to be recognized systematically in 20X3.

Statement of Profit or Loss and Comprehensive Income in 20X2

	Before the Amendments			
	P&L	OCI	Corridor	After the Amendments
Service cost	$ 15.0	$ 15.0	$ 15.0	$ 15.0
Interest cost	1.4	1.4	1.4	–
Expected return on plan assets	(1.6)	(1.6)	(1.6)	–
Net interest	–	–	–	0.6
Actuarial gains and losses	15.2	–	–	–
Profit or loss	30.0	14.8	14.8	15.6
OCI	–	15.2	–	14.4
Total comprehensive income	$ 30.0	$ 30.0	$ 14.8	$ 30.0

Before the amendments to IAS 19, under all three options $15 of service cost, $1.4 (2% of the $70 obligation as of January 1, 20X2) of interest cost, and $1.6 (4% of the $40 plan assets as of January 1, 20X2) of expected return on plan assets are recognized in profit or loss.

After the amendments, the expected return on plan assets is no longer recognized. Instead, net interest, calculated to be $0.6 (2% of the $30 net defined benefit liability as of January 1, 20X2), is recognized in profit or loss along with the service cost. Remeasurements calculated to be $14.4 ($18.6 of actuarial losses on the defined benefit obligations less $4.2 of net return on plan assets) are recognized in OCI.

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