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Straight away

IFRS bulletin from PricewaterhouseCoopers

Significant changes proposed for recognition and measurement of employee benefit expense and disclosures

What is the issue?

The IASB has issued an exposure draft (ED) proposing significant changes to the recognition and measurement of employee benefit expense and to the related disclosure requirements. This amendment to IAS 19, 'Employee benefits', is the latest step in the IASB's project to revise IAS 19 following the discussion paper issued in 2008. The proposed changes are not as far-reaching as the ideas explained in the discussion paper, but they will significantly change the recognition and measurement of employee benefit expense and extend the disclosure requirements.

The key proposals are as follows:

- **Recognition of actuarial gains and losses:** actuarial gains and losses will be recognised immediately in 'other comprehensive income' (OCI). The 'corridor and spreading' option in IAS 19, which allows delayed recognition of actuarial gains and losses for post-employment benefits, will be prohibited. Immediate recognition in profit and loss, which is currently permitted for post-employment benefits and required for other long term benefits, will also be prohibited. Actuarial gains and losses recognised in OCI will not be recycled through profit or loss in subsequent periods.

  Actuarial gains and losses arise both from changes in the assumptions used to measure pension and other long term employee benefit obligations and from differences between previous assumptions and what has actually occurred in the period. These assumptions include, for example, assumptions about increases in salaries and pensions and the mortality rate, and the estimate of the discount rate. The proposed changes will mean increased balance sheet and total comprehensive income volatility for entities that currently use the corridor and spreading method.

- **Recognition of past-service cost:** all past-service cost will be recognised in profit or loss when the employee benefit plan is amended. Past-service cost arises when the terms of a benefit plan are amended to provide additional benefits for service the employee has already delivered. These additional benefits are sometimes conditional on the employee providing future service. IAS 19 currently requires past-service cost to be recognised on a straight-line basis until the future service has been delivered, or recognised immediately if no future service is required. This proposal means that past-service cost can no longer be spread over the future service period, which will increase volatility in profit or loss in the period in which plan amendments occur.

- **Measurement of pension expense:** the expected return on plan assets and the interest cost on the pension obligation will be replaced by a new method of calculating the finance cost associated with a funded pension obligation. The expected return on plan assets is the expected income from the assets held in a funded plan and the changes in the fair value of those assets. IAS 19 currently requires the expected return on plan assets to be one component of the annual cost of the plan, and the difference between this expected return and the actual return in the period is treated as an actuarial gain or loss.

The ED proposes that net interest expense or income will be calculated by applying an appropriate discount rate to the net surplus or deficit in the plan. The discount rate will be a high-quality corporate bond rate in markets where there is a deep market in such bonds, and a government bond rate in other markets. The measurement of interest cost for an unfunded plan remains unchanged.

The effect of this proposal is that the income earned on the assets held by a funded pension plan will be determined using the same discount rate that is used to calculate the present value of the pension obligation. The difference between this amount and the actual return in the period will continue to be treated as an actuarial gain or loss. The expected return on plan assets is usually higher than the discount rate, so the proposed change will increase the pension cost recognised in profit or loss for most entities with funded plans.

- **Presentation of pension expense:** IAS 19 will be amended to remove the flexibility around where in profit or loss the components of pension expense are recognised. The cost of benefits accrued in the current period (service cost) and benefit changes (past-service cost and curtailments) will be recognised as an operating expense. Interest expense or income will be recognised as a financing item. Any other re-measurements (actuarial gains and losses, the effects of the asset limitation and settlements) will be recognised net of tax in OCI.

- **Disclosure requirements:** additional disclosures will be required to present the characteristics of the entity's benefit plans, the amounts recognised in the financial statements and the risks arising from defined benefit plans and multi-employer plans. The proposed changes will cover long-term benefits payable in service, as well as post-employment benefits, and are likely to increase the volume of disclosure for many entities.

Am I affected?

The proposed changes will affect all entities that apply IAS 19 to defined benefit plans. They will:

- change the way that information about the benefit obligation is presented in the financial statements;
- increase the volatility in the post-employment benefit liability and in total comprehensive income for entities that currently use the corridor and spreading option for the recognition of actuarial gains and losses;
- increase the net pension cost for many funded pension plans; and
- change the line items in which employee benefit costs are reported for some entities.

These proposals could significantly change a number of performance indicators, including EBITDA, earnings per share and balance sheet ratios. Management should determine the effect of the proposed changes and how they should be communicated to shareholders and other users of the financial statements.

What do I need to do?

The comment deadline is 6 September 2010. A final standard is expected in 2011. The proposed changes are significant for entities with defined benefit plans; management should consider whether to comment on the proposals.

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