



**ACCA-FEE PENSION ACCOUNTING SEMINAR -
CURRENT APPLICATION AND FUTURE ACCOUNTING?**

FEE offices Brussels

Wednesday, 11 March 2009, 16.30 Hrs

SUMMARY NOTES

Key Messages Pension Accounting Seminar:

- ***Broad support for abolishment of the “corridor” approach.***
- ***Further discussion needed on presentation (where to put the debit?): profit and loss or SORIE treatment, given the related volatility in the results; any answer given to this question should be consistent with the broader approach on Financial Statement Presentation.***
- ***Pension accounting should make financial statements more transparent.***
- ***In modern pension arrangements there is increasing risk sharing between employers’ and employees. Current standards were not written for new types of plans (eg, hybrids) which are increasingly common. For this reason, a fundamental review of pension accounting should be a high priority for the IASB.***
- ***Small changes not helpful: IASB needs to give priority to entire Pensions project.***

Olivier Boutellis-Taft, FEE Chief Executive Officer, opened the seminar highlighting the timely nature of the topic being addressed, i.e. the Accounting of Pensions, and thanked the Association of Chartered Certified Accountants (ACCA) for co-organising this event together with FEE and for their outstanding research conducted on the application of IAS 19 *Employee Benefits*. He called for FEE Member Bodies to continue co-organising events of this kind that help the accounting profession being closer to the ground. Pension accounting is a public interest theme; relevant to all citizens and can also impact business sustainability. There will be challenges ahead of the accounting profession during and after the current financial crisis and one of them is for sure Pension Accounting.

Mark Vaessen, Chairman of the FEE Financial Reporting Policy Group introduced the programme of the seminar. He pointed out that pension accounting has always been one of the important topics on which people have focussed because pensions are at the heart of the social contract between employers and their employees, with governments paying due attention and, in many instances, being part of the debate. The amounts involved in pension schemes are huge, both in terms of assets held in funds and liabilities on the books of companies that are to be funded in the future.

Pension accounting under IFRS has long been singled out for revision. From the moment the new IASB Board started in 2001, Sir David Tweedie (having just delivered FRS 17 in the UK) has been announcing that at some point pension accounting under IFRS needed to be revised. Many, like him, have questioned whether the current smoothing mechanisms in IAS 19 provide transparent enough information to be maintained as a model: why do we still have the corridor method and does it provide useful information. Pension laws in various Member States in the EU have been under revision or have already been modernised, with new forms of pension arrangements resulting (eg, with more equal risk sharing between employers and employees). Most recently, also in the light of the credit crisis, pension funds are reviewing again their investment policies and are (considering) switching from equities into bonds. Liability driven investments is being looked at in several countries as a potential new model. This raises the debate again about which discount rates to use and how to present the pension cost in the performance statement.



Professor Donna Street, University of Dayton, and **Jan Fasshauer**, University of Giessen presented the results of the ACCA research on the application of IAS 19 by major European companies under the title “Adoption of IAS 19 by Europe’s Premier Listed Companies”.

Research Objectives - The objectives of the research are to look at the prevalence of defined benefit plans at European blue chip companies, identifying the distribution of the pension accounting method selected (the corridor approach, full recognition through P&L or full recognition through SORIE); understand the rationale and impact of applying the IAS 19 option; quantify the “as-if-recognition impact” on the balance sheet and profit and loss account for companies that have used the corridor approach; assessing the transparency of disclosed pension assumptions; and determining best practice’ disclosures.

Background - Corporate Pension Schemes are found to be split into two types depending on their obligation character into “Defined Contribution Plans” (these are increasingly found in the US, the UK and Australia) and “Defined Benefit Plans”. Funding of defined benefit plans also differs within Europe. In some countries the DBO is funded, often through assets held in separate pension plans (e.g., Netherlands, UK). In other countries the obligation is often unfunded or funded through the company’s own assets (which under accounting standards qualifies as unfunded (traditionally the case in Germany)).

Accounting for defined benefit plans - Accounting for defined benefit plans is complex, primarily as it encompasses long-term liabilities based on several assumptions, including demographic and financial assumptions. Differences between assumptions and actual outcomes, as well as changes in assumptions, result in so called “actuarial gains and losses”. One of the key questions is what to do with these actuarial gains and losses. Current IAS 19 allows companies various options, including systematic spreading of actuarial gains and losses over future years (“the so-called corridor method”) and full recognition, either in profit or loss or, more usual, in equity through the so-called SORIE method.

The views on the “corridor” approach - The views on the “corridor” approach are diverse.

Sample and Findings - From a sample selection of major European companies, material defined benefit plans (2% of total assets) amounted to more than 65%.

In 2005 for the major European companies selected, 46% with material defined benefit plans opted for the full recognition through SORIE method of accounting. The method selected was influenced by country of domicile with most U.K. and Irish companies using full recognition. The majority of companies based in Germany, Denmark and Portugal also selected full recognition. For companies selecting the corridor approach, an estimation of the “as-if-impact” of immediate recognition may be a driving factor in the decision to use the corridor for some companies. However, there was a movement noted during 2006 and 2007 towards full recognition through the SORIE. 2008 data is not available yet.

When looking at why the “corridor” approach may become less popular, there is not much information available, but those companies answering the question appear to provide similar reasons, such as increased transparency, better presentation, ability to fully reflect the pension assets position and removing volatility.

Gilbert Gélard, Member of the IASB, and **Andrea Pryde**, IASB Project Manager presented the future of IAS 19.

Background - In 2008, the IASB issued a Discussion Paper on preliminary views on amendments to IAS 19 Employee Benefits, mainly because there was evidence that the current accounting model might include an inadequate measurement methodology and it was felt that the view of how well plans were funded was misleading. One of the key proposals in the DP is to fully recognise the net pension asset or liability in all cases, or in other words, to abolish the corridor method. Other proposals by the IASB included three new presentation approaches for the movement in the net asset or liability, including one to recognise and present all changes in the value of the plan assets and obligations in income in the period in which the changes occur. The proposals also redefine the boundary between existing defined benefit and contribution plans, by introducing two new definitions: for contribution based promises and for defined benefit promises. For contribution based promises, the DP introduced a new measurement basis, at fair value assuming that the terms of the benefit promise do not change. Finally, the DP also proposes a review of pension disclosures.



Summary of the responses to the Discussion Paper on preliminary views on amendments to IAS 19 Employee Benefits - On recognition, the overview of the feedback received on the discussion paper shows that most respondents support abolition of the corridor method and this is seen as a necessary and sufficient improvement. On presentation, more than 85% of the respondents support recognition (whether this is immediate recognition in the P&L or full recognition of the liability). However, many respondents would favour a final decision on the income statement presentation to be postponed until the Financial Statement Presentation project is completed

There was little support for the proposal of introducing a new category of promises measured at fair value assuming that the terms of the benefit promise do not change. On the disclosures, respondents advocated a principles-based approach, with appropriate sensitivity analysis and reflective of best practice.

Redeliberations to date - The tentative decisions of the IASB include the disaggregation of the changes in the defined benefit obligation and in plan assets into three categories (employment, financing and remeasurement costs) and disclosing the employment and financing components either in the income statement or in the notes. The tentative decision on the remeasurement component is to present it in the income statement, excluding service costs and interest costs and including the total return on plan assets and actuarial gains and losses on the defined benefit obligation. The Board expects to look at other issues of the ED at their March meeting. Decisions yet to be taken include how the remeasurements are presented in the income statement.

Next steps - There will be two separate Exposure Draft issued; the first ED is expected in the third quarter of 2009 and will address the recognition and presentation of the changes in the defined benefit obligation, disclosures and other issues that can be addressed expeditiously, while the second ED is not intended for completion before 2011 and will address contribution-based promises, potentially as part of a comprehensive review of pension accounting.

Stig Enevoldsen, Chairman of EFRAG TEG, and **Andrew Lennard**, Director of Research at the UK Accounting Standards Board (ASB) started their presentation on Pension Accounting by reference to the PAAinE Paper “The Financial Reporting of Pensions”. Pensions are important to a large range of stakeholders and pension accounting is a high priority that should be looked at in the light of sustainability. The main objective of the PAAinE paper was to propose the development of a new accounting standard that can be applied globally and to encourage debate in Europe.

Features of the PAAinE paper include going back to basics as well as looking for consistency between the principles applied in pension accounting and those used elsewhere in the standards, to assess whether there are any reasons why pensions should be treated differently. The concept of a liability to pay benefits is discussed in detail to raise the right questions that should help arrive at a proper accounting. The suggestion of no “corridor” approach or other deferrals is a key point.

There have been a large number of responses to the PAAinE paper and much acceptance of the abolition of the corridor approach and disclosure proposals. Controversial topics included questions as to whether measurement of the liability should be based on current or projected future salaries; whether the discount rate used should be risk free; and how to treat the liabilities in the plans’ accounts.

An analysis of the responses is in the process of being carried out and the proposals will be revised and refined on this basis to present recommendations and a summary of findings to the IASB.



Questions & Answers

- The appropriateness of using a risk free rate discount rate was questioned if the cashflows are uncertain and it was suggested that embedded risk rates might be more relevant, but the discussion on this area is still ongoing.
- Another point made was the necessity for the Pension Accounting project to be linked to the project on Insurance contracts and it was confirmed that consistency with this and other related projects is paramount, in particular with the Financial Statement Presentation project.
- A question was raised regarding the PAAinE paper on Pensions what it meant by taking away the distinction between defined contribution and defined benefit plans. The response was that this is an attempt to make clear what the underlying principles are that should apply to all plans.
- Concerns were expressed regarding the contribution base promise, that the IASB had drawn the line so widely, and that it might not to be suitable for all schemes. This issue was acknowledged now by the two step approach adopted by the Board in dealing with future EDs. The measurement issue is to be considered further in the second part of the IASB project.
- General concerns were noted in the Netherlands about the IASB proposals. The point was made that in the Netherlands many hybrid risk sharing schemes now exist for which the current IAS 19 does not provide a satisfactory answer. Some Dutch representatives expressed a desire, however, to keep the “corridor” approach until a fundamental review of IAS 19 had taken place. Other issues of concern in the Netherlands included in particular the treatment of multi-employer plans.
- Users’ views would agree to the full recognition (either through the SORIE or profit and loss) to minimise the distortion of the financial information presented. On the other hand, representatives from business organisations said that they would have major problems with solutions introducing significant volatility in the income statement. If the corridor method is no longer allowed recognition should be through SORIE, with an option for companies to go through P&L.
- The question was raised whether there may not have been an inconsistency between current practice and the reactions to the IASB proposals to abolish the “corridor” approach, if the results of the ACCA research showed that the corridor method still is a popular method in practice (while full recognition through the SORIE is already an option). An explanation for this might be that most companies and preparers might just be waiting for others to move.
- Regarding the IASB disclosure proposals, what sort of disclosures to provide about risks and variability in the future are key questions. Requiring an adequate volume of disclosures, both for preparers and users is one of the main challenges.
- Some representatives were a bit more sceptical about the consequences of moving to full recognition. They felt that when it comes to achieving transparency in pensions, there may be unintended consequences, in particular if trustees of pension plans are pushed to reduce volatility there may be tension with making the right decisions in the best interest of pension holders.
- There is pressure over accounting rules as a result of the financial crisis and it was noted that the credibility of accounting should not be undermined. The crisis requires a change in behaviour. The crisis could reduce the impact of defined benefit plans which became too expensive, as Gilbert Gélard said “Accounting helps managers think about what they are doing or about what they have been doing”.

(All materials referred to in the seminar including the three presentation slides are available on the FEE website at: http://www.fee.be/news/default.asp?library_ref=2&category_ref=214&content_ref=966).