Employee benefit accounting revised

The amended version of IAS 19 *Employee Benefits* (the amended standard) is the final product of a limited project to revise the current IAS 19. It was issued by the IASB[1] on 16 June 2011.

How this could affect you

The key changes from the current IAS 19 are summarised below.

Key changes from the current IAS 19	Potential impacts
All actuarial gains and losses recognised immediately in other comprehensive income	The change to require immediate recognition of all actuarial gains and losses will affect, and make more volatile, the statement of financial position of entities applying the corridor method under the current IAS 19, which is abolished. It will affect the profit or loss of those entities currently recognising actuarial gains and losses immediately in profit or loss. Those currently applying the corridor method may need to discuss with their lenders revising the definitions of any relevant covenants included in their lending agreements.

Highlights

- Actuarial gains and losses recognised immediately in other comprehensive income
- Expected return on plan assets recognised in profit or loss calculated based on rate used to discount the defined benefit obligation; for most entities this will change net profit
- New requirements effective for annual periods beginning on or after 1 January 2013

Our forthcoming publication *First Impressions: Employee benefits* will provide more detail about the new requirements and discuss some of the potential application issues. Speak to your usual KPMG contact if you would like copies.

Key changes from the current IAS 19	Potential impacts
Finance costs – revised basis of calculation	Since net interest is now calculated simply as the net defined benefit liability (asset) multiplied by the discount rate that is used to measure the defined benefit obligation, the nature of the plan assets held will have no impact on the net finance charge or credit. The impact of this change will be greater, when the gap between the expected rate of return on plan assets and the rate used to discount the obligation is greater. This change might lead to a rebalancing of investment portfolios. Entities may wish to reconsider how their covenant tests will be affected by the amended standard. For instance, this change to finance costs may affect an interest cover calculation. They may wish to reconsider also what performance measures are used in, for example, employee remuneration arrangements.
Additional disclosures for defined benefit plans	Entities with a significant number of post-employment defined benefit plans will need to plan carefully the way that they assess the need for and how best to aggregate the disclosures to be made.
Amended definitions of short-term and other long-term employee benefits	The distinction between short-term and long-term employee benefits affects the measurement of the obligation and not just its classification. More benefits may now be long-term than was previously the case. Entities will need to reconsider the pre-existing classification that they have been using for all employee benefits within the short-term and other long-term employee benefit categories. Entities will also have to keep the classifications under review in case expectations change other than on a temporary basis.
Possible changes to timing of recognition of termination benefits	Entities providing termination benefits as part of a wider restructuring may find that the timing of recognition of those benefits changes, depending on the detail of the termination; this may be sooner than when the entity is 'demonstrably committed'. Currently such benefits are recognised when the entity is demonstrably committed to either terminate employment mandatorily or provide voluntary termination benefits. Under the amended standard they are recognised at the earlier of when the entity recognises related restructuring costs and when it can no longer withdraw the offer of those benefits.

Background

Originally the IASB had planned a comprehensive review of employee benefit accounting but deferred that to focus on more limited changes. The amended standard is the final product of this limited project.

The amended standard makes no change to the current measurement method in IAS 19, under which benefits are attributed to periods of service based on the benefit formula. The amended standard also does not change the current IAS 19 requirement to recognise expenses on a straight-line basis when employee service in later years will lead to a materially higher level of benefit than in earlier years, i.e. back-end loaded benefits.

Summary of changes

Scope and multi-employer plans

The amended standard makes no changes to the scope of IAS 19. There is therefore no blanket exemption for multi-employer plans from defined benefit accounting, which some sought, and the amended standard includes additional disclosures for multi-employer plans.

Recognition – including elimination of the corridor method

All changes in the present value of the defined benefit obligation and in the fair value of plan assets will be recognised in the financial statements immediately in the period they occur. The amended standard:

- eliminates the corridor method; and

- requires that past service costs be recognised in full immediately.

As a result, the net defined benefit liability (asset) will be recognised as:

- the present value of the defined benefit obligation;
- less the fair value of plan assets;
- taking into account the effect of the asset ceiling test, which might involve recognising an additional liability under IFRIC 14 *IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* for minimum funding requirements that relate to past service.

The amended standard will have a significant impact on entities that currently apply the corridor method. Actuarial gains and losses will no longer be deferred, affecting both the net defined benefit liability (asset) in the statement of financial position and the amounts recognised in profit or loss.

Presentation – including net interest income/expense calculation change

The presentation aspects of the amended standard split changes in the net defined benefit liability (asset) into different components, recognised in the statement of comprehensive income as follows:

- service cost (including past service cost and settlements) – recognised in profit or loss;
- net interest – also recognised in profit or loss; and
- remeasurement of the defined benefit liability (asset) – recognised in other comprehensive income.

The amended standard eliminates the ability for entities to recognise all actuarial gains and losses in profit or loss, which currently is allowed under IAS 19.

The exposure draft proposed to specify *where* in profit or loss an entity should present the service cost and finance cost components; this proposal has been dropped.

Service cost

The current service cost will be recognised in profit or loss. In addition, service cost will include past service cost (which now includes any gains and losses on curtailments) and any gains and losses on settlements (see below).

Net interest on the net defined benefit liability (asset)

The amended standard requires calculation of the net interest on the net defined benefit liability (asset) using the discount rate that is used to measure the defined benefit obligation (generally a high quality corporate bond rate). This rate, as determined at the start of the period, is applied to the amount of the net defined benefit liability (asset) at the start of the period, adjusted for any changes in the net defined benefit liability (asset) during the period as a result of contributions and benefit payments.

As a consequence, the full expected return on plan assets will no longer be recognised in profit or loss. The amended standard will reduce net profit for many entities as the discount rate applied to the defined benefit obligation under IAS 19 is often a lower rate than that used under the current IAS 19 to determine the expected return on plan assets. However, some may see net profit increase.

Remeasurements

Under the amended standard, remeasurements of a defined benefit liability (asset) comprise:

- actuarial gains and losses on the defined benefit obligation;
- the return on plan assets, excluding amounts included in net interest on the net defined benefit liability (asset); and
- any change in the effect of the asset ceiling, excluding amounts included in net interest on the net defined benefit liability (asset).

Under the amended standard, remeasurements will be recognised immediately in other comprehensive income. The immediate recognition of actuarial gains and losses (i.e. removal of the corridor method) will have a significant impact on those entities that currently apply the corridor method under IAS 19 and for those that currently recognise all changes in the defined benefit obligation and in plan assets in profit or loss.

The effect of any curtailments or settlements

Under the current IAS 19, entities applying the corridor method include in the calculation of a curtailment or settlement gain or loss a proportion of unrecognised actuarial gains and losses. Under the amended standard, entities will no longer have unrecognised actuarial gains and losses and hence the related guidance included in the current IAS 19 with respect to curtailments and settlements is removed. Settlements continue to be accounted for as part of costs recognised in profit or loss under the amended standard. This is a change from the exposure draft, which proposed that they would be presented as remeasurements in other comprehensive income. The current requirement to recognise curtailments in profit or loss will not change, although they will now form part of past service costs. A narrative description will be given of any settlements, curtailments and plan amendments.

Definitions

Short-term and other long-term employee benefits

The amended standard changes the definitions of short-term employee benefits and other long-term employee benefits so that the distinction between the two will depend on when the entity expects the benefit to be wholly settled. Under the amended definitions a benefit is short-term when it is expected to be settled wholly before 12 months after the end of the annual reporting period in which the employees render the related service. If this is not the case, then it is an other long-term employee benefit.

Since the expectation of settlement may change, the amended standard provides that an entity need not reclassify a short-term employee benefit as long-term if the entity's expectations of the timing of settlement change temporarily. However, the amended standard makes clear that if the change in expectations of the timing of the settlement is not temporary or if the characteristics of the benefit change, then the entity considers whether the classification of the benefit also needs to be changed.

This amendment to the definitions may result in entities having to reclassify some benefits from their current treatment as either short-term or other long-term benefits on adoption of the amended IAS 19 and hence change the measurement requirements that apply to those benefits.

Return on plan assets

The definition of return on plan assets is amended to address the following.

- ***The treatment of administration costs:*** the amendment results in the return on plan assets including any costs of managing plan assets, which therefore will be recognised in other comprehensive income as part of remeasurements. Under the amended standard other administration costs are not deducted from the return on plan assets.
- ***Tax payable by the plan itself:*** under the amended standard the return on plan assets includes any tax payable by the plan itself, other than taxes on contributions relating to service before the reporting date or on benefits resulting from that service, which are reflected in the measurement of the defined benefit obligation. If the nature of the tax is considered in concluding whether it is part of the return on plan assets under the current IAS 19, then we do not expect this amendment to result in significant changes in practice, except that taxes included in the return on plan assets now will be recognised in other comprehensive income rather than in profit or loss.

Termination benefits

The amended standard finalises proposals on termination benefits that were exposed in 2005 in connection with the exposure draft *Amendments to IAS 37 Provisions, Contingent Liabilities and Contingent Assets and IAS 19 Employee Benefits*.

Under the amended standard, a termination benefit is recognised at the earlier of when the entity recognises costs for a restructuring within the scope of IAS 37 that includes the payment of termination benefits and when the entity can no longer withdraw the offer of the termination benefits.

Disclosures

The amended standard makes various changes to current disclosures for defined benefit plans under IAS 19. The amended disclosures are categorised as:

- those that explain the characteristics of the entity's defined benefit plans and risks associated with them, e.g. descriptions of the nature of the benefits provided by the plan(s) and the effects of any regulatory framework;
- those that identify and explain the amounts in the financial statements, e.g. a reconciliation of the opening and closing balances of the net defined benefit liability (asset) showing separately reconciliations for plan assets, the present value of the defined benefit obligation and the effect of the asset ceiling (if any); and
- those that describe how defined benefit plans may affect the amount, timing and uncertainty of future cash flows, e.g. sensitivity analysis showing how changes in the significant actuarial assumptions would affect the net defined benefit liability (asset) and details of any asset-liability matching strategies used to manage risks.

Adoption in periods beginning on or after 1 January 2013

The amended standard is effective for annual periods beginning on or after 1 January 2013. Early adoption is permitted.

The amended standard generally applies retrospectively, in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. However, there are two exceptions to this application requirement.

- An entity need not adjust the carrying amount of assets outside the scope of IAS 19 (such as property, plant and equipment, and inventories) for changes in employee benefit costs that were included in their carrying amount before the date of initial application. The date of initial application is the beginning of the earliest prior period presented in the first financial statements in which the entity adopts the amended IAS 19.
- In financial statements for periods beginning before 1 January 2014, an entity need not present comparative information for the disclosures required about the sensitivity of the defined benefit obligation.

Abbreviations

1 IASB: International Accounting Standards Board

KPMG International Standards Group is part of KPMG IFRG Limited.

Publication name: *In the Headlines*

Publication number: Issue 2011/20

Publication date: June 2011

kpmg.com/ifrs

In the Headlines **is KPMG's update on International Financial Reporting Standards (IFRSs) and financial reporting related regulatory developments.**

If you would like further information on any of the matters discussed in this issue of *In the Headlines*, please talk to your usual local KPMG contact or call any of KPMG firms' offices.