

BBS briefing note

International Accounting Standard IAS19 – Revised Standard

On 16 June 2011 the International Accounting Standards Board (IASB) published the long-awaited revised version of the company accounting standard IAS19.

This *BBS briefing note* summarises the main revisions and explains how they might affect organisations, including listed European companies, that are required to comply with IAS19.

BACKGROUND

In April 2010, the IASB published an Exposure Draft, setting out a number of proposed changes to IAS19. These proposals were considered in some depth in *BBS briefing note* 60. The Exposure Draft attracted more than 220 responses and resulted in a lengthy and extensive consultation exercise, culminating in the publication of a revised standard in June 2011.

SUMMARY OF MAIN CHANGES

Expected Return on Assets: The main change affecting most UK companies is the removal of the distinction between the discount rate and the expected rate of return on assets.

Currently, most companies assume that the assets held in schemes will generate a higher long-term return than the discount rate, which results in a credit to the profit & loss ("P&L") equal to the excess return assumed. In future, the expected return on assets will simply be taken as the discount rate, so this credit will disappear.

Due to the effects of gearing, this seemingly minor change is likely to lead to a significant change in the amount charged to P&L, especially where the assets are large relative to the P&L charge or the assumed rate of return exceeds the discount rate by a significant margin. The change could also lead to more volatility in P&L charges.

Removal of the Corridor Option: Although most companies recognise gains and losses in the period within which they arise, some choose to defer recognition of all gains and losses provided they fall within a "corridor", and spread the recognition of gains and losses outside the corridor over relatively 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.

The revised standard removes these options, so in future the balance sheet will generally reflect the full amount of the relevant surplus or deficit in the scheme at the accounting date.

Most companies already choose to recognise gains and losses immediately, so the changes will have no effect. However, for those employers that currently defer the recognition of gains and losses, especially those that use the corridor approach, the impact is likely to be very substantial. 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 much more volatile than has hitherto been the case.



BBS briefing note (continued)

Treatment of Expenses: Under the current standard, expenses associated with running a pension scheme are usually netted off against the return on assets. This has the effect that the expected, rather than actual, expenses in each year are charged to the P&L account.

In future, companies will need to disclose these expenses separately, meaning that actual rather than estimated expenses will flow through to the P&L. This could draw increased attention to the cost of running defined benefit schemes in the future.

Settlements: Another change is that, in the event of some or all of the scheme's liabilities being extinguished through a one-off cash payment, the full cost will need to be included in the P&L expense even if the transaction occurred outside the pension scheme.

This change is particularly relevant for so-called enhanced transfer value incentive exercises, whereby a cash inducement is offered to members to encourage them to transfer out of the pension scheme.

Currently, the cash inducements can be accounted for as a general expense. In future, however, the cash inducements will need to be combined with the pension assets transferred in order to show the overall impact of the exercise.

Disclosure: It was considered that the large volume of disclosures currently required obscures important information, whilst the disclosures do not adequately highlight the risks inherent within defined-benefit pension schemes.

The new standard reduces the overall volume of disclosures but at the same time enhances

disclosures in certain areas in order to provide more useful information about the characteristics and inherent risks of a defined-benefit pension scheme.

ACTION REQUIRED

The new standard applies for accounting periods starting on or after 1 January 2013 with earlier adoption permitted. Given the potential impact of some of the changes, companies should examine the potential effect on their balance sheets and profit and loss accounts sooner rather than later.

IMPLICATIONS FOR FRS17

Although the changes currently only affect employers who are required to comply with IAS19, it seems highly likely that the equivalent UK standard, FRS17, will follow suit, where relevant, in due course.

BBS will monitor the situation and issue a further *briefing note* should there be any developments in this area.

BBS VIEW

The revisions to IAS19 should make it easier for investors and analysts to understand how defined benefit schemes affect a company's financial position. BBS therefore welcomes the revised standard from transparency and comparability perspectives.

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

