EFRAG

European Financial Reporting Advisory Group

EFRAG'S EVALUATION OF THE COSTS AND BENEFITS OF IAS 19 (2011)

Introduction

1 Following discussions between the various parties involved in the EU endorsement process, the European Commission decided in 2007 that more extensive information than hitherto needs to be gathered on the costs and benefits of all new or revised Standards and Interpretations as part of the endorsement process. It has further been agreed that EFRAG will gather that information in the case of the Amendments to IAS 19 *Employee Benefits* (as amended in 2011).

2 EFRAG first considered how extensive the work would need to be. For some Standards or Interpretations, it might be necessary to carry out some fairly extensive work in order to understand fully the cost and benefit implications of the Standard or Interpretation being assessed. However, in the case of the Amendments, EFRAG's view is that the cost and benefit implications can be assessed by carrying out a more modest amount of work. The results of the consultations that EFRAG has carried out seem to confirm this. Therefore, as explained more fully in the main sections of this report, the approach that EFRAG has adopted has been to carry out detailed initial assessments of the likely costs and benefits of implementing the amendments in the EU, to consult on the results of those initial assessments, and to finalise those assessments in the light of the comments received.

EFRAG's endorsement advice

3 EFRAG also carries out a technical assessment of all new and revised Standards and Interpretations issued by the IASB against the so-called endorsement criteria and provides the results of those technical assessments to the European Commission in the form of recommendations as to whether or not the Standard or Interpretation assessed should be endorsed for use in the EU. As part of those technical assessments, EFRAG gives consideration to the costs and benefits that would arise from implementing the new or revised Standard or Interpretation in the EU. EFRAG has therefore taken the conclusion at the end of this report into account in finalising its endorsement advice.

A SUMMARY OF IAS 19 (2011)

Background

4 IAS 19 *Employee Benefits* sets out accounting requirements for various types of benefits provided by an employer to its employees, including post-employment and termination benefits. Employee benefits may have a significant impact on an entity's financial position and performance, and usually draw special attention of users of the financial statements. Accounting for employee benefits, particularly for post-employment defined benefit plans, is a complex issue involving numerous judgements and complicated calculations. The

Amendments made to IAS 19 in 2011 relate primarily to accounting for post-employment defined benefit plans and termination benefits.

The issue

5 Existing accounting options for recognition of actuarial gains and losses in relation to defined benefit plans and diverging interpretations of some definitions resulted in a lack of comparability between entities, which attracted significant concerns of the user community. To address these concerns, the IASB undertook a short-term project to improve the reporting requirements for post-employment defined benefit plans and termination benefits.

What has changed?

6 The Amendments made to IAS 19 in June 2011 are detailed below:

Immediate recognition of all changes in the net liability or asset – Elimination of the 'corridor approach' and elimination of options in the presentation of actuarial gains and losses

7 Entities will be required to recognise all changes in the present value of the defined benefit obligation and in the fair value of plan assets in the period, in which those changes occur. Before the Amendments, three options were permitted for the recognition of actuarial gains and losses:

(a) No recognition of actuarial gains and losses if they were within a 'corridor' and deferred recognition of those outside the corridor.

(b) Immediate recognition in profit or loss.

(c) Immediate Recognition in other comprehensive income.

The amendments require immediate recognition of actuarial gains and losses in other comprehensive income.

Disaggregation and presentation of defined benefit cost components

8 Entities will be required to disaggregate and recognise defined benefit cost as follows:

(a) Service cost relating to the cost of the services received – in profit or loss,

(b) Net interest on the net defined benefit liability (asset), representing the financing effect of paying for the benefits in advance or in arrears – in profit or loss, and

(c) Remeasurements, representing the period to period fluctuations in the amounts of defined benefit obligations and plan assets – in other comprehensive income.

Redefining the components of defined benefit cost

9 The service cost component will include current service cost, past service cost and any gain or loss on settlement. The changes in demographic assumptions will remain included in the remeasurements component together with other actuarial gains and losses and will be excluded from the service cost.

10 The net interest will be determined by multiplying the net defined benefit liability (asset) by the discount rate used to determine the defined benefit obligation. Before the Amendments, the expected return of plan assets was required to be used.

11 The remeasurements will comprise the actuarial gains and losses on the defined benefit obligation, the difference between the actual total return on assets and the interest income on plan assets calculated based on the discount rate used to determine the defined benefit obligation, as well as any changes in the effect of the asset ceiling excluding the amount included in net interest. This definition of remeasurements differs from the definition of actuarial gains and losses in IAS 19 before the Amendments because the introduction of the net interest approach has changed the disaggregation of the return on plan assets and the effect of the asset ceiling.

Treatment of plan amendments, curtailments and settlements

12 An entity will be required to recognise both vested and unvested past service costs in the period of the plan amendment that gives rise to the past service cost. Before the amendment, IAS 19 required immediate recognition of vested past service costs, while unvested past service costs would be recognised over the vesting period. Plan amendments and curtailments will be recognised when they occur. Previously, curtailments were recognised when an entity was demonstrably committed to make a reduction in the number of employees covered by the plan. IAS 19 (2011) treats plan amendments and curtailments in the same way.

13 IAS 19 (2011) states 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, IAS 19 (2011) clarifies that a settlement is a payment of benefits that is not set out in the terms of the plan. The payment of benefits that are set out in the terms of the plan, including terms that provide members with options on the nature of benefit payment such as an option to take a lump sum instead of an annuity, would be included in the actuarial assumptions. As a consequence, any difference between an estimated benefit payment and the actual benefit payment is an actuarial gain or loss.

Risk sharing

14 One of the objectives of the IAS 19 (2011) was to harmonise and clarify areas where there was diversity in current practice. One of these areas is the accounting for risk sharing features such as employee contributions, conditional indexation and variable benefits.

15 Under IAS 19 (2011):

(a) The effect of employee and third-party contributions should be considered in determining the defined benefit cost, the present value of the defined benefit obligation and the measurement of any reimbursement right.

(b) The benefit to be attributed to periods of service is net of the effect of any employee contributions in respect of service.

(c) Any conditional indexation should be reflected in the measurement of the defined benefit obligation.

(d) The present value of the defined benefit obligations should reflect any existing limits on the legal and constructive obligation to pay additional contributions.

Taxes and administration costs

16 IAS 19 (2011) clarifies that the estimate of the defined benefit obligation includes the present value of taxes payable by the plan if they relate to service before the reporting date or are imposed on benefits resulting from that service. Other taxes should reduce the return on plan assets.

17 The recognition of administration costs depends on their nature. Administration costs relating to the management of plan assets will be deducted from the total return on plan assets. Other administration costs will be recognised when the administration services are provided. Previously, IAS 19 did not specify which administration costs had to be included in the actuarial assumptions used to measure the obligation and which had to be deducted from the estimated return on assets in profit or loss.

Recognition and measurement of termination benefits

18 IAS 19 (2011) requires an entity to recognise termination benefits at the earlier of the following dates:

(a) When it can no longer withdraw an offer, i.e., when an employee accepts the offer or when the entity communicates a termination plan to the affected employees, or

(b) When the entity recognises costs for a restructuring that involves the payment of termination benefits.

Previously, an entity had to recognise termination benefits when it was demonstrably committed to providing those benefits (i.e. when the entity had a detailed formal plan and did have a realistic possibility of withdrawal).

19 Termination benefits will be measured as short-term or long-term benefits depending on their nature. Previously, termination benefits that were due more than twelve months after the reporting period had to be discounted. IAS 19 did not provide further measurement guidance.

Disclosures

20 The disclosure objectives have been reviewed to focus on the matters most relevant to users of the employer's financial statements. Some new disclosures will be required to meet these revised objectives, including additional information about the exposure to risk and information about asset-liability matching strategies. For a multi-employer plan, IAS 19 (2011) requires an entity to provide a description of any withdrawal or wind-up agreement and to indicate the level of its participation in a multi-employer plan.

Other long-term and short-term benefits

21 IAS 19 (2011) clarifies

(a) that the classification of employee benefits as short-term employee benefits should depend on when the whole amounts resulting from that type of benefit are expected to be settled; and

(b) that an entity should revisit the classification of a short-term employee benefit if the benefit no longer meets the definition of a short-term employee benefit.

Transitional provisions

22 An entity should apply IAS 19 (2011) retrospectively in accordance with IAS 8 with two exceptions:

(a) An entity needs not to adjust the carrying amount of assets outside the scope of IAS 19 (2011) for changes in employee benefits costs that were included in the carrying amount before the date of initial application.

(b) Comparative information for the disclosures required by paragraph 145 about the sensitivity of the defined benefit obligation is not needed in financial statements for periods beginning before 1 January 2014.

When does the IAS 19 (2011) become effective?

23 IAS 19 (2011) becomes effective for financial years beginning on or after 1 January 2013. Earlier application is permitted.

EFRAG'S FINAL ANALYSIS OF THE COSTS AND BENEFITS OF THE AMENDMENTS

Cost for preparers

1 EFRAG has carried out an assessment of the cost implications for preparers resulting from IAS 19 (2011).

2 EFRAG notes that most of the changes introduced to IAS 19 do not require capturing or tracking any *new* information. The current IAS 19 already requires entities to obtain most of the information needed to comply with the revised standard. Most of the changes require presenting the *existing* information in a different way or clarify the factors to consider in performing a calculation based on the *existing* information. However, the following changes to IAS 19 may require capturing or tracking of new information:

(a) Net interest: entities will be required to determine the appropriate interest rate and the changes in the net asset/liability during the year.

(b) Disclosures: entities may be required to collect more data for the increased number of disclosures.

(c) Accounting for schemes with risk-sharing: entities would be required to estimate the expected future employee contributions.

(d) Termination benefits linked to restructurings: more detailed information could be required for their recognition (triggering event, characteristics of the restructuring plan, etc).

3 It is expected that preparers will have to incur one-off costs to familiarise themselves with the new requirements, to train their employees and to reconstruct information in order to apply the Amendments retrospectively, however these costs are not expected to be significant.

4 The new presentation and disclosure requirements will lead to one-off costs of adjusting the information and accounting systems, but these incremental costs are not expected to be significant.

5 Except for the new disclosure requirements, no incremental costs are expected in relation to documentation of new business processes, controls or accounting policies. However, certain entities will incur costs in applying those Amendments that reduce diverse practices that existed under IAS 19 before. Those will depend on the extent to which its current practices differ from the requirements under IAS 19 (2011).

6 Except for the additional effort to prepare, review and audit the increased number of disclosures, no significant incremental ongoing costs are expected to arise, because most of the changes to IAS 19 are not associated with new information. Also, certain recognition, measurement and presentation requirements have been simplified.

7 Some of the changes to IAS 19, such as the elimination of the corridor approach, could result in a minor reduction in costs as the revised guidance requires less information to be kept. Based on the above, EFRAG's assessment is that IAS 19 (2011) would involve some ongoing incremental costs (those included in paragraph 7) compared to the existing requirements. Some one-off costs (those included from paragraphs 4 to 6) are expected on the implementation of IAS 19 (2011), however they are not expected to be significant.

Costs for users

8 EFRAG has carried out an assessment of the cost implications for users resulting from IAS 19 (2011).

9 As noted above, except for the enhanced disclosure requirements, most of the changes to IAS 19 do not result in any fundamentally new information. The objective of the project was to provide more transparency and to simplify the accounting for employee benefits, therefore users' costs associated with the analysis of information are expected to be reduced. For example, these are the cases with the elimination of the deferred recognition of gains and losses and of the changes in the net asset/liability; and with the elimination of the options.

10 The increased number of disclosures, which could add to complexity, may require additional time and effort to analyse. Apart from this fact, IAS 19 (2011) is not expected to result in any incremental costs for users in order to incorporate the new requirements in their analysis.

11 Based on the above, EFRAG's assessment is that IAS 19 (2011) is likely to result in cost savings for users.

Benefits for preparers and users

12 EFRAG has carried out an assessment of the benefits for users and preparers resulting from IAS 19 (2011).

13 As indicated above, IAS 19 (2011) eliminates options in the recognition, measurement and presentation of employee benefits, and requires entities to recognise all changes in the pension costs and/or in the asset/liability as they occur. Previously, under the deferred recognition approach the statement of financial position may not always have reflected the surplus or deficit in the pension plan. In addition, in accordance with IAS 19 (2011) gains and losses will be presented in a more uniform way after elimination of presentation options. As a result, IAS 19 (2011) would make it easier for users to analyse and compare financial information about employee benefits.

14 The new disclosure requirements would assist users in forecasting future cash flows, and in analysing company's strategies and risks related to the pension plan.

15 IAS 19 (2011) is also expected to result in several benefits for preparers associated with cost savings following the simplification of the accounting model for defined benefits schemes (e.g., elimination of the corridor approach) and the removal of accounting options. IAS 19 (2011) also allows preparers to align their accounting for pension schemes with risk-sharing features closer with the underlying economic substance of those schemes, thereby resulting in better quality financial reporting.

16 Overall, EFRAG's assessment is that users and preparers are likely to benefit from IAS 19 (2011).

Conclusion

17 EFRAG's overall assessment is that the overall benefits for preparers and users of IAS 19 (2011) are likely to outweigh one-off incremental costs and ongoing costs for preparers and users associated with understanding and implementation of IAS 19 (2011).