

Analysis of not-for-profit/public sector considerations for revised AASB 119

Background

In May 2010, the AASB issued [ED 195](#) *Defined Benefit Plans (proposed amendments to AASB 119)*, which incorporates the IASB's ED/2010/3 *Defined Benefit Plans – Proposed amendments to IAS 19*. ED 2010/3 is intended to bring about short-term targeted improvements, and not be a substitute for a comprehensive project. A revised IAS 19 is expected to be issued by the IASB in June 2011. The analysis in this memorandum is based on the pre-ballot draft of IAS 19 *Defined Benefit Plans: Amendments to IAS 19 Employee Benefits (2011)*. If the revised IAS 19 is issued prior to the June Board meeting staff will provide a verbal update on any significant differences from the pre-ballot draft.

A summary of comments received by the AASB in relation to public sector, not-for-profit and GAAP/GFS issues is provided in Appendix A to this paper.

Analysis

Not-for-profit public sector

The current version of AASB 119 includes one 'Aus' paragraph specific to not-for-profit public sector entities. This paragraph is as follows:

Aus78.1 Notwithstanding paragraph 78, in respect of not-for-profit public sector entities, post-employment benefit obligations denominated in Australian currency shall be discounted using market yields on government bonds.

Aus78.1 was amended in 2007 by AASB 2007-4 paragraph 65. The minutes to the AASB meeting held in March 2007 note the following conclusion made by the AASB at the time of including paragraph Aus78.1:

...an Aus paragraph should be inserted to require not-for-profit public sector entities to use a discount rate determined by reference to market yields on government bonds because it would be inappropriate for such entities to use corporate bonds as the basis for determining a rate at which to discount long-term employee benefit liabilities;

Revised IAS 19 did not amend the requirements of AASB 119 paragraph 78. Staff consider that none of the amendments to IAS 19 impact on the previous decision made by the Board in relation to the discount rate to be applied by not-for-profit public sector entities, and as such, recommend that Aus78.1 be retained when the revised AASB 119 incorporating the IASB's revised IAS 19 is issued.

Staff have considered the *Process for Modifying IFRSs for PBE/NFP* and do not consider any additional not-for-profit/public sector modifications need to be made to AASB 119 resulting from the revised IAS 19. This is because the main changes from the current IAS 19 do not impact on not-for-profit/public sector entities. The corridor approach, for example, is not being applied by any Australian not-for-profit /public sectors of which staff are aware.

Consequential amendments to AASB 1049

At the March 2011 AASB meeting, Agenda paper 3.2 highlighted two potential issues in relation to GAAP/GFS harmonisation arising from the revised IAS 19:

ED 195 specifically sought comments on the possible GAAP/GFS harmonisation implications of the proposals.

Most respondents on this question considered that there would be few implications, and some noted that the proposals appear closer to GFS on the basis that they are equating OCI with 'other economic flows'. However, one respondent noted that, if the ABS does not agree that all 'remeasurements' should be in 'other economic flows' there could be GAAP/GFS complications.

In the HoTARAC response, it was noted that a minority of HoTARAC members believe that, as GFS does not advocate netting, the proposal to present a net interest expense may have implications for GAAP/GFS.

Staff have further analysed these issues and the results of this analysis are outlined below.

Issue 1: Remeasurements

Revised IAS 19 introduces the concept of 'remeasurements' of the net defined benefit liability or asset. Remeasurements comprise:

- (a) actuarial gains on the defined benefit obligation;
- (b) the return on plan assets, excluding amounts included in net interest on the net defined benefit liability (asset); and
- (c) any change in the effect of the asset ceiling, excluding amounts included in net interest on the net defined benefit liability (asset).

Staff are of the view that although the concept of 'remeasurements' has been introduced in the revised IAS 19, the accounting treatment for each of the components within 'remeasurements' is consistent with the accounting treatment that is available under the current version of AASB 119. That is, each component of 'remeasurements' is currently permitted to be recognised in other comprehensive income under the current version of AASB 119, although whether these amounts are recognised in other comprehensive income or profit and loss depends on the accounting policy choice adopted by an entity.

The current and revised accounting treatments for each component of remeasurements are summarised below:

Remeasurement	Current AASB 119	Revised IAS 19	Comments
Actuarial gains on the defined benefit obligation	May be recognised: <ul style="list-style-type: none"> • in full through profit or loss, • in full through OCI, or • Partially deferred using the ‘corridor approach’ 	Recognised in full through OCI.	Accounting treatment in revised IAS 19 aligns with one of the alternative methods available under current AASB 119 accounting.
Return on plan assets excluding amounts included in net interest on the net defined benefit liability (asset).	The difference between the expected return on plan assets and the actual return on plan assets is an actuarial gain or loss; it is included with the actuarial gains and losses on the defined benefit obligation in determining the net amount that is compared with the limits of the 10% corridor...(para. 105).	Recognised in OCI. The difference between the interest income on plan assets and the actual return on plan assets is included with the actuarial gains and losses on the defined benefit obligation in determining the remeasurements of the net defined liability (asset).	The recognition of the difference aligns with AASB 119 accounting. However, the calculation of the amount to be included within actuarial gains and losses differs from AASB 119. ¹ Staff consider that this calculation difference does not impact on GAAP/GFS as the amount is accounted for as an actuarial gain or loss and therefore, as noted above, the accounting treatment in revised IAS 19 aligns with one of the alternative methods available under current AASB 119 accounting.
Any change in the effect of the asset ceiling excluding amounts included in net interest on the net defined benefit liability (asset).	Recognise in profit or loss unless actuarial gains and losses are recognised in OCI.	Recognised in OCI.	Accounting treatment in revised IAS 19 aligns with one of the alternative methods available under current AASB 119 accounting.

¹ The approach in revised IAS 19 effectively assumes an expected rate of return on plan assets equal to the discount rate.

AASB 1049 currently notes that:

- 14 Examples of particular optional treatments in Australian Accounting Standards that paragraph 13 of this Standard has the effect of limiting include:
- ...
- (c) actuarial gains and losses relating to defined benefit superannuation plans that may be recognised in full through operating result (which is part of comprehensive result), recognised in full through other non-owner changes in equity (which is also part of comprehensive result), or partially deferred using a 'corridor approach' under AASB 119 *Employee Benefits*. For the purpose of this Standard, the option to partially defer using a 'corridor approach' is not available because it is not acceptable under the ABS GFS Manual. The other two options are available;

Although the above paragraph does not specifically discuss the treatment of any change in the effect of the asset ceiling, it may be implied that the treatment is equally applicable to these changes on the basis that the current AASB 119 links the treatment of the two items such that any adjustments arising from the asset ceiling follow the recognition of actuarial gains and losses as being recognised either in profit or loss or other comprehensive income. Further, in practice, entities applying the ABS GFS Manual are unlikely to be applying the requirements of AASB 119 relating to the asset ceiling.

Based on the above analysis, staff recommend the following amendments to AASB 1049:

- 14(c) ~~actuarial gains and losses relating to defined benefit superannuation plans that may be recognised in full through operating result (which is part of comprehensive result), recognised in full through other non-owner changes in equity (which is also part of comprehensive result), or partially deferred using a 'corridor approach' under AASB 119 *Employee Benefits*. For the purpose of this Standard, the option to partially defer using a 'corridor approach' is not available because it is not acceptable under the ABS GFS Manual. The other two options are available;~~ [deleted by the AASB]
- 31 The following examples illustrate how the approach in paragraph 30 applies to particular items:
- (a) in both the whole of government and GGS financial reporting context:
- ...
- (iii) ~~actuarial gains and losses~~ remeasurements of the defined benefit liability (asset) relating to defined benefit superannuation plans are classified as other economic flows, ~~irrespective of whether they are included in the calculation of operating result or the other non-owner changes in equity section of the statement of comprehensive income;~~
- 34 ~~As noted in paragraph 14(c), actuarial gains and losses relating to defined benefit superannuation plans may be recognised in full either through operating result or in full through other non-owner changes in equity.~~ [deleted by the AASB]

ILLUSTRATIVE EXAMPLE A

Whole of Government Statement of Comprehensive Income, Statement of Financial Position, Statement of Changes in Equity, Statement of Cash Flows and Selected Notes

Statement of Comprehensive Income for the Whole of Government of the ABC Government for the Year Ended 30 June 20XX

	Notes	\$m
...		
Other Economic Flows – Included in Operating Result		
...		
Net actuarial gains ^a Remeasurements of the defined benefit liability		866

^a Explanatory note: As noted in paragraph 14(c) of this Standard, an alternative treatment of net actuarial gains relating to defined benefit superannuation plans [consistent with paragraph 93B of AASB 119 *Employee Benefits*] would be to recognise them in full through other non-owner changes in equity (which is part of comprehensive result).

R1 Statement of Comprehensive Income for the Whole of Government by Sector of the ABC Government for the Year Ended 30 June 20XX

	Notes	GGS \$m	PNFC Sector \$m	PFC sector \$m	Eliminations \$m	Whole of Government \$m
...						
Other Economic Flows – Included in Operating Result						
...						
Net actuarial gains Remeasurements of the defined benefit liability		840	21	5	-	866

ILLUSTRATIVE EXAMPLE B

General Government Sector Statement of Comprehensive Income, Statement of Financial Position, Statement of Changes in Equity, Statement of Cash Flows and Selected Notes

Statement of Comprehensive Income for the General Government Sector of the ABC Government for the Year Ended 30 June 20XX

	Notes	\$m
...		
Other Economic Flows – Included in Operating Result		
...		
Net actuarial gains ^a Remeasurements of the defined benefit liability		866

^a Explanatory note: As noted in paragraph 14(c) of this Standard, an alternative treatment of net actuarial gains relating to defined benefit superannuation plans [consistent with paragraph 93B of AASB 119 *Employee Benefits*] would be to recognise them in full through other non-owner changes in equity (which is part of comprehensive result).

Issue 2: Net interest

Revised IAS 19 includes a single line item ‘net interest on the net defined benefit liability (asset)’. Net interest is defined in the revised IAS 19 as the change during the period in the net defined benefit liability (asset) that arises from the passage of time. Changes in net interest are required to be recognised in profit or loss.

Net interest on the net defined benefit liability (asset) is comprised of three components:

- interest income on plan assets;
- interest cost on the defined benefit obligation; and
- interest on the effect of the asset ceiling.

The current version of AASB 119 requires separate disclosure of the expected return on plan assets and the interest cost on the defined benefit obligation.

Revised IAS 19 effectively assumes an expected rate of return on plan assets such that the interest income on plan assets and the interest cost on the defined benefit obligation are calculated using the same discount rate. This is different from the current version of AASB 119 under which the interest cost on the expected increase in the defined benefit obligation and the expected return on plan assets are calculated separately.

Staff are of the view that although the term ‘net interest’ is used in the revised IAS 19, this amount does not involve ‘netting’ of interest amounts that would otherwise be presented on a gross basis in the financial statements. Rather, ‘net interest’ represents the interest amount calculated based on a net defined benefit liability (asset). That is, the statement of financial position of an employer presents a single asset or liability (which is the net amount of assets and liabilities of the defined benefit plan) and interest income or expense is the amount recognised on that single asset or liability.

Based on the above analysis, staff do not recommend amending AASB 1049 in relation to the requirement to recognise ‘net interest on the net defined benefit liability (asset)’.

Appendix A

Extract from AASB Agenda paper 11.2 1-2 September 2010

Summary of the main issues raised in responses to the AASB specific matters for comment in ED 195

AASB Question 1

The Preface to AASB 1049 *Whole of Government and General Government Sector Financial Reporting* notes that, as a result of potential amendments to the requirements in other Australian Accounting Standards, differences between Generally Accepted Accounting Principles (GAAP) and Government Finance Statistics (GFS) not contemplated in AASB 1049 may eventuate. Consistent with the AASB's comments in the Preface to AASB 1049 addressing this matter, the AASB will have regard to the implications for whole of government and GGS financial reporting in decided whether to amend the proposals in this ED or the requirements in AASB 1049 to either avoid or confirm the existence of a difference. In that regard, do you think the proposed changes to the treatment of:

- (a) past service cost;
- (b) gains and losses arising from curtailments;
- (c) net interest on the net defined benefit liability (asset); or
- (d) remeasurements of the net defined benefit liability (asset);

would have implications for GAAP/GFS harmonisation and, if so, how do you think those implications should be dealt with in the context of the principles in AASB 1049?

84. Four (ACAG #3, GT #5, CPA, ICAA and NIA #6 and HoTARAC #7) of the seven responses comment on AASB Question 1. Three of the responses (ACAG #3, GT #5, CPA, ICAA and NIA #6) and a majority of HoTARAC members express a view that the proposed changes to AASB 119 would have no significant implications for GAAP/GFS harmonisation. In particular:

- (a) ACAG believes that the proposed changes would align AASB 119 to the accounting treatments required under GFS, particularly by eliminating the 'corridor' approach;
- (b) HoTARAC does not believe that the revisions will impact on GAAP/GFS harmonisation *per se*. HoTARAC believes that, under GFS, paragraph (d) 'remeasurements' would be classified as 'other economic flows' and the 'net interest on the net defined benefit liability (asset)' at paragraph (c) would be classified as 'transactions', though this would be subject to confirmation with the Australian Bureau of Statistics (ABS). In accordance with paragraph 30 of AASB 1049, the GFS classification would also be applied in the harmonised GAAP/GFS financial statements. In addition, HoTARAC notes that:
 - (i) it expects the revision to AASB 119 will have a negative impact on the Net Operating Balance due to the discount rate being lower than the expected return on plan assets;

- (ii) in principle, the introduction of a concept of ‘remeasurements’ better aligns with GFS and the concept of ‘other economic flows’. However, if the IASB more commonly introduces the concept of ‘remeasurements’, GAAP/GFS harmonisation is likely to be made more complicated. Complications with harmonisation will arise if the ABS does not agree that all ‘remeasurements’ under AASB 119 should be classified as ‘other economic flows’; and
- (iii) a minority of HoTARAC members believe that, as GFS does not advocate netting, the proposal to present a net interest expense may have implications for AASB 1049 reporting, especially for jurisdictions where the defined benefit plan is part of the public sector.

...

AASB Question 3

The AASB would particularly value comments on whether:

- (a) in addition to the issues raised in relation to Question 1 above, there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, particularly any issues relating to:
 - (i) not-for-profit entities; and
 - (ii) public sector entities;
- (b) overall, the proposals would result in financial statements that would be useful to users; and
- (c) the proposals are in the best interests of the Australian and New Zealand economies.

86. Six (IAA #2, ACAG #3, Mercer #4, GT #5, CPA, ICAA and NIA #6 and HoTARAC #7) of the seven responses comment on AASB Question 3. Four (Mercer #4, ACAG #3, GT #5 and CPA, ICAA and NIA #6) of these responses indicate that they not aware of any regulatory or other issues that may affect the implementation of the proposals by reporting entities in the Australian environment. In addition, four (IAA #2, ACAG #3, Mercer #4 and CPA, ICAA and NIA #6) of these responses indicate that the proposals would enhance the usefulness of financial statements for users, in particular by improving the comparability of financial statements.

87. However, four (IAA #2, ACAG #3, Mercer #4 and CPA, ICAA and NIA #6) of the responses express concerns regarding the costs that some entities, including entities with long-service leave obligations and public sector superannuation schemes, will incur as a result of the presentation and disclosure proposals. Consequently, all of these responses indicate that, subject to their comments in relation to these matters, the proposals are generally in the best interests of the Australian and New Zealand economies. In addition, one response (HoTARAC #7) expresses concern with the approach for calculating net interest on the net defined benefit liability (asset), primarily because it omits useful information in the form of the expected returns on plan assets and does not reflect the underlying nature of a plan’s asset portfolio.

88. Two responses (IAA #2 and Mercer #4) express concern with the disclosure proposals in respect of defined benefit plans applying to public sector entities. Both responses:

- (a) suggest that some of the proposed disclosures are not justified on cost-benefit grounds as they deal with the risks that typically arise in the context of private sector defined benefit arrangements, and that the risks associated with unfunded or partially funded public sector superannuation schemes generally reside with the ultimate State or Commonwealth government rather than any particular public sector entity; and
- (b) recommend that public sector be scoped out of IAS 19 and AASB 119, and Mercer recommends that the International Public Sector Accounting Standard for employee benefits be adopted for public sector entities.

In addition, Mercer suggests that a defined benefit public sector scheme sponsored by a State government could be accounted for under the requirements applicable to state plans. This would facilitate the government (or the relevant public sector entity) accounting for the plan as if it was a defined contribution plan, which is arguably contrary to the intention of AASB 119.

89. One response (GT #5) recommends that the proposals not apply to non-publicly accountable entities as they would add significant complexity and costs that would not be borne by similar structured entities reporting in jurisdictions other than Australia.

...