

# BBS briefing note

## International Accounting Standard IAS19 – New Exposure Draft

The International Accounting Standards Board (IASB) has recently published an exposure draft setting out some proposed amendments to the company accounting standard IAS19.

This *BBS briefing note* summarises the proposals and explains how they might be expected to affect organisations that are required to comply with IAS19, e.g. listed European companies.

### PROPOSED CHANGES

The IASB has identified a number of deficiencies in the existing standard for the treatment of defined-benefit pension schemes, and has proposed amendments accordingly:

**Recognition:** Currently, companies do not need to recognise gains and losses in the period within which they arise. Instead, companies can choose to defer recognition of all gains and losses if they are within a “corridor”, and can spread the recognition of gains and losses outside the corridor over lengthy periods. Consequently, the amount reported in the balance sheet may bear little relationship to the surplus or deficiency in the scheme, making it difficult for investors and analysts to understand the amounts set out in financial statements.

It is proposed in future to remove the options that currently allow the recognition of gains and losses to be deferred (including the corridor). Therefore, the balance sheet will generally reflect the full amount of the relevant surplus or deficit in the scheme at the accounting date.

**Presentation:** Currently, companies may choose different options for the presentation of the components of the recognised amounts.

This makes it difficult for investors and analysts to compare companies with similar obligations. Furthermore, companies are currently free to choose the expected rate of return on the assets, which potentially allows them to manipulate profit or loss.

The IASB proposes to remove the various options for the presentation of the components of the recognised amounts. Instead, it will require:

- All service costs (the cost of future benefit accrual) to be presented within profit and loss.
- All finance costs to be presented as part of the finance charge within profit and loss.
- The distinction between the discount rate and the expected rate of return to be removed (meaning that the finance charge will merely reflect interest on the surplus or deficit).
- The effect of re-measurements on assets and liabilities to be presented within other comprehensive income - currently, employers may choose to recognise these at least in part within profit and loss.

**Disclosure:** The large volume of disclosures currently required obscure important information. At the same time they do not adequately highlight the risks arising from defined-benefit schemes.

The IASB proposes to reduce the overall volume of disclosures and at the same time require improved disclosures in certain areas, including:

- Descriptive information relating to the nature of the pension scheme;
- A reconciliation of the amounts recognised in the financial statements at the start and end of the period, including separate reconciliations for scheme assets and liabilities;
- Information on the risks arising from the pension scheme, i.e. sensitivity analysis;
- Details of employers’ participation in multi-employer plans.



## BBS briefing note (continued)

**Other issues:** In addition to the above, there are some further proposals, most notably:

- Future administration expenses should be capitalised and included in the defined benefit obligation, whilst investment management expenses should continue to be netted off the return on assets;
- IAS19 will be amended to incorporate IFRIC 14 (dealing with limits on the defined benefit asset and the impact of minimum agreed contributions) without substantive change.

### IMPLICATIONS FOR EMPLOYERS

The main impact of the changes will be for those employers that currently defer the recognition of gains and losses, especially those that use the corridor approach. Such employers will see significant changes to their balance sheets and to the amounts recognised in the statement of comprehensive income. In addition, future balance sheet positions will be significantly more volatile than has hitherto been the case.

The change to bring the expected rate of return on assets into line with the discount rate will generally result in an increase in the charge to profit and loss. Due to the effects of gearing, this seemingly minor change in the approach to setting the expected return could lead to a significant change in the amount charged to profit and loss, especially where the assets are relatively large or the assumed rate of return previously has exceeded the discount rate by a significant margin.

### TIMETABLE

The exposure draft is open for public comment until 6 September 2010 with a revised IAS19 standard expected around the middle of 2011. No date has yet been set for possible implementation, but this is unlikely to be before January 2012, meaning that many employers would probably not be obliged to implement the proposals until accounting years ending on or after 31 December 2012 at the earliest.

No details of transitional provisions have been provided.

### ACTION REQUIRED

The proposals are only in exposure draft form at present and, in any event, are unlikely to be implemented for at least another two years. No action is therefore required at this stage, although it would be advisable for those employers likely to be affected to examine the potential effect on their balance sheet and profit and loss assuming that they did come in in their present form. Some employers may also wish to anticipate matters by opting for immediate recognition of accumulated gains and losses before the requirements take effect.

### BBS VIEW

The proposed changes should make it easier for investors and analysts to understand how defined benefit schemes affect a company's financial position. BBS therefore welcomes the proposals from a transparency perspective.

However, with commentators estimating that the amendments might reduce the reported earnings of UK companies by as much as £10 billion, the proposals will come as an unwelcome blow to many employers.

Furthermore, the loss of the ability by employers to adjust the expected return on assets in order to smooth earnings might potentially be a driver for change in the scheme's investment strategy. Yet another example of the tail wagging the dog?

BBS will provide further information on the proposed changes once these have been confirmed.

