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Implications of adopting IAS 19 (Revised)

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Agenda

- Introduction
- Objectives of IAS 19 (Revised)
- Key changes and impact of these changes

Why the revision?

- Delayed recognition of actuarial gains/losses
- Can result in entities recognising an asset on the balance sheet for unfunded or underfunded plans and liability for overfunded plans
- Difficulty in comparing the effects of defined benefit plans across different entities
- Current disclosures do not adequately explain risks arising from defined benefit plans

Key changes

1	Balance sheet and other comprehensive income	Immediate recognition of all changes in funded status
2	P&L	Interest cost and expected return on plan assets replaced with net interest income/costs
3	Balance sheet/P&L	Immediate recognition of past service costs
4	Administration costs	Different treatment of administration costs
5	Disclosures	Expanded disclosures about plan and risks

Immediate recognition of actuarial gains/losses

Previous IAS 19 Options	IAS 19 (Revised)
Immediate recognition in Other Comprehensive Income (OCI)	Immediate recognition of **'remeasurements'** in OCI
Immediate recognition in P&L	~~Immediate recognition in P&L~~
Deferred recognition through the 'corridor method'	~~Deferred recognition through the 'corridor method'~~

Corridor method is currently the most commonly used method

Net interest cost or credit

Previous IAS 19	IAS 19 (Revised)
Interest cost on DBO using discount rate	Single net interest cost/credit on net defined benefit obligation/asset (after application of asset ceiling) using discount rate
Expected return on <u>gross</u> plan assets using portfolio expectations	

Immediate recognition of past service costs

Previous IAS 19	IAS 19 (Revised)
Deferral of unvested past service cost over the remaining future vesting period.	All past service costs expensed in the period of a plan amendment
	Unvested past service costs can no longer be spread over a future service period

Administration costs

Previous IAS 19	IAS 19 (Revised)
Expected amount of total administration costs recognised in P&L either as service cost or as a deduction from expected return on plan assets with true-up to actual reflected in actuarial gains/losses	Cost of managing plan assets deducted from return on plan assets and effectively recognised through 'remeasurements' in OCI
	Other administration costs should be expensed in arriving at operating profit

What are the implications?

- Absence of smoothing will result in greater volatility in OCI and net assets/liabilities recorded on balance sheet
- Balance sheet ratios and covenants (debt/equity) may be impacted significantly
- Reduced P&L volatility as all actuarial gains and losses will be recognised outside P&L
- For entities with an asset ceiling restriction, movements in the asset ceiling will no longer go through P&L.

What are the implications?

- Potentially a double hit for earnings as result of asset ceiling restrictions, as the net interest item is calculated on lower assumed return (discount rate vs. expected return on assets) as well as on a lower asset base (assets less asset ceiling).
- Overall, there is likely to be greater focus on investment policy of DB pension schemes as the asset value fluctuations will flow through directly to the balance sheet of the sponsor.

Issues with current disclosures

- The disclosure requirements are extensive and sometimes difficult to understand.
- Disclosures do not provide adequate information to enable users of financial statements to understand how DB plans affect the financial statements
- Current disclosures do not highlight information about risks arising from participation in DB plans

New disclosure requirements

- Nature of benefits provided by the plan
- Description of risks to which the plan exposes the sponsor
- Sensitivity analysis for reasonably possible variations in each of the significant actuarial assumptions
- Narrative description of funding arrangements
- Maturity profile including duration of pension liabilities
- Breakdown of the plans assets into categories that distinguish the risk and liquidity characteristics and whether or not they have a quoted market price in an active market

Interim reporting

- Typically, under previous IAS 19, the net DBO was only remeasured between year ends in the event of a plan amendment, curtailment or settlement. The magnitude of change that would result in a material difference given deferral of actuarial gains/losses was much larger.
- The removal of the corridor and spreading options may make it necessary for an entity to value plan assets and the defined benefit obligation at each interim balance sheet date.
- This is to ensure that the amounts reported are not materially different from those that would be reported if all remeasurements had been taken into account.

Retrospective application

Dec 31, 2011

Balance sheet only restated as if IAS 19 (Revised) had been applied.

Dec 31, 2012

Comparatives restated as if IAS 19 (Revised) had always been applied.

Dec 31, 2013

IAS 19 (Revised) becomes mandatory.

All unrecognised amounts recognised.

A quick look at some very recent developments…..

IFRS Interpretations Committee Decision on discount rates

- The IFRS IC has discussed the discount rate several times in the last year. The IC was asked to provide guidance on how to determine the discount rate and the meaning of 'high-quality'.
- The IC concluded that a project to develop new guidance around the discount rate would be too broad for it to address efficiently. The issues should be addressed as part of the IASB's research project on discount rates in general.
- However, the IC's agenda decision included some helpful observations.

IFRS Interpretations Committee Decision on discount rates

The IC noted that the discount rate:

- reflects the time value of money but not actuarial or investment risk;
- does not reflect entity-specific credit risk;
- does not reflect the risk that future experience may differ from actuarial assumptions; and
- reflects the currency and estimated timing of benefit payments.

The IC also observed that the concept of 'high-quality' is an absolute notion, not a relative notion.

IFRS Interpretations Committee Decision on discount rates

- The IC and the IASB have decided to amend IAS 19 to clarify that it is the currency, and not the country, that is considered when determining whether or not there is a deep market in high-quality corporate bonds. An exposure draft is expected in 2014.
- The amendment is not expected to address the question of which government bond rate should be used if there is no longer a deep market in high-quality corporate bonds.

November 2013 Amendment for Employee Contributions

- November 2013 amendments clarifies treatment for plans that require employees or third parties to contribute towards the cost of benefits.
- The amendment allows contributions that are linked to service, and do not vary with the length of employee service, to be deducted from the cost of benefits earned in the period that the service is provided.
- The amendment does not affect the accounting for voluntary contributions.
- The amendment is effective for years commencing on or after 1 July 2014, and early adoption is permitted.

November 2013 Amendment for Employee Contributions

Example 1

- A plan that requires employees to contribute 4% of salary if they are below age 40, and 7% of salary if they are 40 or above
- The contributions are linked to age and salary, but are not dependent on the length of service. So the contributions would be recognised as a reduction of pension expense in the year in which the related service is delivered.

November 2013 Amendment for Employee Contributions

Example 2

- A plan that provides a lump sum benefit on retirement of 10% of final salary for the first ten years of service, plus 20% of final salary for each subsequent year of service, and requires employee contributions equal to 5% of salary for the first ten years of service and 8% thereafter.
- The contributions vary with the length of service, as well as salary, and so they have to be recognised over the working life. The benefit earned and the employee contributions would be recognised on a straight line basis over the employee's working life.