

International Accounting Standard IAS 19

Employee Benefits

January 2010

(incorporating amendments from IFRSs issued up to 31 December 2009 with an effective date no later than 1 January 2010)

BASIS FOR CONCLUSIONS

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CONTENTS

*paragraphs***BASIS FOR CONCLUSIONS ON
IAS 19 *EMPLOYEE BENEFITS***

BACKGROUND	BC1-BC2
SUMMARY OF CHANGES TO IAS 19	BC3
SUMMARY OF CHANGES TO E54	BC4
DEFINITIONS	BC4A-BC4C
DEFINED CONTRIBUTION PLANS	BC5-BC6
MULTI-EMPLOYER PLANS AND STATE PLANS	BC7-BC10K
Multi-employer plans: amendment issued by the IASB in December 2004	BC9A-BC10
Application of IAS 19 in the separate or individual financial statements of entities in a consolidated group: amendment issued by the IASB in December 2004	BC10A-BC10K
DEFINED BENEFIT PLANS	BC11-BC85E
Recognition and measurement: balance sheet	BC11-BC14
Measurement date	BC15-BC16
Actuarial valuation method	BC17-BC22
Attributing benefit to periods of service	BC23-BC25
Actuarial assumptions: discount rate	BC26-BC34
Actuarial assumptions: salaries, benefits and medical costs	BC35-BC37
Actuarial gains and losses	BC38-BC48
An additional option for the recognition of actuarial gains and losses: amendment adopted by the IASB in December 2004	BC48A-BC48EE
Past service cost	BC49-BC62B
Recognition and measurement: an additional minimum liability	BC63-BC65
Plan assets	BC66-BC75E
Plan assets: revised definition adopted in 2000	BC68A-BC68L
Plan assets: measurement	BC69-BC75
Reimbursements	BC75A-BC75E
Limit on the recognition of an asset	BC76-BC78
Asset ceiling: amendment issued in May 2002	BC78A-BC78F
Curtailments and settlements	BC79-BC80
Presentation and disclosure	BC81-BC85
Disclosures: amendment issued by the IASB in December 2004	BC85A-BC85E
BENEFITS OTHER THAN POST-EMPLOYMENT BENEFITS	BC86-BC94
Compensated absences	BC86-BC88
Death-in-service benefits	BC89
Other long-term employee benefits	BC90
Termination benefits	BC91-BC93
TRANSITION AND EFFECTIVE DATE	BC95-BC97

Basis for Conclusions on IAS 19 *Employee Benefits*

The original text has been marked up to reflect the revision of IAS 39 Financial Instruments: Recognition and Measurement in 2003 and the issue of IFRS 2 Share-based Payment in 2004 and Improvements to IFRSs in May 2008; new text is underlined and deleted text is struck through. The terminology has not been amended to reflect the changes made by IAS 1 Presentation of Financial Statements (as revised in 2007).

For greater clarity and for consistency with other IFRSs, paragraph numbers have been prefixed BC.

This appendix gives the Board's reasons for rejecting certain alternative solutions. Individual Board members gave greater weight to some factors than to others. Paragraphs BC9A–BC9D, BC10A–BC10K, BC48A–BC48EE and BC85A–BC85E were added in relation to the amendment to IAS 19 issued in December 2004. Paragraphs BC4A–BC4C, BC62A, BC62B and BC97 were added by Improvements to IFRSs issued in May 2008.

Background

- BC1 The IASC Board (the 'Board') approved IAS 19 *Accounting for Retirement Benefits in the Financial Statements of Employers*, in 1983. Following a limited review, the Board approved a revised Standard IAS 19 *Retirement Benefit Costs* ('the old IAS 19'), in 1993. The Board began a more comprehensive review of IAS 19 in November 1994. In August 1995, the IASC Staff published an Issues Paper on *Retirement Benefit and Other Employee Benefit Costs*. In October 1996, the Board approved E54 *Employee Benefits*, with a comment deadline of 31 January 1997. The Board received more than 130 comment letters on E54 from over 20 countries. The Board approved IAS 19 *Employee Benefits* ('the new IAS 19') in January 1998.
- BC2 The Board believes that the new IAS 19 is a significant improvement over the old IAS 19. Nevertheless, the Board believes that further improvement may be possible in due course. In particular, several Board members believe that it would be preferable to recognise all actuarial gains and losses immediately in a statement of financial performance. However, the Board believes that such a solution is not feasible for actuarial gains and losses until the Board makes further progress on various issues relating to the reporting of financial performance. When the Board makes further progress with those issues, it may decide to revisit the treatment of actuarial gains and losses.

Summary of changes to IAS 19

- BC3 The most significant feature of the new IAS 19 is a market-based approach to measurement. The main consequences are that the discount rate is based on market yields at the balance sheet date and any plan assets are measured at fair value. In summary, the main changes from the old IAS 19 are the following:
- (a) there is a revised definition of defined contribution plans and related guidance (see paragraphs BC5 and BC6 below), including more detailed guidance than the old IAS 19 on multi-employer plans and state plans (see paragraphs BC7–BC10 below) and on insured plans;

- (b) there is improved guidance on the balance sheet treatment of liabilities and assets arising from defined benefit plans (see paragraphs BC11–BC14 below).
- (c) defined benefit obligations should be measured with sufficient regularity that the amounts recognised in the financial statements do not differ materially from the amounts that would be determined at the balance sheet date (see paragraphs BC15 and BC16 below);
- (d) projected benefit methods are eliminated and there is a requirement to use the accrued benefit method known as the Projected Unit Credit Method (see paragraphs BC17–BC22 below). The use of an accrued benefit method makes it essential to give detailed guidance on the attribution of benefit to individual periods of service (see paragraphs BC23–BC25 below);
- (e) the rate used to discount post-employment benefit obligations and other long-term employee benefit obligations (both funded and unfunded) should be determined by reference to market yields at the balance sheet date on high quality corporate bonds. In countries where there is no deep market in such bonds, the market yields (at the balance sheet date) on government bonds should be used. The currency and term of the corporate bonds or government bonds should be consistent with the currency and estimated term of the post-employment benefit obligations (see paragraphs BC26–BC34 below);
- (f) defined benefit obligations should consider all benefit increases that are set out in the terms of the plan (or result from any constructive obligation that goes beyond those terms) at the balance sheet date (see paragraphs BC35–BC37 below);
- (g) an entity should recognise, as a minimum, a specified portion of those actuarial gains and losses (arising from both defined benefit obligations and any related plan assets) that fall outside a ‘corridor’. An entity is permitted, but not required, to adopt certain systematic methods of faster recognition. Such methods include, among others, immediate recognition of all actuarial gains and losses (see paragraphs BC38–BC48 below);
- (h) an entity should recognise past service cost on a straight-line basis over the average period until the benefits become vested. To the extent that the benefits are already vested immediately, an entity should recognise past service cost immediately (see paragraphs BC49–BC62 below);
- (i) plan assets should be measured at fair value. Fair value is estimated by discounting expected future cash flows only if no market price is available (see paragraphs BC66–BC75 below);
- (j) amounts recognised by the reporting entity as an asset should not exceed the net total of:
 - (i) any unrecognised actuarial losses and past service cost; and
 - (ii) the present value of any economic benefits available in the form of refunds from the plan or reductions in contributions to the plan (see paragraphs BC76–BC78 below);

- (k) curtailment and settlement losses should be recognised not when it is probable that the settlement or curtailment will occur, but when the settlement or curtailment occurs (see paragraphs BC79 and BC80 below);
- (l) improvements have been made to the disclosure requirements (see paragraphs BC81–BC85 below);
- (m) the new IAS 19 deals with all employee benefits, whereas IAS 19 deals only with retirement benefits and certain similar post-employment benefits (see paragraphs BC86–BC94 below); and
- (n) the transitional provisions for defined benefit plans are amended (see paragraphs BC95 and BC96 below).

The Board rejected a proposal to require recognition of an ‘additional minimum liability’ in certain cases (see paragraphs BC63–BC65 below).

Summary of changes to E54

- BC4 The new IAS 19 makes the following principal changes to the proposals in E54:
- (a) an entity should attribute benefit to periods of service following the plan’s benefit formula, but the straight-line basis should be used if employee service in later years leads to a materially higher level of benefit than in earlier years (see paragraphs BC23–BC25 below);
 - (b) actuarial assumptions should include estimates of benefit increases not if there is reliable evidence that they will occur, but only if the increases are set out in the terms of the plan (or result from any constructive obligation that goes beyond those terms) at the balance sheet date (see paragraphs BC35–BC37 below);
 - (c) actuarial gains and losses that fall outside the 10% ‘corridor’ need not be recognised immediately as proposed in E54. The minimum amount that an entity should recognise for each defined benefit plan is the part that fell outside the ‘corridor’ as at the end of the previous reporting period, divided by the expected average remaining working lives of the employees participating in that plan. The new IAS 19 also permits certain systematic methods of faster recognition. Such methods include, among others, immediate recognition of all actuarial gains and losses (see paragraphs BC38–BC48 below);
 - (d) E54 set out two alternative treatments for past service cost and indicated that the Board would eliminate one of these treatments after considering comments on the Exposure Draft. One treatment was immediate recognition of all past service cost. The other treatment was immediate recognition for former employees, with amortisation for current employees over the remaining working lives of the current employees. The new IAS 19 requires that an entity should recognise past service cost on a straight-line basis over the average period until the benefits become vested. To the extent that the benefits are already vested immediately an entity should recognise past service cost immediately (see paragraphs BC49–BC59 below);

- (e) the effect of 'negative plan amendments' should not be recognised immediately (as proposed in E54) but treated in the same way as past service cost (see paragraphs BC60–BC62 below);
- (f) non-transferable securities issued by the reporting entity have been excluded from the definition of plan assets (see paragraphs BC67 and BC68 below);
- (g) plan assets should be measured at fair value rather than market value, as defined in E54 (see paragraphs BC69 and BC70 below);
- (h) plan administration costs (not just investment administration costs, as proposed in E54) are to be deducted in determining the return on plan assets (see paragraph BC75 below);
- (i) the limit on the recognition of plan assets has been changed in two respects from the proposals in E54. The limit does not override the corridor for actuarial losses or the deferred recognition of past service cost. Also, the limit refers to **available** refunds or reductions in future contributions. E54 referred to the **expected** refunds or reductions in future contributions (see paragraphs BC76–BC78 below);
- (j) unlike E54, the new IAS 19 does not specify whether an income statement should present interest cost and the expected return on plan assets in the same line item as current service cost. The new IAS 19 requires an entity to disclose the line items in which they are included;
- (k) improvements have been made to the disclosure requirements (see paragraphs BC81–BC85 below);
- (l) the guidance in certain areas (particularly termination benefits, curtailments and settlements, profit-sharing and bonus plans and various references to constructive obligations) has been conformed to the proposals in E59 *Provisions, Contingent Liabilities and Contingent Assets*. Also, the Board has added explicit guidance on the measurement of termination benefits, requiring discounting for termination benefits not payable within one year (see paragraphs BC91–BC93 below); and
- (m) on initial adoption of the new IAS 19, there is a transitional option to recognise an increase in defined benefit liabilities over not more than five years. The new IAS 19 is operative for financial statements covering periods beginning on or after 1 January 1999, rather than 2001 as proposed in E54 (see paragraphs BC95 and BC96 below).

Definitions

- BC4A The IASB identified a perceived inconsistency in the definitions when a compensated absence that is due to the employee but is not expected to occur for more than twelve months is neither an 'other long-term employee benefit' nor a 'short-term compensated absence' as previously defined in paragraphs 7 and 8(b). The IASB decided to amend those definitions and replace the term 'fall due' to remove this potential gap as part of the *Improvements to IFRSs* issued in May 2008.

- BC4B Noting respondents' comments on the exposure draft of proposed *Improvements to International Financial Reporting Standards* published in 2007, the IASB concluded that the critical factor in distinguishing between long-term and short-term benefits is the timing of the expected settlement. Therefore, the IASB clarified that other long-term benefits are those that are not *due to be settled* within twelve months after the end of the period in which the employees rendered the service.
- BC4C The IASB noted that this distinction between short-term and long-term benefits is consistent with the current/non-current liability distinction in IAS 1 *Presentation of Financial Statements*. However, the fact that for presentation purposes a long-term benefit may be split into current and non-current portions does not change how the entire long-term benefit would be measured.

Defined contribution plans (paragraphs 24–47 of the standard)

- BC5 The old IAS 19 defined:
- (a) **defined contribution plans** as retirement benefit plans under which amounts to be paid as retirement benefits are determined by reference to contributions to a fund together with investment earnings thereon; and
 - (b) **defined benefit plans** as retirement benefit plans under which amounts to be paid as retirement benefits are determined by reference to a formula usually based on employees' remuneration and/or years of service.
- The Board considers these definitions unsatisfactory because they focus on the benefit receivable by the employee, rather than on the cost to the entity. The definitions in paragraph 7 of the new IAS 19 focus on the downside risk that the cost to the entity may increase. The definition of defined contribution plans does not exclude the upside potential that the cost to the entity may be less than expected.
- BC6 The new IAS 19 does not change the accounting for defined contribution plans, which is straightforward because there is no need for actuarial assumptions and an entity has no possibility of any actuarial gain or loss. The new IAS 19 gives no guidance equivalent to paragraphs 20 (past service costs in defined contribution plans) and 21 (curtailment of defined contribution plans) of the old IAS 19. The Board believes that these issues are not relevant to defined contribution plans.

Multi-employer plans and state plans (paragraphs 29–38 of the Standard)

- BC7 An entity may not always be able to obtain sufficient information from multi-employer plans to use defined benefit accounting. The Board considered three approaches to this problem:
- (a) use defined contribution accounting for some and defined benefit accounting for others;
 - (b) use defined contribution accounting for all multi-employer plans, with additional disclosure where the multi-employer plan is a defined benefit plan; or

- (c) use defined benefit accounting for those multi-employer plans that are defined benefit plans. However, where sufficient information is not available to use defined benefit accounting, an entity should disclose that fact and use defined contribution accounting.
- BC8 The Board believes that there is no conceptually sound, workable and objective way to draw a distinction so that an entity could use defined contribution accounting for some multi-employer defined benefit plans and defined benefit accounting for others. Also, the Board believes that it is misleading to use defined contribution accounting for multi-employer plans that are defined benefit plans. This is illustrated by the case of French banks that used defined contribution accounting for defined benefit pension plans operated under industry-wide collective agreements on a pay-as-you-go basis. Demographic trends made these plans unsustainable and a major reform in 1993 replaced these by defined contribution arrangements for future service. At this point, the banks were compelled to quantify their obligations. Those obligations had previously existed, but had not been recognised as liabilities.
- BC9 The Board concluded that an entity should use defined benefit accounting for those multi-employer plans that are defined benefit plans. However, where sufficient information is not available to use defined benefit accounting, an entity should disclose that fact and use defined contribution accounting. The Board agreed to apply the same principle to state plans. The new IAS 19 notes that most state plans are defined contribution plans.

Multi-employer plans: amendment issued by the IASB in December 2004

- BC9A In April 2004 the International Financial Reporting Interpretations Committee (IFRIC) published a draft Interpretation, D6 *Multi-employer Plans*, which proposed the following guidance on how multi-employer plans should apply defined benefit accounting, if possible:
 - (a) the plan should be measured in accordance with IAS 19 using assumptions appropriate for the plan as a whole
 - (b) the plan should be allocated to plan participants so that they recognise an asset or liability that reflects the impact of the surplus or deficit on the future contributions from the participant.
- BC9B The concerns raised by respondents to D6 about the availability of the information about the plan as a whole, the difficulties in making an allocation as proposed and the resulting lack of usefulness of the information provided by defined benefit accounting were such that the IFRIC decided not to proceed with the proposals.
- BC9C The International Accounting Standards Board (IASB), when discussing group plans (see paragraphs BC10A–BC10K) noted that, if there were a contractual agreement between a multi-employer plan and its participants on how a surplus would be distributed or deficit funded, the same principle that applied to group plans should apply to multi-employer plans, ie the participants should recognise an asset or liability. In relation to the funding of a deficit, the IASB regarded this principle as consistent with the recognition of a provision in accordance with IAS 37.

BC9D The IASB therefore decided to clarify in IAS 19 that, if a participant in a defined benefit multi-employer plan:

- (a) accounts for that participation on a defined contribution basis in accordance with paragraph 30 of IAS 19 because it had insufficient information to apply defined benefit accounting but
- (b) has a contractual agreement that determined how a surplus would be distributed or a deficit funded,

it recognises the asset or liability arising from that contractual agreement.

BC10 In response to comments on E54, the Board considered a proposal to exempt wholly owned subsidiaries (and their parents) participating in group defined benefit plans from the recognition and measurement requirements in their individual non-consolidated financial statements, on cost-benefit grounds. The Board concluded that such an exemption would not be appropriate.

Application of IAS 19 in the separate or individual financial statements of entities in a consolidated group: amendment issued by the IASB in December 2004

BC10A Some constituents asked the IASB to consider whether entities participating in a group defined benefit plan should, in their separate or individual financial statements, either have an unqualified exemption from defined benefit accounting or be able to treat the plan as a multi-employer plan.

BC10B In developing the exposure draft, the IASB did not agree that an unqualified exemption from defined benefit accounting for group defined benefit plans in the separate or individual financial statements of group entities was appropriate. In principle, the requirements of International Financial Reporting Standards (IFRSs) should apply to separate or individual financial statements in the same way as they apply to any other financial statements. Following that principle would mean amending IAS 19 to allow group entities that participate in a plan that meets the definition of a multi-employer plan, except that the participants are under common control, to be treated as participants in a multi-employer plan in their separate or individual financial statements.

BC10C However, in the exposure draft, the IASB concluded that entities within a group should always be presumed to be able to obtain the necessary information about the plan as a whole. This implies that, in accordance with the requirements for multi-employer plans, defined benefit accounting should be applied if there is a consistent and reliable basis for allocating the assets and obligations of the plan.

BC10D In the exposure draft, the IASB acknowledged that entities within a group might not be able to identify a consistent and reliable basis for allocating the plan that results in the entity recognising an asset or liability that reflects the extent to which a surplus or deficit in the plan would affect their future contributions. This is because there may be uncertainty in the terms of the plan about how surpluses will be used or deficits funded across the consolidated group. However, the IASB concluded that entities within a group should always be able to make at least a consistent and *reasonable* allocation, for example on the basis of a percentage of pensionable pay.

IAS 19 BC

- BC10E The IASB then considered whether, for some group entities, the benefits of defined benefit accounting using a consistent and *reasonable* basis of allocation were worth the costs involved in obtaining the information. The IASB decided that this was not the case for entities that meet criteria similar to those in IAS 27 *Consolidated and Separate Financial Statements* for the exemption from preparing consolidated financial statements.
- BC10F The exposure draft therefore proposed that:
- (a) entities that participate in a plan that would meet the definition of a multi-employer plan except that the participants are under common control, and that meet the criteria set out in paragraph 34 of IAS 19 as proposed to be amended in the exposure draft, should be treated as if they were participants in a multi-employer plan. This means that if there is no consistent and reliable basis for allocating the assets and liabilities of the plan, the entity should use defined contribution accounting and provide additional disclosures.
 - (b) all other entities that participate in a plan that would meet the definition of a multi-employer plan except that the participants are under common control should be required to apply defined benefit accounting by making a consistent and reasonable allocation of the assets and liabilities of the plan.
- BC10G Respondents to the exposure draft generally supported the proposal to extend the requirements in IAS 19 on multi-employer plans to group entities. However, many disagreed with the criteria proposed in the exposure draft, for the following reasons:
- (a) the proposed amendments and the interaction with D6 were unclear.
 - (b) the provisions for multi-employer accounting should be extended to a listed parent company.
 - (c) the provisions for multi-employer accounting should be extended to group entities with listed debt.
 - (d) the provisions for multi-employer plan accounting should be extended to all group entities, including partly-owned subsidiaries.
 - (e) there should be a blanket exemption from defined benefit accounting for all group entities.
- BC10H The IASB agreed that the proposed requirements for group plans were unnecessarily complex. The IASB also concluded that it would be better to treat group plans separately from multi-employer plans because of the difference in information available to the participants: in a group plan information about the plan as a whole should generally be available. The IASB further noted that, if the parent wishes to comply with IFRSs in its separate financial statements or wishes its subsidiaries to comply with IFRSs in their individual financial statements, then it must obtain and provide the necessary information for the purposes of disclosure, at least.

- BC10I The IASB noted that, if there were a contractual agreement or stated policy on charging the net defined benefit cost to group entities, that agreement or policy would determine the cost for each entity. If there is no such contractual agreement or stated policy, the entity that is the sponsoring employer by default bears the risk relating to the plan. The IASB therefore concluded that a group plan should be allocated to the individual entities within a group in accordance with any contractual agreement or stated policy. If there is no such agreement or policy, the net defined benefit cost is allocated to the sponsoring employer. The other group entities recognise a cost equal to any contribution collected by the sponsoring employer.
- BC10J This approach has the advantages of (a) all group entities recognising the cost they have to bear for the defined benefit promise and (b) being simple to apply.
- BC10K The IASB also noted that participation in a group plan is a related party transaction. As such, disclosures are required to comply with IAS 24 *Related Party Disclosures*. Paragraph 20 of IAS 24 requires an entity to disclose the nature of the related party relationship as well as information about the transactions and outstanding balances necessary for an understanding of the potential effect of the relationship on the financial statements. The IASB noted that information about each of (a) the policy on charging the defined benefit cost, (b) the policy on charging current contributions and (c) the status of the plan as a whole was required to give an understanding of the potential effect of the participation in the group plan on the entity's separate or individual financial statements.

Defined benefit plans

Recognition and measurement: balance sheet (paragraphs 49–60 of the Standard)

- BC11 Paragraph 54 of the new IAS 19 summarises the recognition and measurement of liabilities arising from defined benefit plans and paragraphs 55–107 of the new IAS 19 describe various aspects of recognition and measurement in greater detail. Although the old IAS 19 did not deal explicitly with the recognition of retirement benefit obligations as a liability, it is likely that most entities would recognise a liability for retirement benefit obligations at the same time under both Standards. However, the two Standards differ in the measurement of the resulting liability.
- BC12 Paragraph 54 of the new IAS 19 is based on the definition of, and recognition criteria for, a liability in IASC's *Framework for the Preparation and Presentation of Financial Statements* (the 'Framework'). The Framework defines a liability as a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits. The Framework states that an item which meets the definition of a liability should be recognised if:
- (a) it is probable that any future economic benefit associated with the item will flow from the entity; and
 - (b) the item has a cost or value that can be measured with reliability.

IAS 19 BC

BC13 The Board believes that:

- (a) an entity has an obligation under a defined benefit plan when an employee has rendered service in return for the benefits promised under the plan. Paragraphs 67–71 of the new IAS 19 deal with the attribution of benefit to individual periods of service in order to determine whether an obligation exists;
- (b) an entity should use actuarial assumptions to determine whether the entity will pay those benefits in future reporting periods (see paragraphs 72–91 of the Standard); and
- (c) actuarial techniques allow an entity to measure the obligation with sufficient reliability to justify recognition of a liability.

BC14 The Board believes that an obligation exists even if a benefit is not vested, in other words if the employee's right to receive the benefit is conditional on future employment. For example, consider an entity that provides a benefit of 100 to employees who remain in service for two years. At the end of the first year, the employee and the entity are not in the same position as at the beginning of the first year, because the employee will only need to work for one year, instead of two, before becoming entitled to the benefit. Although there is a possibility that the benefit may not vest, that difference is an obligation and, in the Board's view, should result in the recognition of a liability at the end of the first year. The measurement of that obligation at its present value reflects the entity's best estimate of the probability that the benefit may not vest.

Measurement date (paragraphs 56 and 57 of the Standard)

BC15 Some national standards permit entities to measure the present value of defined benefit obligations at a date up to three months before the balance sheet date. However, the Board decided that entities should measure the present value of defined benefit obligations, and the fair value of any plan assets, at the balance sheet date. Therefore, if an entity carries out a detailed valuation of the obligation at an earlier date, the results of that valuation should be updated to take account of any significant transactions and other significant changes in circumstances up to the balance sheet date.

BC16 In response to comments on E54, the Board has clarified that full actuarial valuation is not required at the balance sheet date, provided that an entity determines the present value of defined benefit obligations and the fair value of any plan assets with sufficient regularity that the amounts recognised in the financial statements do not differ materially from the amounts that would be determined at the balance sheet date.

Actuarial valuation method (paragraphs 64–66 of the Standard)

BC17 The old IAS 19 permitted both accrued benefit valuation methods (benchmark treatment) and projected benefit valuation methods (allowed alternative

treatment). The two groups of methods are based on fundamentally different, and incompatible, views of the objectives of accounting for employee benefits:

- (a) **accrued benefit methods** (sometimes known as 'benefit', 'unit credit' or 'single premium' methods) determine the present value of employee benefits attributable to service to date; but
- (b) **projected benefit methods** (sometimes described as 'cost', 'level contribution' or 'level premium' methods) project the estimated total obligation at retirement and then calculate a level funding cost, taking into account investment earnings, that will provide the total benefit at retirement.

The differences between the two groups of methods were discussed in more detail in the Issues Paper published in August 1995.

- BC18 The two methods may have similar effects on the income statement, but only by chance or if the number and age distribution of participating employees remains relatively stable over time. There can be significant differences in the measurement of liabilities under the two groups of methods. For these reasons, the Board believes that a requirement to use a single group of methods will significantly enhance comparability.
- BC19 The Board considered whether it should continue to permit projected benefit methods as an allowed alternative treatment while introducing a new requirement to disclose information equivalent to the use of an accrued benefit method. However, the Board believes that disclosure cannot rectify inappropriate accounting in the balance sheet and income statement. The Board concluded that projected benefit methods are not appropriate, and should be eliminated, because such methods:
- (a) focus on future events (future service) as well as past events, whereas accrued benefit methods focus only on past events;
 - (b) generate a liability which does not represent a measure of any real amount and can be described only as the result of cost allocations; and
 - (c) do not attempt to measure fair value and cannot, therefore, be used in a business combination, as required by IAS 22 *Business Combinations*.^{*} If an entity uses an accrued benefit method in a business combination, it would not be feasible for the entity to use a projected benefit method to account for the same obligation in subsequent periods.
- BC20 The old IAS 19 did not specify which forms of accrued benefit valuation method should be permitted under the benchmark treatment. The new IAS 19 requires a single accrued benefit method: the most widely used accrued benefit method, which is known as the Projected Unit Credit Method (sometimes known as the 'accrued benefit method pro-rated on service' or as the 'benefit/years of service method').

^{*} IAS 22 was withdrawn in 2004 and replaced by IFRS 3 *Business Combinations*.

- BC21 The Board acknowledges that the elimination of projected benefit methods, and of accrued benefit methods other than the Projected Unit Credit Method, has cost implications. However, with modern computing power, it will be only marginally more expensive to run a valuation on two different bases and the advantages of improved comparability will outweigh the additional cost.
- BC22 An actuary may sometimes, for example, in the case of a closed fund, recommend a method other than the Projected Unit Credit Method for funding purposes. Nevertheless, the Board agreed to require the use of the Projected Unit Credit Method in all cases because that method is more consistent with the accounting objectives laid down in the new IAS 19.

Attributing benefit to periods of service (paragraphs 67–71 of the Standard)

- BC23 As explained in paragraph BC13 above, the Board believes that an entity has an obligation under a defined benefit plan when an employee has rendered service in return for the benefits promised under the plan. The Board considered three alternative methods of accounting for a defined benefit plan which attributes different amounts of benefit to different periods:
- (a) apportion the entire benefit on a straight-line basis over the entire period to the date when further service by the employee will lead to no material amount of further benefits under the plan, other than from further salary increases;
 - (b) apportion benefit under the plan's benefit formula. However, a straight-line basis should be used if the plan's benefit formula attributes a materially higher benefit to later years; or
 - (c) apportion the benefit that vests at each interim date on a straight-line basis over the period between that date and the previous interim vesting date.

The three methods are illustrated by the following two examples.

Example 1		
A plan provides a benefit of 400 if an employee retires after more than ten and less than twenty years of service and a further benefit of 100 (500 in total) if an employee retires after twenty or more years of service.		
<i>The amounts attributed to each year are as follows:</i>		
	<i>Years 1–10</i>	<i>Years 11–20</i>
<i>Method (a)</i>	25	25
<i>Method (b)</i>	40	10
<i>Method (c)</i>	40	10

Example 2

A plan provides a benefit of 100 if an employee retires after more than ten and less than twenty years of service and a further benefit of 400 (500 in total) if an employee retires after twenty or more years of service.

The amounts attributed to each year are as follows:

	<i>Years 1–10</i>	<i>Years 11–20</i>
<i>Method (a)</i>	25	25
<i>Method (b)</i>	25	25
<i>Method (c)</i>	10	40

Note: this plan attributes a higher benefit to later years, whereas the plan in Example 1 attributes a higher benefit to earlier years.

- BC24 In approving E54, the Board adopted method (a) on the grounds that this method was the most straightforward and that there were no compelling reasons to attribute different amounts of benefit to different years, as would occur under either of the other methods.
- BC25 A significant minority of commentators on E54 favoured following the benefit formula (or alternatively, if the final Standard were to retain straight-line attribution, the recognition of a minimum liability based on the benefit formula). The Board agreed with these comments and decided to require method (b).

Actuarial assumptions: discount rate (paragraphs 78–82 of the Standard)

- BC26 One of the most important issues in measuring defined benefit obligations is the selection of the criteria used to determine the discount rate. According to the old IAS 19, the discount rate assumed in determining the actuarial present value of promised retirement benefits reflected the long-term rates, or an approximation thereto, at which such obligations are expected to be settled. The Board rejected the use of such a rate because it is not relevant for an entity that does not contemplate settlement and it is an artificial construct, as there may be no market for settlement of such obligations.
- BC27 Some believe that, for funded benefits, the discount rate should be the expected rate of return on the plan assets actually held by a plan, on the grounds that the return on plan assets represents faithfully the expected ultimate cash outflow (ie future contributions). The Board rejected this approach because the fact that a fund has chosen to invest in certain kinds of asset does not affect the nature or amount of the obligation. In particular, assets with a higher expected return carry more risk and an entity should not recognise a smaller liability merely because the plan has chosen to invest in riskier assets with a higher expected return. Therefore, the measurement of the obligation should be independent of the measurement of any plan assets actually held by a plan.

BC28 The most significant decision is whether the discount rate should be a risk-adjusted rate (one that attempts to capture the risks associated with the obligation). Some argue that the most appropriate risk-adjusted rate is given by the expected return on an appropriate portfolio of plan assets that would, over the long term, provide an effective hedge against such an obligation. An appropriate portfolio might include:

- (a) fixed-interest securities for obligations to former employees to the extent that the obligations are not linked, in form or in substance, to inflation;
- (b) index-linked securities for index-linked obligations to former employees; and
- (c) equity securities for benefit obligations towards current employees that are linked to final pay. This is based on the view that the long-term performance of equity securities is correlated with general salary progression in the economy as a whole and hence with the final-pay element of a benefit obligation.

It is important to note that the portfolio actually held need not necessarily be an appropriate portfolio in this sense. Indeed, in some countries, regulatory constraints may prevent plans from holding an appropriate portfolio. For example, in some countries, plans are required to hold a certain proportion of their assets in the form of fixed-interest securities. Furthermore, if an appropriate portfolio is a valid reference point, it is equally valid for both funded and unfunded plans.

BC29 Those who support using the interest rate on an appropriate portfolio as a risk-adjusted discount rate argue that:

- (a) portfolio theory suggests that the expected return on an asset (or the interest rate inherent in a liability) is related to the undiversifiable risk associated with that asset (or liability). Undiversifiable risk reflects not the variability of the returns (payments) in **absolute** terms but the **correlation** of the returns (or payments) with the returns on other assets. If cash inflows from a portfolio of assets react to changing economic conditions over the long term in the same way as the cash outflows of a defined benefit obligation, the undiversifiable risk of the obligation (and hence the appropriate discount rate) must be the same as that of the portfolio of assets;
- (b) an important aspect of the economic reality underlying final salary plans is the correlation between final salary and equity returns that arises because they both reflect the same long-term economic forces. Although the correlation is not perfect, it is sufficiently strong that ignoring it will lead to systematic overstatement of the liability. Also, ignoring this correlation will result in misleading volatility due to short-term fluctuations between the rate used to discount the obligation and the discount rate that is implicit in the fair value of the plan assets. These factors will deter entities from operating defined benefit plans and lead to switches from equities to fixed interest investments. Where defined benefit plans are largely funded by equities, this could have a serious impact on share prices. This switch will also increase the cost of pensions. There will be pressure on companies to remove the apparent (but non-existent) shortfall;

- (c) if an entity settled its obligation by purchasing an annuity, the insurance company would determine the annuity rates by looking to a portfolio of assets that provides cash inflows that substantially offset all the cash flows from the benefit obligation as those cash flows fall due. Therefore, the expected return on an appropriate portfolio measures the obligation at an amount that is close to its market value. In practice, it is not possible to settle a final pay obligation by buying annuities since no insurance company would insure a final pay decision that remained at the discretion of the person insured. However, evidence can be derived from the purchase/sale of businesses that include a final salary pension scheme. In this situation the vendor and purchaser would negotiate a price for the pension obligation by reference to its present value, discounted at the rate of return on an appropriate portfolio;
- (d) although investment risk is present even in a well-diversified portfolio of equity securities, any general decline in securities would, in the long term, be reflected in declining salaries. Since employees accepted that risk by agreeing to a final salary plan, the exclusion of that risk from the measurement of the obligation would introduce a systematic bias into the measurement; and
- (e) time-honoured funding practices in some countries use the expected return on an appropriate portfolio as the discount rate. Although funding considerations are distinct from accounting issues, the long history of this approach calls for careful scrutiny of any other proposed approach.

BC30 Those who oppose a risk-adjusted rate argue that:

- (a) it is incorrect to look at returns on assets in determining the discount rate for liabilities;
- (b) if a sufficiently strong correlation between asset returns and final pay actually existed, a market for final salary obligations would develop, yet this has not happened. Furthermore, where any such apparent correlation does exist, it is not clear whether the correlation results from shared characteristics of the portfolio and the obligations or from changes in the contractual pension promise;
- (c) the return on equity securities does not correlate with other risks associated with defined benefit plans, such as variability in mortality, timing of retirement, disability and adverse selection;
- (d) in order to evaluate a liability with uncertain cash flows, an entity would normally use a discount rate lower than the risk-free rate, yet the expected return on an appropriate portfolio is higher than the risk-free rate;
- (e) the assertion that final salary is strongly correlated with asset returns implies that final salary will tend to decrease if asset prices fall, yet experience shows that salaries tend not to decline;
- (f) the notion that equities are not risky in the long term, and the associated notion of long-term value, are based on the fallacious view that the market always bounces back after a crash. Shareholders do not get credit in the market for any additional long-term value if they sell their shares today.

Even if some correlation exists over long periods, benefits must be paid as they become due. An entity that funds its obligations with equity securities runs the risk that equity prices may be down when benefits must be paid. Also, the hypothesis that the real return on equities is uncorrelated with inflation does not mean that equities offer a risk-free return, even in the long term; and

- (g) the expected long-term rate of return on an appropriate portfolio cannot be determined sufficiently objectively in practice to provide an adequate basis for an accounting standard. The practical difficulties include specifying the characteristics of the appropriate portfolio, selecting the time horizon for estimating returns on the portfolio and estimating those returns.

BC31 The Board has not identified clear evidence that the expected return on an appropriate portfolio of assets provides a relevant and reliable indication of the risks associated with a defined benefit obligation, or that such a rate can be determined with reasonable objectivity. Therefore, the Board decided that the discount rate should reflect the time value of money but should not attempt to capture those risks. Furthermore, the discount rate should not reflect the entity's own credit rating, as otherwise an entity with a lower credit rating would recognise a smaller liability. The rate that best achieves these objectives is the yield on high quality corporate bonds. In countries where there is no deep market in such bonds, the yield on government bonds should be used.

BC32 Another issue is whether the discount rate should be the long-term average rate, based on past experience over a number of years, or the current market yield at the balance sheet date for an obligation of the appropriate term. Those who support a long-term average rate argue that:

- (a) a long-term approach is consistent with the transaction-based historical cost approach that is either required or permitted in other International Accounting Standards;
- (b) point in time estimates pursue a level of precision that is not attainable in practice and lead to volatility in reported profit that may not be a faithful representation of changes in the obligation but may simply reflect an unavoidable inability to predict accurately the future events that are anticipated in making period-to-period measures;
- (c) for an obligation based on final salary, neither market annuity prices nor simulation by discounting expected future cash flows can determine an unambiguous annuity price; and
- (d) over the long term, a suitable portfolio of plan assets may provide a reasonably effective hedge against an employee benefit obligation that increases in line with salary growth. However, there is much less assurance that, at a given measurement date, market interest rates will match the salary growth built into the obligation.

BC33 The Board decided that the discount rate should be determined by reference to market yields at the balance sheet date as:

- (a) there is no rational basis for expecting efficient market prices to drift towards any assumed long-term average, because prices in a market of

sufficient liquidity and depth incorporate all publicly available information and are more relevant and reliable than an estimate of long-term trends by any individual market participant;

- (b) the cost of benefits attributed to service during the current period should reflect prices of that period;
- (c) if expected future benefits are defined in terms of projected future salaries that reflect current estimates of future inflation rates, the discount rate should be based on current market interest rates (in nominal terms), as these also reflect current market expectations of inflation rates; and
- (d) if plan assets are measured at a current value (ie fair value), the related obligation should be discounted at a current discount rate in order to avoid introducing irrelevant volatility through a difference in the measurement basis.

BC34 The reference to market yields at the balance sheet date does not mean that short-term discount rates should be used to discount long-term obligations. The new IAS 19 requires that the discount rate should reflect market yields (at the balance sheet date) on bonds with an expected term consistent with the expected term of the obligations.

Actuarial assumptions: salaries, benefits and medical costs (paragraphs 83–91 of the Standard)

BC35 Some argue that estimates of future increases in salaries, benefits and medical costs should not affect the measurement of assets and liabilities until they are granted, on the grounds that:

- (a) future increases are future events; and
- (b) such estimates are too subjective.

BC36 The Board believes that the assumptions are used not to determine whether an obligation exists, but to measure an existing obligation on a basis which provides the most relevant measure of the estimated outflow of resources. If no increase is assumed, this is an implicit assumption that no change will occur and it would be misleading to assume no change if an entity expects a change. The new IAS 19 maintains the existing requirement that measurement should take account of estimated future salary increases. The Board also believes that increases in future medical costs can be estimated with sufficient reliability to justify incorporation of those estimated increases in the measurement of the obligation.

BC37 E54 proposed that measurement should also assume future benefit increases if there is reliable evidence that those benefit increases will occur. In response to comments, the Board concluded that future benefit increases do not give rise to a present obligation and that there would be no reliable or objective way of deciding which future benefit increases were reliable enough to be incorporated in actuarial assumptions. Therefore, the new IAS 19 requires that future benefit increases should be assumed only if they are set out in the terms of the plan (or result from any constructive obligation that goes beyond the formal terms) at the balance sheet date.

Actuarial gains and losses (paragraphs 92–95 of the Standard)

BC38 The Board considered five methods of accounting for actuarial gains and losses:

- (a) deferred recognition in both the balance sheet and the income statement over the average expected remaining working life of the employees concerned (see paragraph BC39 below);
- (b) immediate recognition both in the balance sheet and outside the income statement in equity (IAS 1 *Presentation of Financial Statements* sets out requirements for the presentation or disclosure of such movements in equity)* (see paragraphs BC40 and BC41 below);
- (c) a ‘corridor’ approach, with immediate recognition in both the balance sheet and the income statement for amounts falling outside a ‘corridor’ (see paragraph BC42 below);
- (d) a modified ‘corridor’ approach with deferred recognition of items within the ‘corridor’ and immediate recognition for amounts falling outside the ‘corridor’ (see paragraph BC43 below); and
- (e) deferred recognition for amounts falling outside a ‘corridor’ (see paragraphs BC44–BC46 below).

BC39 The old IAS 19 required a deferred recognition approach: actuarial gains and losses were recognised as an expense or as income systematically over the expected remaining working lives of those employees. Arguments for this approach are that:

- (a) immediate recognition (even when reduced by a ‘corridor’) can cause volatile fluctuations in liability and expense and implies a degree of accuracy which can rarely apply in practice. This volatility may not be a faithful representation of changes in the obligation but may simply reflect an unavoidable inability to predict accurately the future events that are anticipated in making period-to-period measures; and
- (b) in the long term, actuarial gains and losses may offset one another. Actuarial assumptions are projected over many years, for example, until the expected date of death of the last pensioner, and are, accordingly, long-term in nature. Departures from the assumptions do not normally denote definite changes in the underlying assets or liability, but are indicators which, if not reversed, may accumulate to denote such changes in the future. They are not a gain or loss of the period but a fine tuning of the cost that emerges over the long term; and
- (c) the immediate recognition of actuarial gains and losses in the income statement would cause unacceptable volatility.

* IAS 1 (as revised in 2007) requires non-owner transactions to be presented separately from owner transactions in a statement of comprehensive income.

BC40 Arguments for an immediate recognition approach are that:

- (a) deferred recognition and 'corridor' approaches are complex, artificial and difficult to understand. They add to cost by requiring entities to keep complex records. They also require complex provisions to deal with curtailments, settlements and transitional matters. Also, as such approaches are not used for other uncertain assets and liabilities, it is not clear why they should be used for post-employment benefits;
- (b) it requires less disclosure because all actuarial gains and losses are recognised;
- (c) it represents faithfully the entity's financial position. An entity will report an asset only when a plan is in surplus and a liability only when a plan has a deficit. Paragraph 95 of the *Framework* notes that the application of the matching concept does not allow the recognition of items in the balance sheet which do not meet the definition of assets or liabilities. Deferred actuarial losses do not represent future benefits and hence do not meet the *Framework's* definition of an asset, even if offset against a related liability. Similarly, deferred actuarial gains do not meet the *Framework's* definition of a liability;
- (d) the balance sheet treatment is consistent with the proposals in the Financial Instruments Steering Committee's March 1997 Discussion Paper *Accounting for Financial Assets and Liabilities*;
- (e) it generates income and expense items that are not arbitrary and that have information content;
- (f) it is not reasonable to assume that all actuarial gains or losses will be offset in future years; on the contrary, if the original actuarial assumptions are still valid, future fluctuations will, on average, offset each other and thus will not offset past fluctuations;
- (g) deferred recognition attempts to avoid volatility. However, a financial measure should be volatile if it purports to represent faithfully transactions and other events that are themselves volatile. Moreover, concerns about volatility could be addressed adequately by using a second performance statement or a statement of changes in equity;
- (h) immediate recognition is consistent with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. Under IAS 8, the effect of changes in accounting estimates should be included in profit or loss for the period if the change affects the current period only but not future periods. Actuarial gains and losses are not an estimate of future events, but result from events before the balance sheet date that resolve a past estimate (experience adjustments) or from changes in the estimated cost of employee service before the balance sheet date (changes in actuarial assumptions);

- (i) any amortisation period (or the width of a 'corridor') is arbitrary. In addition, the amount of benefit remaining at a subsequent date is not objectively determinable and this makes it difficult to carry out an impairment test on any expense that is deferred; and
- (j) in some cases, even supporters of amortisation or the 'corridor' may prefer immediate recognition. One possible example is where plan assets are stolen. Another possible example is a major change in the basis of taxing pension plans (such as the abolition of dividend tax credits for UK pension plans in 1997). However, although there might be agreement on extreme cases, it would prove very difficult to develop objective and non-arbitrary criteria for identifying such cases.

BC41 The Board found the immediate recognition approach attractive. However, the Board believes that it is not feasible to use this approach for actuarial gains and losses until the Board resolves substantial issues about performance reporting. These issues include:

- (a) whether financial performance includes those items that are recognised directly in equity;
- (b) the conceptual basis for determining whether items are recognised in the income statement or directly in equity;
- (c) whether net cumulative actuarial losses should be recognised in the income statement, rather than directly in equity; and
- (d) whether certain items reported initially in equity should subsequently be reported in the income statement ('recycling').

When the Board makes further progress with those issues, it may decide to revisit the treatment of actuarial gains and losses.

BC42 E54 proposed a 'corridor approach'. Under this approach, an entity does not recognise actuarial gains and losses to the extent that the cumulative unrecognised amounts do not exceed 10% of the present value of the obligation (or, if greater, 10% of the fair value of plan assets). Arguments for such approaches are that they:

- (a) acknowledge that estimates of post-employment benefit obligations are best viewed as a range around the best estimate. As long as any new best estimate of the liability stays within that range, it would be difficult to say that the liability has really changed. However, once the new best estimate moves outside that range, it is not reasonable to assume that actuarial gains or losses will be offset in future years. If the original actuarial assumptions are still valid, future fluctuations will, on average, offset each other and thus will not offset past fluctuations;
- (b) are easy to understand, do not require entities to keep complex records and do not require complex provisions to deal with settlements, curtailments and transitional matters;

- (c) result in the recognition of an actuarial loss only when the liability (net of plan assets) has increased in the current period and an actuarial gain only when the (net) liability has decreased. By contrast, amortisation methods sometimes result in the recognition of an actuarial loss even if the (net) liability is unchanged or has decreased in the current period, or an actuarial gain even if the (net) liability is unchanged or has increased;
 - (d) represent faithfully transactions and other events that are themselves volatile. Paragraph 34 of the *Framework* notes that it may be relevant to recognise items and to disclose the risk of error surrounding their recognition and measurement despite inherent difficulties either in identifying the transactions and other events to be measured or in devising and applying measurement and presentation techniques that can convey messages that correspond with those transactions and events; and
 - (e) are consistent with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. Under IAS 8, the effect of changes in accounting estimates is included in profit or loss for the period if the change affects the current period only but not future periods. Actuarial gains and losses are not an estimate of future events, but arise from events before the balance sheet date that resolve a past estimate (experience adjustments) or from changes in the estimated cost of employee service before the balance sheet date (changes in actuarial assumptions).
- BC43 Some commentators on E54 argued that an entity should, over a period, recognise actuarial gains and losses within the 'corridor'. Otherwise, certain gains and losses would be deferred permanently, even though it would be more appropriate to recognise them (for example, to recognise gains and losses that persist for a number of years without reversal or to avoid a cumulative effect on the income statement where the net liability returns ultimately to the original level). However, the Board concluded that such a requirement would add complexity for little benefit.
- BC44 The 'corridor' approach was supported by fewer than a quarter of the commentators on E54. In particular, the vast majority of preparers argued that the resulting volatility would not be a realistic portrayal of the long-term nature of post-employment benefit obligations. The Board concluded that there was not sufficient support from its constituents for such a significant change in current practice.
- BC45 Approximately one third of the commentators on E54 supported the deferred recognition approach. Approximately another third of the respondents proposed a version of the corridor approach which applies deferred recognition to amounts falling outside the corridor. It results in less volatility than the corridor alone or deferred recognition alone. In the absence of any compelling conceptual reasons for choosing between these two approaches, the Board concluded that the latter approach would be a pragmatic means of avoiding a level of volatility that many of its constituents consider to be unrealistic.

BC46 In approving the final Standard, the Board decided to specify the minimum amount of actuarial gains or losses to be recognised, but permit any systematic method of faster recognition, provided that the same basis is applied to both gains and losses and the basis is applied consistently from period to period. The Board was persuaded by the following arguments:

- (a) both the extent of volatility reduction and the mechanism adopted to effect it are essentially practical issues. From a conceptual point of view, the Board found the immediate recognition approach attractive. Therefore, the Board saw no reason to preclude entities from adopting faster methods of recognising actuarial gains and losses. In particular, the Board did not wish to discourage entities from adopting a consistent policy of recognising all actuarial gains and losses immediately. Similarly, the Board did not wish to discourage national standard-setters from requiring immediate recognition; and
- (b) where mechanisms are in place to reduce volatility, the amount of actuarial gains and losses recognised during the period is largely arbitrary and has little information content. Also, the new IAS 19 requires an entity to disclose both the recognised and unrecognised amounts. Therefore, although there is some loss of comparability in allowing entities to use different mechanisms, the needs of users are not likely to be compromised if faster (and systematic) recognition methods are permitted.

BC47 The Board noted that changes in the fair value of any plan assets are, in effect, the results of changing estimates by market participants and are, therefore, inextricably linked with changes in the present value of the obligation. Consequently, the Board decided that changes in the fair value of plan assets are actuarial gains and losses and should be treated in the same way as the changes in the related obligation.

BC48 The width of a 'corridor' (ie the point at which it becomes necessary to recognise gains and losses) is arbitrary. To enhance comparability, the Board decided that the width of the 'corridor' should be consistent with the current requirement in those countries that have already adopted a 'corridor' approach, notably the USA. The Board noted that a significantly narrower 'corridor' would suffer from the disadvantages of the 'corridor', without being large enough to generate the advantages. On the other hand, a significantly wider 'corridor' would lack credibility.

An additional option for the recognition of actuarial gains and losses: amendment adopted by the IASB in December 2004

BC48A In 2004 the IASB published an exposure draft proposing an additional option for the recognition of actuarial gains and losses. The proposed option allowed an entity that recognised actuarial gains and losses in full in the period in which they occurred to recognise them outside profit or loss in a statement of recognised income and expense.

- BC48B The argument for immediate recognition of actuarial gains and losses is that they are economic events of the period. Recognising them when they occur provides a faithful representation of those events. It also results in a faithful representation of the plan in the balance sheet. In contrast, when recognition is deferred, the information provided is partial and potentially misleading. Furthermore, any net cumulative deferred actuarial losses can give rise to a debit item in the balance sheet that does not meet the definition of an asset. Similarly, any net cumulative deferred actuarial gains can give rise to a credit item in the balance sheet that does not meet the definition of a liability.
- BC48C The arguments put forward for deferred recognition of actuarial gains and losses are, as noted above:
- (a) immediate recognition can cause volatile fluctuations in the balance sheet and income statement. It implies a degree of accuracy of measurement that rarely applies in practice. As a result, the volatility may not be a faithful representation of changes in the defined benefit asset or liability, but may simply reflect an unavoidable inability to predict accurately the future events that are anticipated in making period-to-period measurements.
 - (b) in the long term, actuarial gains and losses may offset one another.
 - (c) whether or not the volatility resulting from immediate recognition reflects economic events of the period, it is too great to be acceptable in the financial statements. It could overwhelm the profit or loss and financial position of other business operations.
- BC48D The IASB does not accept arguments (a) and (b) as reasons for deferred recognition. It believes that the defined benefit asset or liability can be measured with sufficient reliability to justify its recognition. Recognition in a transparent manner of the current best estimate of the events of the period and the resulting asset and liability provides better information than non-recognition of an arbitrary amount of that current best estimate. Further, it is not reasonable to assume that existing actuarial gains and losses will be offset in future years. This implies an ability to predict future market prices.
- BC48E The IASB also does not accept argument (c) in relation to the balance sheet. If the post-employment benefit amounts are large and volatile, the post-employment plan must be large and risky compared with other business operations. However, the IASB accepts that requiring actuarial gains and losses to be recognised in full in profit or loss in the period in which they occur is not appropriate at this time because the IASB has yet to develop fully the appropriate presentation of profit or loss and other items of recognised income and expense.
- BC48F The IASB noted that the UK standard FRS 17 *Retirement Benefits* requires recognition of actuarial gains and losses in full as they occur outside profit or loss in a statement of total recognised gains and losses.
- BC48G The IASB does not believe that immediate recognition of actuarial gains and losses outside profit or loss is necessarily ideal. However, it provides more transparent information than deferred recognition. The IASB therefore decided to propose such an option pending further developments on the presentation of profit or loss and other items of recognised income and expense.

IAS 19 BC

- BC48H IAS 1 (as revised in 2003) requires income and expense recognised outside profit or loss to be presented in a statement of changes in equity.* The statement of changes in equity must present the total income and expense for the period, being the profit or loss for the period and each item of income and expense for the period that, as required or permitted by other IFRSs, is recognised directly in equity. IAS 1 also permits these items, together with the effect of changes in accounting policies and the correction of errors, to be the only items shown in the statement of changes in equity.
- BC48I To emphasise its view that actuarial gains and losses are items of income or expense, the IASB decided that actuarial gains and losses that are recognised outside profit or loss must be presented in the form of a statement of changes in equity that excludes transactions with equity holders acting in their capacity as equity holders. The IASB decided that this statement should be titled 'the statement of recognised income and expense'.
- BC48J The responses from the UK to the exposure draft strongly supported the proposed option. The responses from outside the UK were divided. The main concerns expressed were:
- (a) the option is not a conceptual improvement compared with immediate recognition of actuarial gains and losses in profit or loss.
 - (b) the option prejudices issues relating to IAS 1 that should be resolved in the project on reporting comprehensive income.
 - (c) adding options to Standards is not desirable and obstructs comparability.
 - (d) the IASB should not tinker with IAS 19 before undertaking a comprehensive review of the Standard.
 - (e) the option could lead to divergence from US GAAP.
 - (f) deferred recognition is preferable to immediate recognition.
- BC48K The IASB agrees that actuarial gains and losses are items of income and expense. However, it believes that it would be premature to require their immediate recognition in profit or loss before a comprehensive review of both accounting for post-employment benefits and reporting comprehensive income. The requirement that actuarial gains and losses that are recognised outside profit or loss must be recognised in a statement of recognised income and expense does not prejudice any of the discussions the IASB is yet to have on reporting comprehensive income. Rather, the IASB is allowing an accounting treatment currently accepted by a national standard-setter (the UK ASB) to continue, pending the comprehensive review of accounting for post-employment benefits and reporting comprehensive income.
- BC48L The IASB also agrees that adding options to Standards is generally undesirable because of the resulting lack of comparability between entities. However, IAS 19 permits an entity to choose *any* systematic method of recognition for actuarial gains and losses that results in faster recognition than the minimum required by

* IAS 1 *Presentation of Financial Statements* (as revised in 2007) requires non-owner transactions to be presented separately from owner transactions in a statement of comprehensive income.

the Standard. Furthermore, the amount to be recognised under any deferral method will depend on when that method was first applied, ie when an entity first adopted IAS 19 or started a defined benefit plan. There is, therefore, little or no comparability because of the existing options in IAS 19.

- BC48M The IASB further agrees that a fundamental review of accounting for post-employment benefits is needed. However, such a review is likely to take some time to complete. In the meantime, the IASB believes that it would be wrong to prohibit a method of recognising actuarial gains and losses that is accepted by a national standard-setter and provides more transparent information about the costs and risks of running a defined benefit plan.
- BC48N The IASB agrees that the new option could lead to divergence from US GAAP. However, although IAS 19 and US GAAP share the same basic approach, they differ in several respects. The IASB has decided not to address these issues now. Furthermore, the option is just that. No entity is obliged to create such divergence.
- BC48O Lastly, as discussed above, the IASB does not agree that deferred recognition is better than immediate recognition of actuarial gains and losses. The amounts recognised under a deferral method are opaque and not representationally faithful, and the inclusion of deferral methods creates a complex difficult standard.
- BC48P The IASB considered whether actuarial gains and losses that have been recognised outside profit or loss should be recognised in profit or loss in a later period (ie recycled). The IASB noted that there is not a consistent policy on recycling in IFRSs and that recycling in general is an issue to be resolved in its project on reporting comprehensive income. Furthermore, it is difficult to see a rational basis on which actuarial gains and losses could be recycled. The exposure draft therefore proposed prohibiting recycling of actuarial gains and losses that have been recognised in the statement of recognised income and expense.
- BC48Q Most respondents supported not recycling actuarial gains and losses. However, many argued in favour of recycling, for the following reasons:
- (a) all income and expense should be recognised in profit or loss at some time.
 - (b) a ban on recycling is a new approach in IFRSs and should not be introduced before a fundamental review of reporting comprehensive income.
 - (c) to ban recycling could encourage abuse in setting over-optimistic actuarial assumptions.
- BC48R The IASB notes that most items under IFRSs that are recognised outside profit or loss are recycled, but not all. Revaluation gains and losses on property, plant and equipment and intangibles are not recycled. The question of recycling therefore remains open in IFRSs. The IASB does not believe that a general decision on the matter should be made in the context of these amendments. The decision in these amendments not to recycle actuarial gains and losses is made because of the pragmatic inability to identify a suitable basis and does not prejudice the wider debate that will take place in the project on reporting comprehensive income.

IAS 19 BC

- BC48S In the meantime, the IASB acknowledges the concern of some respondents that some items of income or expense will not be recognised in profit or loss in any period. The IASB has therefore required disclosure of the cumulative amounts recognised in the statement of recognised income and expense so that users of the financial statements can assess the effect of this policy.
- BC48T The IASB also notes the argument that to ban recycling could lead to abuse in setting over-optimistic assumptions. A lower cost could be recognised in profit or loss with resulting experience losses being recognised in the statement of recognised income and expense. Some of the new disclosures help to counter such concerns, for example, the narrative description of the basis for the expected rate of return and the five-year history of experience gains and losses. The IASB also notes that under a deferred recognition approach, if over-optimistic assumptions are used, a lower cost is recognised immediately in profit or loss and the resulting experience losses are recognised only gradually over the next 10–15 years. The incentive for such abuse is just as great under deferred recognition as it is under immediate recognition outside profit or loss.
- BC48U The IASB also considered whether actuarial gains and losses recognised outside profit or loss should be recognised immediately in a separate component of equity and transferred to retained earnings at a later period. Again the IASB concluded that there is no rational basis for a transfer to retained earnings in later periods. Hence, the exposure draft proposed that actuarial gains and losses that are recognised outside profit or loss should be recognised in retained earnings immediately.
- BC48V A small majority of the respondents supported this proposal. The arguments put forward against immediate recognition in retained earnings were:
- (a) the IASB should not set requirements on the component of equity in which items should be recognised before a fundamental review of the issue.
 - (b) retained earnings should be the cumulative total of profit or loss less amounts distributed to owners.
 - (c) the volatility of the amounts means that separate presentation would be helpful.
 - (d) the impact on distributions needs to be considered.
 - (e) actuarial gains and losses are temporary in nature and hence should be excluded from retained earnings.
- BC48W In IFRSs, the phrase 'retained earnings' is not defined and the IASB has not discussed what it should mean. In particular, retained earnings is not defined as the cumulative total of profit or loss less amounts distributed to owners. As with recycling, practice varies under IFRSs. Some amounts that are recognised outside profit or loss are required to be presented in a separate component of equity, for example exchange gains and losses on foreign subsidiaries. Other such amounts are not, for example gains and losses on available-for-sale financial assets.
- BC48X The IASB does not believe that it is appropriate to introduce a definition of retained earnings in the context of these amendments to IAS 19. The proposal in the exposure draft was based on practical considerations. As with recycling, there is no rational basis for transferring actuarial gains and losses from a separate

component in equity into retained earnings at a later date. As discussed above, the IASB has added a requirement to disclose the cumulative amount recognised in the statement of recognised income and expense to provide users with further information.

BC48Y Consideration of the implications of IFRSs on the ability of an entity to make distributions to equity holders is not within the IASB's remit. In addition, the IASB does not agree that even if actuarial gains and losses were temporary in nature this would justify excluding them from retained earnings.

BC48Z Finally, the IASB considered whether, if actuarial gains and losses are recognised when they occur, entities should be required to present separately in retained earnings an amount equal to the defined benefit asset or liability. Such a presentation is required by FRS 17. The IASB noted that such a presentation is not required by IFRSs for any other item, however significant its size or volatility, and that entities can provide the information if they wish. The IASB therefore decided not to require such a presentation.

BC48AA IAS 19 limits the amount of a surplus that can be recognised as an asset ('the asset ceiling') to the present value of any economic benefits available to an entity in the form of refunds from the plan or reductions in future contributions to the plan.* The IASB considered whether the effect of this limit should be recognised outside profit or loss, if that is the entity's accounting policy for actuarial gains and losses, or treated as an adjustment of the other components of the defined benefit cost and recognised in profit or loss.

BC48BB The IASB decided that the effect of the limit is similar to an actuarial gain or loss because it arises from a remeasurement of the benefits available to an entity from a surplus in the plan. The IASB therefore concluded that, if the entity's accounting policy is to recognise actuarial gains and losses as they occur outside profit or loss, the effect of the limit should also be recognised outside profit or loss in the statement of recognised income and expense.

BC48CC Most respondents supported this proposal. The arguments opposing the proposal were:

- (a) the adjustment arising from the asset ceiling is not necessarily caused by actuarial gains and losses and should not be treated in the same way.
- (b) it is not consistent with FRS 17, which allocates the change in the recoverable surplus to various events and hence to different components of the defined benefit cost.

BC48DD The IASB agrees that the adjustment from the asset ceiling is not necessarily caused by actuarial gains and losses. The asset ceiling effectively imposes a different measurement basis for the asset to be recognised (present value of refunds and reductions in future contributions) from that used to derive the actuarial gains and losses and other components of the defined benefit cost (fair value of plan assets less projected unit credit value of plan liabilities). Changes in the recognised asset arise from changes in the present value of refunds and reductions in future contributions. Such changes can be caused by events of the same type as those that cause actuarial gains and losses, for example

* The limit also includes unrecognised actuarial gains and losses and past service costs.

changes in interest rates or assumptions about longevity, or by events that do not cause actuarial gains and losses, for example trustees agreeing to a refund in exchange for benefit enhancements or a management decision to curtail the plan.

BC48EE Because the asset ceiling imposes a different measurement basis for the asset to be recognised, the IASB does not believe it is possible to allocate the effect of the asset ceiling to the components of the defined benefit cost other than on an arbitrary basis. The IASB reaffirmed its view that the adjustment arising from the asset ceiling should, therefore, be regarded as a remeasurement and similar to an actuarial gain or loss. This treatment also has the advantages of (a) being simple and (b) giving transparent information because the cost of the defined benefit promise (ie the service costs and interest cost) remains unaffected by the funding of the plan.

Past service cost (paragraphs 96–101 of the Standard)

BC49 E54 included two alternative treatments for past service cost. The first approach was similar to that used in the old IAS 19 (amortisation for current employees and immediate recognition for former employees). The second approach was immediate recognition of all past service cost.

BC50 Those who support the first approach argue that:

- (a) an entity introduces or improves employee benefits for current employees in order to generate future economic benefits in the form of reduced employee turnover, improved productivity, reduced demands for increases in cash compensation and improved prospects for attracting additional qualified employees;
- (b) although it may not be feasible to improve benefits for current employees without also improving benefits for former employees, it would be impracticable to assess the resulting economic benefits for an entity and the period over which those benefits will flow to the entity; and
- (c) immediate recognition is too revolutionary. It would also have undesirable social consequences because it would deter companies from improving benefits.

BC51 Those who support immediate recognition of all past service cost argue that:

- (a) amortisation of past service cost is inconsistent with the view of employee benefits as an exchange between an entity and its employees for services rendered: past service cost relates to past events and affects the employer's present obligation arising from employees' past service. Although an entity may improve benefits in the expectation of future benefits, an obligation exists and should be recognised;
- (b) deferred recognition of the liability reduces comparability; an entity that retrospectively improves benefits relating to past service will report lower liabilities than an entity that granted identical benefits at an earlier date, yet both have identical benefit obligations. Also, deferred recognition encourages entities to increase pensions instead of salaries;

- (c) past service cost does not give an entity control over a resource and thus does not meet the *Framework's* definition of an asset. Therefore, it is not appropriate to defer recognition of the expense; and
 - (d) there is not likely to be a close relationship between cost—the only available measure of the effect of the amendment—and any related benefits in the form of increased loyalty.
- BC52 Under the old IAS 19, past service cost for current employees was recognised as an expense systematically over the expected remaining working lives of the employees concerned. Similarly, under the first approach set out in E54, past service cost was to be amortised over the average expected remaining working lives of the employees concerned. However, E54 also proposed that the attribution period for current service cost should end when the employee's entitlement to receive all significant benefits due under the plan is no longer conditional on further service. Some commentators on E54 felt that these two provisions were inconsistent.
- BC53 In the light of comments received, the Board concluded that past service cost should be amortised over the average period until the amended benefits become vested, because:
- (a) once the benefits become vested, there is clearly a liability that should be recognised; and
 - (b) although non-vested benefits give rise to an obligation, any method of attributing non-vested benefits to individual periods is essentially arbitrary. In determining how that obligation builds up, no single method is demonstrably superior to all others.
- BC54 Some argue that a 'corridor' approach should be used for past service cost because the use of a different accounting treatment for past service cost than for actuarial gains and losses may create an opportunity for accounting arbitrage. However, the purpose of the 'corridor' is to deal with the inevitable imprecision in the measurement of defined benefit obligations. Past service cost results from a management decision, rather than inherent measurement uncertainty. Consequently, the Board rejected the 'corridor' approach for past service cost.
- BC55 The Board rejected proposals that:
- (a) past service cost should (as under the old IAS 19) be recognised over a shorter period where plan amendments provide an entity with economic benefits over that shorter period: for example, when plan amendments were made regularly, the old IAS 19 stated that the additional cost may be recognised as an expense or income systematically over the period to the next expected plan amendment. The Board believes that the actuarial assumptions should allow for such regular plan amendments and that subsequent differences between the assumed increase and the actual increase are actuarial gains or losses, not a past service cost;
 - (b) past service cost should be recognised over the remaining life expectancy of the participants if all or most plan participants are inactive. The Board believes that it is not clear that the past service cost will lead to economic benefits to the entity over that period; and

IAS 19 BC

- (c) even if past service cost is generally recognised on a delayed basis, past service cost should not be recognised immediately if the past service cost results from legislative changes (such as a new requirement to equalise retirement ages for men and women) or from decisions by trustees who are not controlled, or influenced, by the entity's management. The Board decided that such a distinction would not be practicable.

BC56 The old IAS 19 did not specify the basis upon which an entity should amortise the unrecognised balance of past service cost. The Board agreed that any amortisation method is arbitrary and decided to require straight-line amortisation, as that is the simplest method to apply and understand. To enhance comparability, the Board decided to require a single method and not to permit alternative methods, such as methods that assign:

- (a) an equal amount of past service cost to each expected year of employee service; or
- (b) past service cost to each period in proportion to estimated total salaries in that period.

Paragraph 99 confirms that the amortisation schedule is not amended for subsequent changes in the average remaining working life, unless there is a curtailment or settlement.

BC57 Unlike the old IAS 19, the new IAS 19 treats past service cost for current employees differently from actuarial gains. This means that some benefit improvements may be funded out of actuarial gains that have not yet been recognised in the financial statements. Some argue that the resulting past service cost should not be recognised because:

- (a) the cost of the improvements does not meet the *Framework's* definition of an expense, as there is no outflow or depletion of any asset which was previously recognised in the balance sheet; and
- (b) in some cases, benefit improvements may have been granted only because of actuarial gains.

The Board decided to require the same accounting treatment for all past service cost (ie recognise over the average period until the amended benefits become vested) whether or not they are funded out of an actuarial gain that is already recognised in the entity's balance sheet.

BC58 Some commentators on E54 argued that the recognition of actuarial gains should be limited if there is unamortised past service cost. The Board rejected this proposal because it would introduce additional complexity for limited benefit. Other commentators would prohibit the recognition of actuarial gains that are earmarked for future benefit improvements. However, the Board believes that if such earmarking is set out in the formal (or constructive) terms of the plan, the benefit improvements should be included in the actuarial assumptions. In other cases, there is insufficient linkage between the actuarial gains and the benefit improvements to justify an exceptional treatment.

- BC59 The old IAS 19 did not specify the balance sheet treatment for past service cost. Some argue that an entity should recognise past service cost immediately both as an addition to the liability and as an asset (prepaid expense) on the grounds that deferred recognition of the liability offsets a liability against an asset (unamortised past service cost) that cannot be used to settle the liability. However, the Board decided that an entity should recognise past service cost for current employees as an addition to the liability gradually over a period, because:
- (a) past service cost does not give an entity control over a resource and thus does not meet the *Framework*'s definition of an asset;
 - (b) separate presentation of a liability and a prepaid expense may confuse users; and
 - (c) although non-vested benefits give rise to an obligation, any method of attributing non-vested benefits to individual periods is essentially arbitrary. In determining how that obligation builds up, no single method is demonstrably superior to all others.
- BC60 The old IAS 19 appeared to treat plan amendments that reduce benefits as negative past service cost (ie amortisation for current employees, immediate recognition for former employees). However, some argue that this results in the recognition of deferred income that conflicts with the *Framework*. They also argue that there is only an arbitrary distinction between amendments that should be treated in this way and curtailments or settlements. Therefore, E54 proposed that:
- (a) plan amendments are:
 - (i) a curtailment if the amendment reduces benefits for future service; and
 - (ii) a settlement if the amendment reduces benefits for past service; and
 - (b) any gain or loss on the curtailment or settlement should be recognised immediately when the curtailment or settlement occurs.
- BC61 Some commentators on E54 argued that such 'negative plan amendments' should be treated as negative past service cost by being recognised as deferred income and amortised into the income statement over the working lives of the employees concerned. The basis for this view is that 'negative' amendments reduce employee morale in the same way that 'positive' amendments increase morale. Also, a consistent treatment avoids the abuses that might occur if an entity could improve benefits in one period (and recognise the resulting expense over an extended period) and then reduce the benefits (and recognise the resulting income immediately). The Board agreed with this view. Therefore, the new IAS 19 treats both 'positive' and 'negative' plan amendments in the same way.
- BC62 The distinction between negative past service cost and curtailments would be important if:
- (a) a material amount of negative past service cost were amortised over a long period (this is unlikely, as the new IAS 19 requires that negative past service cost should be amortised until the time when those (reduced) benefits that relate to prior service are vested); or

- (b) unrecognised past service cost or actuarial gains exist. For a curtailment these would be recognised immediately, whereas they would not be affected directly by negative past service cost.

~~The Board believes that the distinction between negative past service cost and curtailments is unlikely to have any significant effect in practice and that any attempt to deal with exceptional cases would result in excessive complexity.~~

- BC62A In 2007 the IFRIC reported that practices differ for the recognition of gains or losses on plan amendments that reduce existing benefits, and that such differences in practices can lead to substantial differences in amounts that entities recognise in profit or loss. The IFRIC asked the IASB to clarify when entities should account for those plan amendments as a curtailment instead of as negative past service costs.
- BC62B As part of *Improvements to IFRSs* issued in May 2008, the IASB made the distinction between curtailments and negative past service costs clearer. In particular, the Board clarified how a reduction in the extent to which future salary increases are linked to the benefits payable for past service should be treated. The Board noted that an employee is entitled to future salary increases after the reporting date only as a result of future service. Therefore, if a change to a benefit plan affects the extent to which future salary increases after the reporting date are linked to benefits payable for past service, all of the effect of that change on the present value of the defined benefit obligation should be treated as a curtailment, not a negative past service cost. This is consistent with the treatment of a change related to future service.

Recognition and measurement: an additional minimum liability

- BC63 The Board considered whether it should require an entity to recognise an additional minimum liability where:
- (a) an entity's immediate obligation if it discontinued a plan at the balance sheet date would be greater than the present value of the liability that would otherwise be recognised in the balance sheet;
 - (b) vested post-employment benefits are payable at the date when an employee leaves the entity. Consequently, because of the effect of discounting, the present value of the vested benefit would be greater if an employee left immediately after the balance sheet date than if the employee completes the expected period of service; or
 - (c) the present value of vested benefits exceeds the amount of the liability that would otherwise be recognised in the balance sheet. This could occur where a large proportion of the benefits are fully vested and an entity has not recognised actuarial losses or past service cost.
- BC64 One example of a requirement for an entity to recognise an additional minimum liability is in the US Standard SFAS 87 *Employers' Accounting for Pensions*: the minimum liability is based on current salaries and excludes the effect of deferring certain past service cost and actuarial gains and losses. If the minimum

* Text deleted as a consequence of amendments by *Improvements to IFRSs* issued in May 2008.

liability exceeds the obligation measured on the normal projected salary basis (with deferred recognition of certain income and expense), the excess is recognised as an intangible asset (not exceeding the amount of any unamortised past service cost, with any further excess deducted directly from equity) and as an additional minimum liability.

- BC65 The Board believes that such additional measures of the liability are potentially confusing and do not provide relevant information. They would also conflict with the *Framework's* going concern assumption and with its definition of a liability. The new IAS 19 does not require the recognition of an additional minimum liability. Certain of the circumstances discussed in the preceding two paragraphs may give rise to contingent liabilities requiring disclosure under IAS 10 *Events after the Balance Sheet Date*.^{*}

Plan assets (paragraphs 102–107 of the Standard)

- BC66 The new IAS 19 requires explicitly that defined benefit obligations should be recognised as a liability after deducting plan assets (if any) out of which the obligations are to be settled directly (see paragraph 54 of the Standard). This is already widespread, and probably universal, practice. The Board believes that plan assets reduce (but do not extinguish) an entity's own obligation and result in a single, net liability. Although the presentation of that net liability as a single amount in the balance sheet differs conceptually from the offsetting of separate assets and liabilities, the Board decided in issuing IAS 19 in 1998 that the definition of plan assets should be consistent with the offsetting criteria in IAS 32 *Financial Instruments: Disclosure and Presentation*.[†] IAS 32 states that a financial asset and a financial liability should be offset and the net amount reported in the balance sheet when an entity:
- (a) has a legally enforceable right to set off the recognised amounts; and
 - (b) intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.
- BC67 IAS 19 (revised 1998) defined plan assets as assets (other than non-transferable financial instruments issued by the reporting entity) held by an entity (a fund) that satisfies all of the following conditions:
- (a) the entity is legally separate from the reporting entity;
 - (b) the assets of the fund are to be used only to settle the employee benefit obligations, are not available to the entity's own creditors and cannot be returned to the entity (or can be returned to the entity only if the remaining assets of the fund are sufficient to meet the plan's obligations); and
 - (c) to the extent that sufficient assets are in the fund, the entity will have no legal or constructive obligation to pay the related employee benefits directly.

^{*} In September 2007 the IASB amended the title of IAS 10 from *Events after the Balance Sheet Date* to *Events after the Reporting Period* as a consequence of the revision of IAS 1 *Presentation of Financial Statements* in 2007.

[†] In 2005 the IASB amended IAS 32 as *Financial Instruments: Presentation*.

- BC67A In issuing IAS 19 in 1998, the Board considered whether the definition of plan assets should include a fourth condition: that the entity does not control the fund. The Board concluded that control is not relevant in determining whether the assets in a fund reduce an entity's own obligation.
- BC68 In response to comments on E54, the Board decided to modify the definition of plan assets to exclude non-transferable financial instruments issued by the reporting entity. If this were not done, an entity could reduce its liabilities, and increase its equity, by issuing non-transferable equity instruments to a defined benefit plan.

Plan assets: revised definition adopted in 2000

- BC68A In 1999, the Board began a limited scope project to consider the accounting for assets held by a fund that satisfies parts (a) and (b) of the definition set out in paragraph BC67 above, but does not satisfy condition (c) because the entity retains a legal or constructive obligation to pay the benefits directly. IAS 19 (revised 1998) did not address assets held by such funds.
- BC68B The Board considered two main approaches to such funds:
- (a) a **net** approach – the entity recognises its entire obligation as a liability after deducting the fair value of the assets held by the fund; and
 - (b) a **gross** approach – the entity recognises its entire obligation as a liability and recognises its rights to a refund from the fund as a separate asset.
- BC68C Supporters of a net approach made one or more of the following arguments:
- (a) a gross presentation would be misleading, because:
 - (i) where conditions (a) and (b) of the definition in paragraph BC67 above are met, the entity does not control the assets held by the fund; and
 - (ii) even if the entity retains a legal obligation to pay the entire amount of the benefits directly, this legal obligation is a matter of form rather than substance;
 - (b) a gross presentation would be an unnecessary change from current practice, which generally permits a net presentation. It would introduce excessive complexity into the Standard, for limited benefit to users, given that paragraph 120A(c) already requires disclosure of the gross amounts;
 - (c) a gross approach may lead to measurement difficulties because of the interaction with the 10% corridor for the obligation.
 - (i) One possibility would be to measure the assets at fair value, with all changes in fair value recognised immediately. This might seem inconsistent with the treatment of plan assets, because changes in the fair value of plan assets are one component of the actuarial gains and losses to which the corridor is applied under IAS 19. In other words, this approach would deny entities the opportunity of offsetting gains and losses on the assets against gains and losses on the liability.
 - (ii) A second possibility would be to defer changes in the fair value of the assets to the extent that there are unrecognised actuarial gains and

losses on the obligations. However, the carrying amount of the assets would then have no easily describable meaning. It would probably also require complex and arbitrary rules to match the gains and losses on the assets with gains and losses on the obligation.

- (iii) A third possibility would be to measure the assets at fair value, but to aggregate the changes in fair value with actuarial gains and losses on the liability. In other words, the assets would be treated in the same way as plan assets, except the balance sheet presentation would be gross rather than net. However, this would mean that changes in the fair value of the assets could affect the measurement of the obligation; and
- (d) a net approach might be viewed as analogous to the treatment of joint and several liabilities under paragraph 29 of IAS 37. An entity recognises a provision for the part of the obligation for which an outflow of resources embodying economic benefits is probable. The part of the obligation that is expected to be met by other parties is treated as a contingent liability.

BC68D Supporters of a gross approach advocated that approach for one or more of the following reasons:

- (a) paragraph BC66 above gives an explanation for presenting defined benefit obligations net of plan assets. The explanation focuses on whether offsetting is appropriate. Part (c) of the 1998 definition focuses on offsetting. This suggests that assets that satisfy parts (a) and (b) of the definition, but fail part (c) of the definition, should be treated in the same way as plan assets for recognition and measurement purposes, but should be shown gross on the face of the balance sheet without offsetting;
- (b) if offsetting is allowed when condition (c) is not met, this would seem to be equivalent to permitting a net presentation for 'in-substance defeasance' and other analogous cases where IAS 32 indicates explicitly that offsetting is inappropriate. The Board has rejected 'in-substance defeasance' for financial instruments (see IAS 39 Application Guidance, paragraph AG59) and there is no obvious reason to permit it in accounting for defined benefit plans. In these cases the entity retains an obligation that should be recognised as a liability and the entity's right to reimbursement from the plan is a source of economic benefits that should be recognised as an asset. Offsetting would be permitted if the conditions in paragraph 3342 of IAS 32 are satisfied;
- (c) the Board decided in IAS 37 to require a gross presentation for reimbursements related to provisions, even though this was not previously general practice. There is no conceptual reason to require a different treatment for employee benefits;
- (d) although some consider that a gross approach requires an entity to recognise assets that it does not control, others believe that this view is incorrect. A gross approach requires the entity to recognise an asset representing its right to receive reimbursement from the fund that holds those assets. It does not require the entity to recognise the underlying assets of the fund;

- (e) in a plan with plan assets that meet the definition adopted in 1998, the employees' first claim is against the fund—they have no claim against the entity if sufficient assets are in the fund. In the view of some, the fact that employees must first claim against the fund is more than just a difference in form—it changes the substance of the obligation; and
- (f) defined benefit plans might be regarded under SIC-12 *Consolidation—Special Purpose Entities* as special purpose entities that the entity controls—and should consolidate. As the offsetting criterion in IAS 19 is consistent with offsetting criteria in other International Accounting Standards, it is relatively unimportant whether the pension plan is consolidated in cases where the obligation and the plan assets qualify for offset. If the assets are presented as a deduction from the related benefit obligations in cases where condition (c) is not met, it could become important to assess whether the entity should consolidate the plan.

BC68E Some argued that a net approach should be permitted when an entity retains an obligation to pay the entire amount of the benefits directly, but the obligation is considered unlikely to have any substantive effect in practice. The Board concluded that it would not be practicable to establish guidance of this kind that could be applied in a consistent manner.

BC68F The Board also considered the possibility of adopting a 'linked presentation' that UK Financial Reporting Standard FRS 5 *Reporting the Substance of Transactions*, requires for non-recourse finance. Under FRS 5, the face of the balance sheet presents both the gross amount of the asset and, as a direct deduction, the related non-recourse debt. Supporters of this approach argued that it portrays the close link between related assets and liabilities without compromising general offsetting requirements. Opponents of the linked presentation argued that it creates a form of balance sheet presentation that IASC has not used previously and may cause confusion. The Board decided not to adopt the linked presentation.

BC68G The Board concluded that a net presentation is justified where there are restrictions (including restrictions that apply on bankruptcy of the reporting entity) on the use of the assets so that the assets can be used only to pay or fund employee benefits. Accordingly, the Board decided to modify the definition of plan assets set out in paragraph BC67 above by:

- (a) emphasising that the creditors of the entity should not have access to the assets held by the fund, even on bankruptcy of the reporting entity; and
- (b) deleting condition (c), so that the existence of a legal or constructive obligation to pay the employee benefits directly does not preclude a net presentation, and modifying condition (b) to explicitly permit the fund to reimburse the entity for paying the long-term employee benefits.

- BC68H When an entity retains a direct obligation to the employees, the Board acknowledges that the net presentation is inconsistent with the derecognition requirements for financial instruments in IAS 39 and with the offsetting requirements in IAS 32. However, in the Board's view, the restrictions on the use of the assets create a sufficiently strong link with the employee benefit obligations that a net presentation is more relevant than a gross presentation, even if the entity retains a direct obligation to the employees.
- BC68I The Board believes that such restrictions are unique to employee benefit plans and does not intend to permit this net presentation for other liabilities if the conditions in IAS 32 and IAS 39 are not met. Accordingly, condition (a) in the new definition refers to the reason for the existence of the fund. The Board believes that an arbitrary restriction of this kind is the only practical way to permit a pragmatic exception to IASC's general offsetting criteria without permitting an unacceptable extension of this exception to other cases.
- BC68J In some plans that exist in some countries, an entity is entitled to receive a reimbursement of employee benefits from a separate fund but the entity has discretion to delay receipt of the reimbursement or to claim less than the full reimbursement. Some argue that this element of discretion weakens the link between the benefits and the reimbursement so much that a net presentation is not justifiable. They believe that the definition of plan assets should exclude assets held by such funds and that a gross approach should be used in such cases. The Board concluded that the link between the benefits and the reimbursement is strong enough in such cases that a net approach is still appropriate.
- BC68K The Board's proposal for extending the definition of plan assets was set out in Exposure Draft E67 *Pension Plan Assets*, published in July 2000. The vast majority of the 39 respondents to E67 supported the proposal.
- BC68L A number of respondents to E67 proposed a further extension of the definition to include certain insurance policies that have similar economic effects to funds whose assets qualify as plan assets under the revised definition proposed in E67. Accordingly, the Board decided to extend the definition of plan assets to include certain insurance policies (now described in IAS 19 as qualifying insurance policies) that satisfy the same conditions as other plan assets. These decisions were implemented in a revised IAS 19, approved by the Board in October 2000.

Plan assets: measurement

- BC69 The old IAS 19 stated that plan assets are valued at fair value, but did not define fair value. However, other International Accounting Standards define fair value as 'the amount for which an asset could be exchanged or a liability settled between knowledgeable, willing parties in an arm's length transaction'. This may imply that no deduction is made for the estimated costs necessary to sell the asset (in other words, it is a mid-market value, with no adjustment for transaction costs). However, some argue that a plan will eventually have to dispose of its assets in order to pay benefits. Therefore, the Board concluded in E54 that plan assets should be measured at market value. Market value was defined, as in IAS 25 *Accounting for Investments*,* as the amount obtainable from the sale of an asset in an active market.

* superseded by IAS 39 *Financial Instruments: Recognition and Measurement* and IAS 40 *Investment Property*.

IAS 19 BC

- BC70 Some commentators on E54 felt that the proposal to measure plan assets at market value would not be consistent with IAS 22 *Business Combinations** and with the measurement of financial assets as proposed in the discussion paper *Accounting for Financial Assets and Financial Liabilities* published by IASC's Financial Instruments Steering Committee in March 1997. Therefore, the Board decided that plan assets should be measured at fair value.
- BC71 Some argue that concerns about volatility in reported profit should be countered by permitting or requiring entities to measure plan assets at a market-related value that reflects changes in fair value over an arbitrary period, such as five years. The Board believes that the use of market-related values would add excessive and unnecessary complexity and that the combination of the 'corridor' approach to actuarial gains and losses with deferred recognition outside the 'corridor' is sufficient to deal with concerns about volatility.
- BC72 The old IAS 19 stated that, when fair values were estimated by discounting future cash flows, the long-term rate of return reflected the average rate of total income (interest, dividends and appreciation in value) expected to be earned on the plan assets during the time period until benefits are paid. It was not clear whether the old IAS 19 allowed a free choice between market values and discounted cash flows, or whether discounted cash flows could be used only when no market value was available. The Board decided that plan assets should be measured by techniques such as discounting expected future cash flows only when no market value is available.
- BC73 Some believe that plan assets should be measured on the following basis, which is required by IAS 25 *Accounting for Investments*:†
- (a) long-term investments are carried in the balance sheet at either cost, revalued amounts or, in the case of marketable equity securities, the lower of cost and market value determined on a portfolio basis. The carrying amount of a long-term investment is reduced to recognise a decline other than temporary in the value of the investment; and
 - (b) current investments are carried in the balance sheet at either market value or the lower of cost and market value.
- The Board rejected this basis because it is not consistent with the basis used for measuring the related obligations.
- BC74 The Board decided that there should not be a different basis for measuring investments that have a fixed redemption value and that match the obligations of the plan, or specific parts thereof. IAS 26 *Accounting and Reporting by Retirement Benefit Plans* permits such investments to be measured on an amortised cost basis.
- BC75 In response to comments on E54, the Board decided that all plan administration costs (not just investment administration costs, as proposed in E54), should be deducted in determining the return on plan assets. The IASB concluded that if the actuarial assumptions used to measure the defined benefit obligation include an allowance for plan administration costs, the deduction of such costs in calculating the return on plan assets would result in double-counting them.

* IAS 22 was withdrawn in 2004 and replaced by IFRS 3 *Business Combinations*.

† superseded by IAS 39 *Financial Instruments: Recognition and Measurement* and IAS 40 *Investment Property*.

Therefore, as part of *Improvements to IFRSs* issued in May 2008, the IASB amended the definition of the return on plan assets to require the deduction of plan administration costs only to the extent that such costs have not been reflected in the measurement of the defined benefit obligation.

Reimbursements (paragraphs 104A–104D of the Standard)

- BC75A Paragraph 41 of IAS 19 states that an entity recognises its rights under an insurance policy as an asset if the policy is held by the entity itself. IAS 19 (revised 1998) did not address the measurement of these insurance policies. The entity's rights under the insurance policy might be regarded as a financial asset. However, rights and obligations arising under insurance contracts are excluded from the scope of IAS 39 *Financial Instruments: Recognition and Measurement*. Also, IAS 39 does not apply to 'employers' ~~assets and liabilities~~ rights and obligations under employee benefit plans, to which IAS 19 *Employee Benefits* applies'. Paragraphs 39–42 of IAS 19 discuss insured benefits in distinguishing defined contribution plans and defined benefit plans, but this discussion does not deal with measurement.
- BC75B In reviewing the definition of plan assets (see paragraphs BC68A–BC68L above), the Board decided to review the treatment of insurance policies that an entity holds in order to fund employee benefits. Even under the revised definition adopted in 2000, the entity's rights under an insurance policy that is not a qualifying insurance policy (as defined in the 2000 revision to IAS 19) are not plan assets.
- BC75C In 2000, the Board decided to introduce recognition and measurement requirements for reimbursements under such insurance policies (see paragraphs 104A–104D). The Board based these requirements on the treatment of reimbursements under paragraphs 53–58 of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. In particular, the Standard requires an entity to recognise a right to reimbursement of post-employment benefits as a separate asset, rather than as a deduction from the related obligations. In all other respects (for example, the use of the 'corridor') the Standard requires an entity to treat such reimbursement rights in the same way as plan assets. This requirement reflects the close link between the reimbursement right and the related obligation.
- BC75D Paragraph 104 states that where plan assets include insurance policies that exactly match the amount and timing of some or all of the benefits payable under the plan, the plan's rights under those insurance policies are measured at the same amount as the related obligations. Paragraph 104D extends that conclusion to insurance policies that are assets of the entity itself.
- BC75E IAS 37 states that the amount recognised for the reimbursement should not exceed the amount of the provision. Paragraph 104A of the Standard contains no similar restriction, because the asset limit in paragraph 58 already applies to prevent the recognition of an asset that exceeds the available economic benefits.

Limit on the recognition of an asset (paragraphs 58–60 of the Standard)

BC76 In certain cases, paragraph 54 of the new IAS 19 would require an entity to recognise an asset. E54 proposed that the amount of the asset recognised should not exceed the aggregate of the present values of:

- (a) any refunds expected from the plan; and
- (b) any expected reduction in future contributions arising from the surplus.

In approving E54, the Board took the view that an entity should not recognise an asset at an amount that exceeds the present value of the future benefits that are expected to flow to the entity from that asset. This view is consistent with the Board's proposal that assets should not be carried at more than their recoverable amount (see E55 *Impairment of Assets*). The old IAS 19 contained no such restriction.

BC77 On reviewing the responses to E54, the Board concluded that the limit on the recognition of an asset should not over-ride the treatments of actuarial losses or past service cost in order not to defeat the purpose of these treatments. Consequently, the limit is likely to come into play only where:

- (a) an entity has chosen the transitional option to recognise the effect of adopting the new IAS 19 over up to five years, but has funded the obligation more quickly; or
- (b) the plan is very mature and has a very large surplus that is more than large enough to eliminate all future contributions and cannot be returned to the entity.

BC78 Some commentators argued that the limit in E54 was not operable because it would require an entity to make extremely subjective forecasts of expected refunds or reductions in contributions. In response to these comments, the Board agreed that the limit should reflect the available refunds or reductions in contributions.

Asset ceiling: amendment issued in May 2002

BC78A In May 2002 the Board issued an amendment to the limit on the recognition of an asset (the asset ceiling) in paragraph 58 of the Standard. The objective of the amendment was to prevent gains (losses) being recognised solely as a result of the deferred recognition of past service cost and actuarial losses (gains).

BC78B The asset ceiling is specified in paragraph 58 of IAS 19, which requires a defined benefit asset to be measured at the lower of:

- (a) the amount determined under paragraph 54; and
- (b) the total of:
 - (i) any cumulative unrecognised net actuarial losses and past service cost; and
 - (ii) the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan.

- BC78C The problem arises when an entity defers recognition of actuarial losses or past service cost in determining the amount specified in paragraph 54 but is required to measure the defined benefit asset at the net total specified in paragraph 58(b). Paragraph 58(b)(i) could result in the entity recognising an increased asset because of actuarial losses or past service cost in the period. The increase in the asset would be reported as a gain in income. Examples illustrating the issue are given in Appendix C.
- BC78D The Board agreed that recognising gains (losses) arising from past service cost and actuarial losses (gains) is not representationally faithful. Further, the Board holds the view that this issue demonstrates that IAS 19 can give rise to serious problems. The Board intends to undertake a comprehensive review of the aspects of IAS 19 that cause concern, including the interaction of the asset ceiling and the options to defer recognition of certain gains and losses. In the meantime, the Board regards as an improvement a limited amendment to prevent their interaction giving rise to unfaithful representations of events.
- BC78E Paragraph 58A, therefore, prevents gains (losses) from being recognised solely as a result of the deferred recognition of past service cost or actuarial losses (gains).
- BC78F Some Board members and respondents to the exposure draft of this amendment suggested that the issue be dealt with by removing paragraph 58(b)(i). Paragraph 58(b)(i) is the component of the asset ceiling that gives rise to the problem: losses that are unrecognised under paragraph 54 are added to the amount that can be recognised as an asset. However, deleting paragraph 58(b)(i) effectively removes the option of deferred recognition of actuarial losses for all entities that have a defined benefit asset. Removing this option would have wide reaching implications for the deferred recognition approach in IAS 19 that can be considered fully only within the context of the comprehensive review noted above.

Curtailments and settlements (paragraphs 109–115 of the Standard)

- BC79 Under the old IAS 19, curtailment and settlement **gains** were recognised when the curtailment or settlement **occurred**, but **losses** were recognised when it was **probable** that the curtailment or settlement would occur. The Board concluded that management's intent to curtail or settle a defined benefit plan is not a sufficient basis to recognise a loss. The new IAS 19 requires that curtailment and settlement losses, as well as gains, should be recognised when the curtailment or settlement occurs. The guidance on the recognition of curtailments and settlements has been conformed to the proposals in E59 *Provisions, Contingent Liabilities and Contingent Assets*.
- BC80 Under some national standards:
- (a) the gain or loss on a curtailment includes any unamortised past service cost (on the grounds that a curtailment eliminates the previously expected motivational effect of the benefit improvement), but excludes unrecognised actuarial gains or losses (on the grounds that the entity is still exposed to actuarial risk); and

- (b) the gain or loss on a settlement includes any unrecognised actuarial gains or losses (on the grounds that the entity is no longer exposed to actuarial risk), but excludes unamortised past service cost (on the grounds that the previously expected motivational effect of the benefit improvement is still present).

The Board considers that this approach has some conceptual merit, but it leads to considerable complexity. The new IAS 19 requires that the gain or loss on a curtailment or settlement should include the related unrecognised actuarial gains and losses and past service cost. This is consistent with the old IAS 19.

Presentation and disclosure (paragraphs 116–125 of the Standard)

BC81 The Board decided not to specify whether an entity should distinguish current and non-current portions of assets and liabilities arising from post-employment benefits, because such a distinction may sometimes be arbitrary.

BC82 Information about defined benefit plans is particularly important to users of financial statements because other information published by an entity will not allow users to estimate the nature and extent of defined benefit obligations and to assess the risks associated with those obligations. The disclosure requirements are based on the following principles:

- (a) the most important information about employee benefits is information about the uncertainty attaching to measures of employee benefit obligations and costs and about the potential consequences of such uncertainty for future cash flows;
- (b) employee benefit arrangements are often complex, and this makes it particularly important for disclosures to be clear, concise and relevant;
- (c) given the wide range of views on the treatment of actuarial gains and losses and past service cost, the required disclosures should highlight their impact on the income statement and the impact of any unrecognised actuarial gains and losses and unamortised past service cost on the balance sheet; and
- (d) the benefits derived from information should exceed the cost of providing it.

BC83 The Board agreed the following changes to the disclosure requirements proposed in E54:

- (a) the description of a defined benefit plan need only be a general description of the type of plan: for example, flat salary pension plans should be distinguished from final salary plans and from post-employment medical plans. Further detail would not be required;
- (b) an entity should disclose the amounts, if any, included in the fair value of plan assets not only for each category of the reporting entity's own financial instruments, but also for any property occupied by, or other assets used by, the entity;
- (c) an entity should disclose not just the expected return on plan assets, but also the actual return on plan assets;

- (d) an entity should disclose a reconciliation of the movements in the net liability (or asset) recognised in its balance sheet; and
- (e) an entity should disclose any amount not recognised as an asset because of the new limit in paragraph 58(b) of the Standard.

BC84 Some commentators on E54, especially preparers, felt that the disclosures were excessive. A particular concern expressed by several respondents was aggregation: how should an entity aggregate information about many different plans in a concise, meaningful and cost-effective way? Two disclosures that seemed to cause special concern were the analysis of the overall charge in the income statement and the actuarial assumptions. In particular, a number of commentators felt that the requirement to disclose expected rates of salary increases would cause difficulties with employees. However, the Board concluded that all the disclosures were essential.

BC85 The Board considered whether smaller or non-public entities could be exempted from any of the disclosure requirements. However, the Board concluded that any such exemptions would either prevent disclosure of essential information or do little to reduce the cost of the disclosures.

Disclosures: amendment issued by the IASB in December 2004

BC85A From a review of national standards on accounting for post-employment benefits, the IASB identified the following disclosures that it proposed should be added to IAS 19:

- (a) reconciliations showing the changes in plan assets and defined benefit obligations. The IASB believed that these reconciliations give clearer information about the plan. Unlike the reconciliation previously required by IAS 19 that showed the changes in the recognised net liability or asset, the new reconciliations include amounts whose recognition has been deferred. The reconciliation previously required was eliminated.
- (b) information about plan assets. The IASB believed that more information is needed about the plan assets because, without such information, users cannot assess the level of risk inherent in the plan. The exposure draft proposed:
 - (i) disclosure of the percentage that the major classes of assets held by the plan constitute of the total fair value of the plan assets;
 - (ii) disclosure of the expected rate of return for each class of asset; and
 - (iii) a narrative description of the basis used to determine the overall expected rate of return on assets.
- (c) information about the sensitivity of defined benefit plans to changes in medical cost trend rates. The IASB believed that this is necessary because the effects of changes in a plan's medical cost trend rate are difficult to assess. The way in which healthcare cost assumptions interact with caps, cost-sharing provisions, and other factors in the plan precludes reasonable estimates of the effects of those changes. The IASB also noted that the

disclosure of a change of one percentage point would be appropriate for plans operating in low inflation environments but would not provide useful information for plans operating in high inflation environments.

- (d) information about trends in the plan. The IASB believed that information about trends is important so that users have a view of the plan over time, not just at the balance sheet date. Without such information, users may misinterpret the future cash flow implications of the plan. The exposure draft proposed disclosure of five-year histories of the plan liabilities, plan assets, the surplus or deficit and experience adjustments.
- (e) information about contributions to the plan. The IASB believed that this will provide useful information about the entity's cash flows in the immediate future that cannot be determined from the other disclosures about the plan. It proposed the disclosure of the employer's best estimate, as soon as it can reasonably be determined, of contributions expected to be paid to the plan during the next fiscal year beginning after the balance sheet date.
- (f) information about the nature of the plan. The IASB proposed an addition to paragraph 121 of IAS 19 to ensure that the description of the plan is complete and includes all the terms of the plan that are used in the determination of the defined benefit obligation.

BC85B The proposed disclosures were generally supported by respondents to the exposure draft, except for the expected rate of return for each major category of plan assets, sensitivity information about medical cost trend rates and the information about trends in the plan.

BC85C In relation to the expected rate of return for each major category of plan assets, respondents argued that the problems of aggregation for entities with many plans in different geographical areas were such that this information would not be useful. The IASB accepted this argument and decided not to proceed with the proposed disclosure. However, the IASB decided to specify that the narrative description of the basis for the overall expected rate of return should include the effect of the major categories of plan assets.

BC85D Respondents also expressed concerns that the sensitivity information about medical cost trend rates gave undue prominence to that assumption, even though medical costs might not be significant compared with other defined benefit costs. The IASB noted that the sensitivity information need be given only if the medical costs are material and that IAS 1 requires information to be given about all key assumptions and key sources of estimation uncertainty.

BC85E Finally, some respondents argued that requiring five-year histories would give rise to information overload and was unnecessary because the information was available from previous financial statements. The IASB reconfirmed its view that the trend information was useful and noted that it was considerably easier for an entity to take the information from previous financial statements and present it in the current financial statements than it would be for users to find the figures for previous periods. However, the IASB agreed that as a transitional measure entities should be permitted to build up the trend information over time.

Benefits other than post-employment benefits

Compensated absences (paragraphs 11–16 of the Standard)

- BC86 Some argue that an employee's entitlement to future compensated absences does not create an obligation if that entitlement is conditional on future events other than future service. However, the Board believes that an obligation arises as an employee renders service which increases the employee's entitlement (conditional or unconditional) to future compensated absences; for example, accumulating paid sick leave creates an obligation because any unused entitlement increases the employee's entitlement to sick leave in future periods. The probability that the employee will be sick in those future periods affects the measurement of that obligation, but does not determine whether that obligation exists.
- BC87 The Board considered three alternative approaches to measuring the obligation that results from unused entitlement to accumulating compensated absences:
- (a) recognise the entire unused entitlement as a liability, on the basis that any future payments are made first out of unused entitlement and only subsequently out of entitlement that will accumulate in future periods (a FIFO approach);
 - (b) recognise a liability to the extent that future payments for the employee group as a whole are expected to exceed the future payments that would have been expected in the absence of the accumulation feature (a group LIFO approach); or
 - (c) recognise a liability to the extent that future payments for individual employees are expected to exceed the future payments that would have been expected in the absence of the accumulation feature (an individual LIFO approach).

These methods are illustrated by the following example.

Example
<p>An entity has 100 employees, who are each entitled to five working days of paid sick leave for each year. Unused sick leave may be carried forward for one year. Such leave is taken first out of the current year's entitlement and then out of any balance brought forward from the previous year (a LIFO basis). At 31 December 20X1, the average unused entitlement is two days per employee. The entity expects, based on past experience which is expected to continue, that 92 employees will take no more than four days of paid sick leave in 20X2 and that the remaining 8 employees will take an average of six and a half days each.</p> <p><i>Method (a): The entity recognises a liability equal to the undiscounted amount of 200 days of sick pay (two days each, for 100 employees). It is assumed that the first 200 days of paid sick leave result from the unused entitlement.</i></p> <p><i>Method (b): The entity recognises no liability because paid sick leave for the employee group as a whole is not expected to exceed the entitlement of five days each in 20X2.</i></p> <p><i>Method (c): The entity recognises a liability equal to the undiscounted amount of 12 days of sick pay (one and a half days each, for 8 employees).</i></p>

- BC88 The Board selected method (c), the individual LIFO approach, because that method measures the obligation at the present value of the additional future payments that are expected to arise solely from the accumulation feature. The new IAS 19 notes that, in many cases, the resulting liability will not be material.

Death-in-service benefits

- BC89 E54 gave guidance on cases where death-in-service benefits are not insured externally and are not provided through a post-employment benefit plan. The Board concluded that such cases will be rare. Accordingly, the Board agreed to delete the guidance on death-in-service benefits.

Other long-term employee benefits (paragraphs 126–131 of the Standard)

- BC90 The Board decided, for simplicity, not to permit or require a 'corridor' approach for other long-term employee benefits, as such benefits do not present measurement difficulties to the same extent as post-employment benefits. For the same reason, the Board decided to require immediate recognition of all past service cost for such benefits and not to permit any transitional option for such benefits.

Termination benefits (paragraphs 132–143 of the Standard)

- BC91 Under some national standards, termination benefits are not recognised until employees have accepted the offer of the termination benefits. However, the Board decided that the communication of an offer to employees (or their representatives) creates an obligation and that obligation should be recognised as a liability if there is a detailed formal plan. The detailed formal plan both makes it probable that there will be an outflow of resources embodying economic benefits and also enables the obligation to be measured reliably.
- BC92 Some argue that a distinction should be made between:
- (a) termination benefits resulting from an explicit contractual or legal requirement; and
 - (b) termination benefits resulting from an offer to encourage voluntary redundancy.

The Board believes that such a distinction is irrelevant; an entity offers termination benefits to encourage voluntary redundancy because the entity already has a constructive obligation. The communication of an offer enables an entity to measure the obligation reliably. E54 proposed some limited flexibility to allow that communication to take place shortly after the balance sheet date. However, in response to comments on E54, and for consistency with E59 *Provisions, Contingent Liabilities and Contingent Assets*, the Board decided to remove that flexibility.

- BC93 Termination benefits are often closely linked with curtailments and settlements and with restructuring provisions. Therefore, the Board decided that there is a need for recognition and measurement principles to be similar. The guidance on the recognition of termination benefits (and of curtailments and settlements) has been conformed to the proposals in E59 *Provisions, Contingent Liabilities and Contingent Assets*. The Board agreed to add explicit guidance (not given in E54) on the measurement of termination benefits, requiring discounting for termination benefits not payable within one year.

Equity compensation benefits (paragraphs 144–152 of the Standard)

- BC94 ~~The Board decided that the new IAS 19 should not:~~
- ~~(a) include recognition and measurement requirements for equity compensation benefits, in view of the lack of international consensus on the recognition and measurement of the resulting obligations and costs; or~~
 - ~~(b) require disclosure of the fair value of employee share options, in view of the lack of international consensus on the fair value of many employee share options.*~~

* Paragraphs 144–152 of IAS 19 were deleted by IFRS 2 *Share-based Payment*.

Transition and effective date (paragraphs 153–158 of the Standard)

- BC95 The Board recognises that the new IAS 19 will lead to significant changes for some entities. E54 proposed to mitigate this problem by delaying the effective date of the new IAS 19 until 3 years after its approval. In response to comments on E54, the Board introduced a transitional option to amortise an increase in defined benefit liabilities over not more than five years. In consequence, the Board decided that it was not necessary to delay the effective date.
- BC96 E54 proposed no specific transitional provisions. Consequently, an entity applying the new IAS 19 for the first time would have been required to compute the effect of the 'corridor' retrospectively. Some commentators felt that this would be impracticable and would not generate useful information. The Board agreed with these comments. Accordingly, the new IAS 19 confirms that, on initial adoption, an entity does not compute the effect of the 'corridor' retrospectively.
- BC97 The IASB concluded that the amendments to paragraphs 7, 8(b) and 32B simply clarified the existing requirements and thus should be applied retrospectively. The amendments to the paragraphs concerning the distinction between negative past service costs and curtailments are to be applied prospectively. The IASB concluded that the cost of analysing past plan amendments using the clarified definitions and restating them would exceed the benefits.

Dissenting opinions

Dissent of Patricia L O'Malley from the issue in May 2002 of *Employee Benefits: The Asset Ceiling* (Amendment to IAS 19)

- DO1 Ms O'Malley dissents from this amendment of IAS 19. In her view, the perceived problem being addressed is an inevitable result of the interaction of two fundamentally inconsistent notions in IAS 19. The corridor approach allowed by IAS 19 permits the recognition of amounts on the balance sheet that do not meet the *Framework's* definition of assets. The asset ceiling then imposes a limitation on the recognition of some of those assets based on a recoverability notion. A far preferable limited amendment would be to delete the asset ceiling in paragraph 58. This would resolve the identified problem and at least remove the internal inconsistency in IAS 19.
- DO2 It is asserted that the amendment to the standard will result in a more representationally faithful portrayal of economic events. Ms O'Malley believes that it is impossible to improve the representational faithfulness of a standard that permits recording an asset relating to a pension plan that actually has a deficiency, or a liability in respect of a plan that actually has a surplus.

Dissent of James J Leisenring and Tatsumi Yamada from the issue in December 2004 of *Actuarial Gains and Losses, Group Plans and Disclosures* (Amendment to IAS 19)

Mr Leisenring

- DO1 Mr Leisenring dissents from the issue of the Amendment to IAS 19 Employee Benefits—*Actuarial Gains and Losses, Group Plans and Disclosures*.
- DO2 Mr Leisenring dissents because he disagrees with the deletion of the last sentence in paragraph 34 and the addition of paragraphs 34A and 34B. He believes that group entities that give a defined benefit promise to their employees should account for that defined benefit promise in their separate or individual financial statements. He further believes that separate or individual financial statements that purport to be prepared in accordance with IFRSs should comply with the same requirements as other financial statements that are prepared in accordance with IFRSs. He therefore disagrees with the removal of the requirement for group entities to treat defined benefit plans that share risks between entities under common control as defined benefit plans and the introduction instead of the requirements of paragraph 34A.
- DO3 Mr Leisenring notes that group entities are required to give disclosures about the plan as a whole but does not believe that disclosures are an adequate substitute for recognition and measurement in accordance with the requirements of IAS 19.

Mr Yamada

- DO4 Mr Yamada dissents from the issue of the Amendment to IAS 19 Employee Benefits—*Actuarial Gains and Losses, Group Plans and Disclosures*.
- DO5 Mr Yamada agrees that an option should be added to IAS 19 that allows entities that recognise actuarial gains and losses in full in the period in which they occur to recognise them outside profit or loss in a statement of recognised income and expense, even though under the existing IAS 19 they can be recognised in profit or loss in full in the period in which they occur. He agrees that the option provides more transparent information than the deferred recognition options commonly chosen under IAS 19. However, he also believes that all items of income and expense should be recognised in profit or loss in some period. Until they have been so recognised, they should be included in a component of equity separate from retained earnings. They should be transferred from that separate component of equity into retained earnings when they are recognised in profit or loss. Mr Yamada does not, therefore, agree with the requirements of paragraph 93D.
- DO6 Mr Yamada acknowledges the difficulty in finding a rational basis for recognising actuarial gains and losses in profit or loss in periods after their initial recognition in a statement of recognised income and expense when the plan is ongoing. He also acknowledges that, under IFRSs, some gains and losses are recognised directly in a separate component of equity and are not subsequently recognised in profit or loss. However, Mr Yamada does not believe that this justifies expanding this treatment to actuarial gains and losses.

- DO7 The cumulative actuarial gains and losses could be recognised in profit or loss when a plan is wound up or transferred outside the entity. The cumulative amount recognised in a separate component of equity would be transferred to retained earnings at the same time. This would be consistent with the treatment of exchange gains and losses on subsidiaries that have a measurement currency different from the presentation currency of the group.
- DO8 Therefore, Mr Yamada believes that the requirements of paragraph 93D mean that the option is not an improvement to financial reporting because it allows gains and losses to be excluded permanently from profit or loss and yet be recognised immediately in retained earnings.