

Significant changes to accounting for pensions

IFRS Developments

What you need to know

- ▶ Numerous changes and clarifications to IAS 19 *Employee Benefits* have been issued
- ▶ Careful analysis of accounting for employee benefits is required
- ▶ Effective for annual periods beginning on or after 1 January 2013, with earlier application permitted
- ▶ Retrospective application required (with very few exceptions)
- ▶ IAS 19 *Employee Benefits* was published by the IASB on 16 June 2011

Highlights

- ▶ Full balance sheet recognition of pension surpluses and deficits – previous deferral mechanisms removed
- ▶ Actuarial gains and losses recognised in other comprehensive income as they occur
- ▶ Asset return in profit and loss based on corporate bond yields, irrespective of actual portfolio allocations
- ▶ Medium and long-term remuneration plans recognised and measured in the same way as pensions. However, in a change from the Exposure Draft, movements in previous estimates will continue to be recorded in profit and loss
- ▶ Short and long-term benefits will now be distinguished based on the expected timing of settlement, rather than employee entitlement
- ▶ Immediate recognition of past service costs as a result of plan amendments
- ▶ Termination benefits potentially recognised later

What has happened?

The IASB has issued numerous amendments to IAS 19. These range from fundamental changes like removing the corridor mechanism and the concept of expected returns on plan assets to simple clarifications and re-wording.

What's the significance?

These amendments impact earnings for all entities with defined benefit pension plans. Those entities currently deferring the recognition of actuarial gains and losses will see a potentially highly significant change in amounts of reported net plan assets/liabilities and increase in their volatility.

How we see it

These changes represent a significant further step in reporting gains and losses outside of profit and loss, with no subsequent recycling. Actuarial gains and losses will be excluded permanently from earnings. Earnings, and earnings per share, will present less of a complete picture of operations than at present. The challenge will be to explain performance reported in this way to investors.

Presentation of movement in pension surpluses and deficits has fundamentally changed

The corridor mechanism for pension plans has been removed. This means all changes in the value of defined benefit plans will be recognised as they occur. Those movements are recorded in profit or loss and other comprehensive income as follows:

- ▶ Profit or loss will be charged with a service cost and a net interest income or expense. The net interest income or expense is the product of the net balance sheet liability or asset and the discount rate used to measure the obligation – both as at the start of the year. This removes the current concept of expected return on plan assets – where income is credited with the expected long-term yield on the assets in the fund.
- ▶ 'Remeasurements' will be recorded in other comprehensive income. These are all other movements in the balance sheet amount (essentially these are currently described as actuarial gains and losses and any effects of the restriction of a surplus to its recoverable amount).

Entities will no longer be allowed to recognise all movements in profit or loss.

How we see it

- ▶ Fund assets will now produce a credit to income based on bond yields irrespective of the actual composition of assets held. For cautiously invested plans, this could be earnings enhancing. For those plans with higher equity weightings, the change will reduce earnings.
- ▶ There is now no connection between the assets held by a pension fund and the return on assets in earnings. The difference between actual returns and amounts reported in earnings will permanently bypass earnings as an actuarial variance. Care will be needed in explaining performance to investors.

Other modifications in accounting for employee benefits

Other changes as a result of the revised standard include:

- ▶ Past service cost will be expensed when the plan amendments occur regardless of whether or not they are vested.
- ▶ The distinction between short-term and other long-term employee benefits is now based on expected timing of settlement rather than employee entitlement. Changes in the carrying amount of liabilities for other long-term employment benefits will continue to be recognised in profit or loss.

How we see it

Some short-term employee benefit plans will now become 'other long-term employee benefit plans'.

Termination benefits

The revised standard requires termination benefits (outside of a wider restructuring) to be recognised only when the offer becomes legally binding and cannot be withdrawn. In the context of a wider restructuring, termination benefits are recognised at the same time as the other restructuring costs.

How we see it

Recognising the termination costs of a restructuring at the same time as the other costs involved has intuitive appeal. For other terminations, the cost will now likely be recognised later.

Looking ahead

The IASB always considered this project to be an interim step to be followed by a comprehensive review of the accounting for employee benefits. However, the IASB has not yet confirmed this decision.

Further reading

Coming soon – our detailed analysis of all the amendments.

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