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International Accounting Standards Board

INFORMATION FOR OBSERVERS

Board Meeting:	**January 2009, London**
Project:	**Pensions**
Subject:	**Preliminary Views on Amendments to IAS 19 *Employee Benefits* - Presentation of changes in defined benefit obligations and in plan assets (Agenda paper 16C)**

Purpose of this paper

1. The purpose of this paper is to provide a basis for a discussion that will lead to the Board making a tentative decision on the presentation of changes in defined benefit obligations and in plan assets. We ask the Board to answer the following questions:
    a. Should the Board specify how the components of pension cost should be disaggregated?
    b. Should any components of post-employment benefit cost be presented in other comprehensive income rather than profit and loss? If so, which?
    c. Should the Board require such disaggregated components to be displayed on the face of the performance statements when material?
2. This paper is set out as follows:
    a. Background

b. Disaggregation of information about changes in the net pension asset/liability

c. Presentation in other comprehensive income

d. Display on the face of the performance statements

3. This paper does not discuss recognition of changes in the net pension asset/liability. It assumes that the Board will require recognition of all changes in defined benefit obligations and in plan assets in the period in which they occur. We note that if the Board does *not* require that, then discussion of presentation in this project is superfluous. However, we acknowledge that many Board members would like to know how components of pension cost would be presented before they make their final decisions on recognition. Accordingly, we intend to discuss presentation first and ask the Board about recognition at a future meeting.

4. We note the concerns expressed by respondents about how the financial statement presentation project would affect the presentation of pensions items. We acknowledge that the Board's decisions in this project should be consistent with the general direction of the financial statements presentation project. Accordingly, we include in Appendix B a discussion about the consistency of the recommendations in this paper with the proposals in the financial statements presentation discussion paper.

5. We discuss the relationship to the Tech Plan and consequences of not meeting the objectives of this meeting in Agenda paper 16A.

Staff recommendations

6. The staff recommends that the Board:

   a. Require that entities disaggregate information about pension cost into employment, financing and remeasurement components (paragraphs 13-22).

   b. Require all changes in the post-employment benefit obligation and in plan assets to be recognised in profit or loss (paragraphs 23-36).

   c. Does not require mandatory disaggregation of information on the face of the performance statements (paragraphs 37-39).

Background

7. Concern over how components of post employment benefit cost would be presented in profit or loss has historically been a reason for permitting deferred recognition of some components of post-employment benefit cost.

8. Accordingly, the discussion paper considered whether entities could present some components of post-employment benefit cost outside profit or loss. The discussion paper noted in paragraph 3.8 that the Board

"was persuaded that it would be a sufficient short-term improvement to require entities to recognise all components of post-employment benefit costs in comprehensive income, compared with the existing non-recognition or deferred recognition of some components. Accordingly, the Board decided not to restrict its thinking to presentation of all components in profit or loss but also to identify approaches for discussion that present some components of post-employment benefit cost in other comprehensive income."

9. Thus, the discussion paper proposed three possible approaches for the presentation of defined benefit cost:

   a. Approach 1: all changes in the defined benefit obligation and in the value of plan assets in profit or loss in the period in which they occur.

   b. Approach 2: the costs of service in profit or loss. All other costs in other comprehensive income.

   c. Approach 3: remeasurements that arise from changes in financial assumptions (ie arising from changes in the discount rate and in the value of plan assets) in other comprehensive income. All other changes in profit or loss.

10. Although each of the approaches has their supporters, there was no clear consensus that one approach was markedly better than any of the others. Many constituents stated that none of the approaches proposed are significant or valuable improvements on the options already in IAS 19 that allow for immediate recognition, ie (i) recognition of all components of cost in profit or loss and (ii) recognition of actuarial gains and losses in OCI, and all other components in profit or loss. Some respondents also suggested other approaches. These are listed in Appendix A. However, we think that none of the approaches suggested are free from the problems identified with Approaches 2 and 3 from the discussion paper, namely that:

   a. they would require an arbitrary separation of the components of actuarial gains and losses identified in IAS 19;

   b. they are inconsistent with the general approach in IFRSs; and

   c. they include items in other comprehensive income in the absence of a stated principle for items that should be recognised in other comprehensive income.

11. We note that the problems identified in paragraph 10.b and 10.c are also associated with the existing IAS 19.

12. As a result, the staff does not think that it is a worthwhile use of resources to continue to attempt to develop variants on approaches to presentation. Doing so would not generate much advantage over the approaches already developed.

Disaggregation of components of pension expense

13. We note that IAS 19 currently requires that entities provide disaggregated information about pension cost. However, we think that the components that are separately identified in accordance with IAS 19 should be reviewed in the light of the comment letters and the Board's preliminary view on the expected return on assets.

14. The comment letters in response to *Preliminary Views on amendments to IAS 19* Employee Benefits indicated that many constituents think that disaggregated information about the components of pension cost provides decision-useful information to users of financial statements and reflects the management's view of pensions. The reason given is that the components of pension cost have different predictive values. Thus, comment letters argue that disaggregation is essential to provide a proper understanding of the reasons for changes in the post-retirement assets and obligations during the period.

15. For example:

    "We believe that disaggregation is a more meaningful presentation for investors and better forward-looking analysis."[1]

    "We believe users will particularly benefit from adequate disaggregation of pension costs and clarity about where the pension costs have been recognised in comprehensive income. For example, at present users are frequently unable to distinguish between changes in pension liabilities arising from variations in discount rates and those arising from revision of mortality assumptions, as these are combined as "actuarial gains or losses"."[2]

16. Although the comment letters indicated that disaggregation is desirable, it is less clear exactly what components of pension cost respondents thought should be disaggregated. Most respondents were vague as to the components of pension cost that should be disaggregated.

[1] ITAC
[2] CRUF

17. Nonetheless, many comment letters explicitly state the view that pensions have a component that relates directly to employee costs and a component that relates to the deferred payment of those costs (usually referred to as financing). For example:

"Ideally service cost items, which would be expected to be recurring and essentially arise from the current year's trading, should be included when arriving at operating profit. Other items, which are largely the result of changes to previously accumulated assets and liabilities […] should be shown below operating profit."[3]

18. In addition, some constituents also believe that a component that arises from remeasurements should be separately identified:

"We believe that re-measurement of assets and liabilities due to market volatility or one-off factors should be included within other comprehensive income"[4]

19. There are fewer comment letters that explicitly mention a remeasurement component. However, we think that this is because approach 3 in the discussion paper already proposed a separation between remeasurements and all other changes. We think the fact that many comment letters supported approach 3 implies support for a disaggregated remeasurement component. We also think that disaggregation of a remeasurement component would help address some of the concerns about volatility in the statement of comprehensive income.

20. Thus, we think that the comment letters indicate that most respondents think that disaggregation of pension cost into three components provides useful information: employment, financing and remeasurement. As discussed in paragraphs 26-28, we note that entities could already do this under current IFRSs.

Staff recommendation

21. The staff recommends that the Board require that entities disaggregate information about pension cost into employment, financing and remeasurement components.

22. If the Board agrees with this staff recommendation, we will consider the detail of what the different components should include in a future paper.

[3] Fitch
[4] Commonwealth Bank of Australia

Presentation of components in other comprehensive income

23. In the discussion paper, we noted that entities might want to separate components of pension cost on the face of the performance statements. We discussed the following ways that this could be achieved:

    a. Option 1: By displaying all components of pension cost in different line items in profit and loss.

    b. Option 2: By presenting some components of pension cost in other comprehensive income. Approach 2 and 3 of the discussion paper used this approach. Other variants could be developed.

24. Many comment letters stated that we should wait until the outcome of the financial statements presentation project before deciding what should be presented in other comprehensive income. For example:

    "We believe that the issue of the presentation of the defined benefit costs should not be considered in isolation to the Financial Statement Presentation project to develop a long term solution to the presentation of gains and losses in the performance statement."[5]

25. We note that if the financial statement presentation project were intending to develop principles for distinguishing items recognised in other comprehensive income rather than profit or loss, it would have been appropriate to wait until those principles were elucidated before trying to decide which components of pension cost should be recognised in other comprehensive income. However, the recently published discussion paper does not address whether items should be recognised in other comprehensive income, or the basis for including such items in other comprehensive income. This decision is left to individual projects. Accordingly, this project should determine whether any components of pension cost should be recognised in other comprehensive income rather than in profit or loss. If we do not address this issue now, it could be many years before a subsequent pension project addresses the issue.

Option 1

26. Constituents tell us that disaggregation of information about pension cost is useful to users of financial statements. We think that this can be achieved within profit or loss using current IFRSs. IAS 1 states:

[5] HSBC

"Because the effects of an entity's various activities, transactions and other events differ in frequency, potential for gain or loss and predictability, disclosing the components of financial performance assists users in understanding the financial performance achieved and in making projections of future financial performance. An entity includes additional line items in the statement of comprehensive income and in the separate income statement (if presented), and it amends the descriptions used and the ordering of items when this is necessary to explain the elements of financial performance."[6]

27. Thus, entities could distinguish components such as employment costs, financing or remeasurements within profit or loss using additional line items.

28. For example, an entity could display the following in its statement of comprehensive income (bold headings indicate those mandated by IAS 1)

Revenue	**X**
Operating expenses (including pensions employment expense)	(X)
Finance costs (including finance costs on pensions)	**X**
Profit before tax	X
Tax expense	**X**
Profit from continuing operations	X
Remeasurements arising from changes in pension assumptions (net of tax)	X
Post-tax gains or losses on discontinued operations	**X**
Profit or loss	**X**
Components of other comprehensive income	**X**
Total comprehensive income	**X**

29. The advantages of displaying all components of pension cost in different line items in profit and loss are:

   a. It eliminates an item from other comprehensive income without reducing the information provided.

   b. There is no need to address the issue of recycling that was raised in relation the approaches in the discussion paper

   c. It is consistent with the general approach in IFRSs.

[6] paragraph 86 of IAS 1

30. The disadvantage is that we can expect to face widespread opposition from preparers of financial statements to any proposals to recognise all components of pension cost in profit or loss.

Option 2

31. Many comment letters supported presenting some components of changes in post-employment benefit expense and plan assets in other comprehensive income. For example:

    "It is our view that the presentation of all changes of the defined benefit obligation wholly through net income is not appropriate. Presentation of some or all of the changes through OCI presents a better option because it recognizes the long term nature of these costs. However, which components to present through OCI and which components through net income are decisions that may take further discussion to resolve."[7]

32. A summary of the reasons given were as follows:

    a. It helps to reflect risk appropriately. Some note that pension assets and liabilities are accounted for at current value, while many other assets and liabilities are not. The effect is that pension assets and liabilities appear more risky than other comparable long term assets and liabilities. Until all corporate assets and liabilities are measured at current value, the illusion of risk that results from the different treatment of pension assets and liabilities is not a faithful representation. Accordingly, it is appropriate that special consideration should be given to the presentation of the changes in pension assets and liabilities.

    b. It reduces the volatility associated with changes in assets held for the long-term and liabilities whose cash flows are not due for many years. Some argue that the volatility that would otherwise be reported gives a misleading view of the underlying operations of the entity.

33. The advantages of recognising some components of changes in post-employment benefit expense and plan assets in other comprehensive income are:

    a. Many preparers of financial statements are attached to a net profit figure, and prefer to see volatile elements presented outside profit or loss.

    b. Some Board members and constituents think that some components of pension cost are conceptually different from other items in profit or loss and should be clearly demarcated.

[7] Canadian Bankers Association

34. The disadvantages of recognising some components of changes in post-employment benefit expense and plan assets in other comprehensive income are:

   a. The Discussion Paper proposed two approaches that recognised some components of pension cost outside profit or loss. Neither approach was uncriticised. We could try to develop one approach further, or try to develop a new approach, but it is unclear why we would be more successful now in the absence of any new conceptual principles.

   b. The staff's view remains that the *Framework* and IAS 1 provide no basis for recognising any items outside profit or loss. This is true even if one believes that some items are different because of their long-term nature or different risk profiles. Currently, some such long-term items are recognised in profit or loss and some are recognised outside. We acknowledge that the *Framework* was written before the possibility of recognition in other comprehensive income had been contemplated. However, this means that there is no consistent basis in IFRSs for identifying the items to be recognised in other comprehensive income rather than in profit or loss. The *Framework* states that items of income and expense are presented in the income statement and IAS 1 provides no principle for recognising items elsewhere.

Staff recommendation

35. The staff argues as follows:

   a. Constituents state that disaggregation of some components of post-employment benefit costs is useful for users of financial statements.

   b. That disaggregation can be achieved by presenting some components of post-employment benefit cost as separate line items within profit or loss or other comprehensive income.

   c. There is no conceptual basis to present any items outside profit or loss. Further, the disaggregated information that appears to be useful can be achieved using current IFRSs, without any need to resort to recognition of components in other comprehensive income.

36. Accordingly, the staff recommends that the Board require all changes in the post-employment benefit obligation and in plan assets to be recognised in profit or loss.

Display on the face of the performance statements

37. IFRSs permit entities to provide disaggregated information on the face of the performance statements or in the notes if the entity considers it appropriate. However, some users of financial statements argue that the Board should *require* disaggregation on the face of the performance statements. For example:

“[We recommend] that the Board consider mandatory disaggregation, on the face of the income statement, of the components of post-employment benefit cost. ... Although the information is provided in the footnotes, footnote disclosure is not an adequate compensation for the commingling of financing and operating costs on the face of the income statement, costs that investors view as having different natures and are often picked up from the income statement itself.”[8]

38. We recommend that the Board does not require mandatory disaggregation of information on the face of the performance statements for the following reasons:

a. Although material to many entities, there is no reason to single pensions out for special treatment on the face of the performance statements.

b. IAS 1 specifies the items that all entities are required to present on the face of the financial statements. It also specifies that entities should present additional line items where it is relevant to an understanding of the entity’s financial position or financial performance.[9] We do not think that arguments have been presented that would not have been considered when IAS 1 was written that justify the inclusion of additional mandatory line items in IAS 1.

c. If an entity and the users of its financial statements think that information about pensions is sufficiently important to that entity, IFRSs already permit that entity to provide disaggregated information on the face of the performance statements.

d. As discussed in paragraphs 27 and 28, entities can provide disaggregated information on the face of the statement of financial performance without the need for special formats.

39. We note that we intend to explain the Board’s reasons for not requiring disaggregated information on the face of the performance statements in the Basis for Conclusions. This could also include an explanation that the Board did not consider it necessary to create a new

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[8] ITAC

[9] Paragraphs 55 and 85 of IAS 1

format to display pensions costs because the relevant information could already be provided in accordance with IAS 1. An illustrative example could be added if necessary.

Question to the Board

40. Does the Board agree with the staff recommendations in paragraphs 21, 36 and 38 (that are summarised in paragraph 6)?

Appendix A: Other approaches proposed in the comment letters

Other approaches suggested by respondents include:

CL#	Suggested approach
2	As approach 3, but interest on the net asset should be calculated: • At the rate that the company can borrow at for a similar debt in the case of a deficit, and • At the expected rate of return on the assets in the case of a surplus.
16	Develop an approach that recognises that actuarial gains and losses are not based upon observable market values. The approach adopted also needs to be transparent to help understanding by the users of financial statements.
17	Suggests any approach should reduce volatility in the income statement to aid clarity and consistency between companies. Believes that in many circumstances it may be appropriate to have a smoothing mechanism to ensure the reported profitability reflects the profitability of the business.
25	Proposes full recognition of the DBO and full but deferred recognition of actuarial gains and losses in profit and loss. Disaggregate changes in the DBO into: 1) changes in interest rates, market prices and exchange rates 2) biometric and other actuarial changes 3) changes in benefit entitlements
38	'The recognition of actuarial gains and losses in profit and loss remains unchanged. Amounts that arise during the period but are not recognised as components of net periodic cost, have to be recognised as other comprehensive income. Amounts recognised in accumulated other comprehensive income are adjusted as they are subsequently recognised as components of net periodic cost.'
57	Suggests a methodology of amortising actuarial gains and losses would be the best method to value and present economically long term commitments.
140	Proposes the following items should be clearly distinguished on the face of the financial statement: Current - service cost, interest costs Non-current - actuarial gains and losses, plan amendments. With non-current elements recognisied through OCI with recycling.

Appendix B – Relationship to the financial statement presentation project

1. Many comment letters express confusion as to how the proposals in the financial statement presentation project might affect the display of pension cost. At the time the comment letters were written, the financial statement presentation discussion paper had not yet been published.

2. A common theme in the comment letters is that decisions about disaggregation of post-employment benefit cost should not be decided until the financial statement presentation project is completed. For example:

   "In relation to the presentational approaches we feel it is too early to reach a decision in light of other ongoing projects. We believe that this decision should be made only once the basic principles have been set out in the Financial Statements Presentation project."[10]

   "We believe that it is premature for the Board to consider changing the basis on which pension costs are allocated between profit and loss and other comprehensive income until it has concluded its project on financial statement presentation."[11]

3. We expect that the Board will complete this project before the financial statement presentation project. Consequently, if the Board wants to continue to make progress in this project it can do so only in the context of IAS 1. This project cannot accommodate discussions about general issues relating to financial statement presentation. If the Board needs to have those discussions before it can make decisions about pensions, then the Board should defer this project until after the financial statement presentation project is completed.

4. However, we acknowledge that the Board's decisions in this project should be consistent with the general direction of the financial statements presentation project. We see the following emerging issues:

   a. *Cohesiveness:* As set out in paragraphs 8-10, many respondents would like to distinguish employment costs, which they would classify as business, and the costs of deferring payment of those costs, which they regard as financing. Such classification initially appears to be inconsistent with the cohesiveness principle in the financial statement presentation project.

[10] Legal & General
[11] The Hundred Group of Finance Directors

b. *Comparability of disaggregated information:* Many respondents, in particular users, tell us that they would prefer the Board to eliminate the ability for entities to choose whether they present some components of pension costs in business or financing. This would be inconsistent with the management approach in the financial statement presentation discussion paper.

c. *Remeasurements:* Many respondents would like to be able to draw a subtotal in the statement of comprehensive income that could be described as "profit before tax and remeasurements". Unless the Board continues to permit recognition of some items in other comprehensive income, this does not appear possible under the financial statement presentation discussion paper.

5. These are discussed below. We note that these issues are not to be solved in this project. Accordingly, we do not provide staff recommendations.

Cohesiveness

6. Paragraphs 2.45 and 2.46 of the Financial Statements Presentation discussion paper describe the application of the cohesiveness principle to pensions, as follows.

> 2.45. Some users consider some or all elements of postemployment benefits, including pensions, part of an entity's financing activities and exclude related amounts in analyzing an entity's operating activities. Other users regard some or all elements of postemployment benefits as related to employee remuneration or compensation and include them in an analysis of an entity's operating activities. Because both IFRSs and U.S. GAAP require an entity to present plan assets and benefit liabilities on a **net** basis in its statement of financial position, the proposed presentation model requires an entity to classify its net postemployment benefit asset or liability in a single category in the statement of financial position. In other words, an entity could not classify the plan assets separately from the benefit liabilities. Because the **net** postemployment asset or liability relates to employee remuneration or compensation, an entity most likely would classify the net asset or liability in the operating category.
>
> 2.46. Following the cohesiveness principle, an entity should classify the related postemployment benefit expenses, including items such as service cost, interest cost, and return on plan assets, and cash flows in the same category as its net postemployment benefit asset or liability. Even though an entity would present all of the components of postemployment benefit expense in one category in its statement of comprehensive income, it could present those components on two or more lines in that category if that would assist users in predicting future cash flows. The IASB's Discussion Paper, *Preliminary Views on Amendments to IAS 19* Employee Benefits, suggests that disaggregating components of pension costs in the statement of comprehensive income provides useful information.

7. Thus, application of this principle as analysed in the financial statement presentation discussion paper would mean that all changes in the defined benefit obligation or in plan assets would be classified in one category in the statement of comprehensive income, split into one or more lines within that category if appropriate.

8. The staff observes that this result directly contradicts what we have heard from comment letters. However, the staff thinks that such disaggregation need not be inconsistent with the cohesiveness principle if the following analysis is applied.

9. When an employer receives service from employees in exchange for a postemployment benefit, the employer incurs:

   (a) a liability that will be settled on retirement. The classification of changes in the liability recognised in the income statement will depend on classification of the liability.

   (b) an asset for employee service that is immediately consumed. The classification of the expense recognised when the asset is consumed will depend on the classification of the asset.

   Thus, if an entity classifies the liability as financing and the asset as operating, then the service cost will be disaggregated from all other changes in the defined benefit obligation and plan assets. This is consistent with the view that changes in the defined benefit obligation other than service costs arise from deferred payment and are therefore are financing in nature.

10. This analysis would apply not only to post-employment benefit expense, but any operating expense that results in a liability. It is also consistent with the view that operating assets can be acquired using financing liabilities. For example, if an entity acquired a manufacturing facility using the proceeds of a bond issue, the manufacturing facility would be classified as an operating asset and the bond as a financing liability.

11. However, although we could use this analysis to allow for a business cost and a financing cost to arise for pensions and similar items whilst maintaining the idea of cohesiveness between the statement of financial position and statement of financial performance, it leaves open the question of how that idea could be extended to the cash flow statement. For example, if the post-employment benefit liability is classified as financing, this means that all cash flows that are paid to settle that liability would also be classified as financing. This would mean that there would be no operating cash flow associated with the operating post-employment benefit expense.

Comparability of disaggregated information

12. Some comment letters state that comparability will be enhanced if the Board specifies whether pension costs are operating or financing, rather than leaving it up to preparers to choose. For example:

"Key improvements on current standards include...a requirement to show pension-related items in a consistent category (or categories) in the statement of financial performance (for example, avoiding the choice entities currently have to show the financing components of pensions within operating profit or as a financial item). "[12]

13. The staff notes that mandated classification would contradict the principle set out in Chapter 2 of the Financial Statements Presentation discussion paper.

"An entity should classify its assets and liabilities in the business section and in the financing section in a manner that best reflects the way the asset or liability is used within the entity. This discussion paper refers to this as a *management approach* to classification."[13]

14. That discussion paper states that:

"The classification decision would reside with management and its classification rationale would be presented in the notes to financial statements as part of the accounting policy discussion. The board support a management approach to classification rather than a prescriptive approach because they believe it will result in financial statements that reflect how management views and manages the entity and its resources."

15. The issue of classification has been discussed at length in the financial statement presentation project and the financial statement discussion paper sets out the rationale for the Board's preliminary views on classification. The comment letters do not identify any reason to specify classification that would apply only to pensions.

Remeasurements

16. If the financial statement presentation proposals are finalised as set out in the discussion paper, and subject to the discussion paragraphs 6-11, we think that an entity could present employment cost and financing components in separate categories within profit and loss. However, presentation of remeasurements as a separate item might be difficult.

17. At present, the remeasurement components could be separately identified:

    (a) By including it as a component of other comprehensive income; or

[12] Fitch, similar view from CRUF
[13] paragraph 2.27, Preliminary Views on Financial Statement Presentation

(b) By including as a separate line item within either operating or financing.

18. Under the Financial Statement Presentation Discussion paper, entities would only be able to identify remeasurements separately by including a separate line item within operating or financing. This is an example of how it might look:

BUSINESS	
Operating	
Sales	X
Expenses (including pension operating cost)	X
Total operating income	X
Investing	
Total investing income	X
TOTAL BUSINESS INCOME	X
FINANCING	
Interest income	X
Interest expense	X
Finance cost on pensions	X
Remeasurements arising from changes in assumptions for pensions	X
Total net financing expense	X
INCOME TAXES	X
NET INCOME	X
OTHER COMPREHENSIVE INCOME (after tax)	
Unrealised gain on derivatives (operating)	X
Foreign currency translation adjustment (operating)	X
TOTAL OTHER COMPREHENSIVE INCOME	X
TOTAL COMPREHENSIVE INCOME	X

19. We note that this format would not permit entities to show a subtotal representing total comprehensive income excluding tax and remeasurements. We think that some constituents might object as a result.