

**Meeting:** International Public Sector Accounting  
Standards Board

**Meeting Location:** Toronto, Canada

**Meeting Date:** September 22–25, 2015

## Agenda Item 12

For:

☐ Approval

☒ Discussion

☐ Information

### Employee Benefits

#### Objective of Agenda Item

1. The objective of this session is to **review** an Issues Paper on Employee Benefits; and to **provide directions** for further development of the project.

#### Material(s) Presented

Agenda Item 12.1      Issues Paper, *Employee Benefits*

#### Action(s) Requested

2. The IPSASB is asked to **consider** the Matters for Comment presented in Agenda Item 12.1, and to **provide input and direction** on the way forward.

**Issues Paper, *Employee Benefits*****Introduction**

1. At its March 2015 meeting, the IPSASB approved a limited-scope project to revise the current IPSAS 25, *Employee Benefits*, which was drawn primarily from International Accounting Standard (IAS) 19 (2004), *Employee Benefits*, issued by the International Accounting Standards Board (IASB).
2. The IASB revised IAS 19 (2004), *Employee Benefits* in April 2011, to eliminate an option that allowed an entity to leave actuarial gains and losses unrecognized if they are within a “corridor”<sup>1</sup> and to defer the recognition of actuarial gains and losses outside the corridor (“the corridor approach”) and amending some of the disclosure requirements for defined benefit plans and multi-employer plans.
3. IAS 19 was revised again in November 2013, to simplify the requirements for contributions from employers or third parties to a defined benefit plan, when those contributions are applied to a simple contributory plan that is linked to a service.
4. Other IAS/International Financial Reporting Standards (IFRS) have made consequential changes to IAS 19.
5. This project aims to issue a revised IPSAS 25 to maintain convergence with the underlying IAS 19, as published in 2015. Government Finance Statistics (GFS) will also be considered in each section of the Issues Paper.
6. This Issues Paper discusses the main issues that staff has identified to develop the project in line with the IPSASB’s directions on the project brief, and asks the IPSASB to provide input and direction on the way forward.

**Significant Issues**

7. Staff has identified the following issues related with the scope of the project:
  - (a) IAS 19 (2011 revision);
  - (b) Shared risk plans (including revisions in 2011 and 2013 and IASB research project);
  - (c) Composite Social Security Programs
  - (d) Constructive obligation versus legal liability;
  - (e) Public sector specific reasons to depart from IAS 19; and,
  - (f) Terminology update.
8. This Issues Paper discusses issues (a), (b) and (c) and asks the IPSASB to provide a direction on the way forward about the scope of the project. Issues (d), (e) and (f) will be discussed at the IPSASB December 2015 meeting, along with other issues that staff might meanwhile identify.

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<sup>1</sup> The greater of 10 per cent of plan assets and 10 per cent of plan liabilities.

9. This project is classified by IPSASB as a convergence project. Therefore, staff will follow the guidance provided in IPSASB's policy paper *Process for Reviewing and Modifying IASB Documents*<sup>2</sup> when discussing the scope of the project.
10. In order to reduce differences between IPSASs and GFS reporting guidelines, staff will also consider GFS in each section of the Issues Paper by following the IPSASB's policy paper *Process for Considering GFS Reporting Guidelines during Development of IPSASs*<sup>3</sup>.

#### **IAS 19 (2011 revision)**

11. Regarding the 2011 revision of IAS 19, staff has identified the following issues related with the scope of the project<sup>4</sup>:
  - (a) Recognition of changes in the net defined benefit liability (asset);
  - (b) Plan amendments, curtailments and settlements;
  - (c) Disclosures;
  - (d) Accounting for termination benefits;
  - (e) Classification of short-term employee benefits;
  - (f) Current estimates of mortality rates; and
  - (g) Tax and administration costs.

#### *Recognition of changes in the net defined benefit liability (asset)*

12. The changes to recognition in IAS 19 with potential impact in the revision of IPSAS 25 include the immediate recognition of defined benefit cost and the disaggregation of defined benefit cost into components.
  - (A) Immediate recognition of defined benefit cost
13. The most fundamental change to IAS 19 (2004) was eliminating the corridor option that allowed an entity to leave actuarial gains and losses unrecognized if they are within a "corridor" and to defer the recognition of actuarial gains and losses outside the corridor. This corridor option still exists in IPSAS 25.
14. According to paragraph 105 of IPSAS 25, the corridor option requires an entity to "recognize a portion of its actuarial gains and losses as revenue or expense if the net cumulative unrecognized actuarial gains and losses at the end of the previous reporting period exceeded the greater of:
  - (a) 10% of the present value of the defined benefit obligation at that date (before deducting plan assets); and
  - (b) 10% of the fair value of any plan assets at that date."

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<sup>2</sup> <http://www.ifac.org/system/files/publications/files/IPSASB-Rules-of-the-Road-Oct2008.pdf>

<sup>3</sup> <http://www.ifac.org/system/files/publications/files/IPSASB-GFS-Policy-Paper.pdf>

<sup>4</sup> The amendments made in 2011 and 2013 about risk-sharing and conditional indexation features are discussed in the shared-risk plans section (see paragraphs 107-134).

15. Paragraph 106 of IPSAS 25, states that “the portion of actuarial gains and losses to be recognized for each defined benefit plan is the excess determined in accordance with paragraph 105, divided by the expected average remaining working lives of the employees participating in that plan. However, an entity may adopt any systematic method that results in faster recognition of actuarial gains and losses, provided that the same basis is applied to both gains and losses, and the basis is applied consistently from period to period. An entity may apply such systematic methods to actuarial gains and losses even if they are within the limits specified in paragraph 105.”
16. When reviewing the IAS 19 (2004), the IASB took the view that:
  - (a) “immediate recognition provides information that is more relevant to users of financial statements than the information provided by deferred recognition. It also provides a more faithful representation of the financial effect of defined benefit plans on the entity and is easier for users to understand”<sup>5</sup>; and,
  - (b) “makes it easier for users to compare entities”<sup>6</sup>.
17. In contrast, “deferred recognition can produce misleading information in cases [...] [where] an asset may be recognized in the statement of financial position, even in when a plan is in deficit, or the statement of comprehensive income may include gains and losses that arise from economic events that occurred in past periods”<sup>7</sup>.
18. The elimination of the corridor approach implies a recognition of all changes in the fair value of plan assets and in the employee benefits obligation in the period in which those changes occur. Appendix A presents a simplified illustrative example of the accounting treatments before and after the necessary amendments to IPSAS 25 to converge with IAS 19.
19. As a first step in modifying IASB documents, the IPSASB's policy paper requires an assessment on whether public sector issues warrant a departure in recognition or measurement, or in presentation or disclosure. This assessment includes:
  - (a) Whether applying the requirements of the IASB document would mean that the objectives of public sector financial reporting would not be adequately met;
  - (b) Whether applying the requirements of the IASB document would mean that the qualitative characteristics of public sector financial reporting would not be adequately met; and,
  - (c) Whether applying the requirements of the IASB document would require undue cost or effort.

Objectives of public sector financial reporting

20. According to paragraph 2.1 of *The Conceptual Framework for General Purpose Financial Reporting By Public Sector Entities*, the objectives of financial reporting are “to provide information about the entity that is useful to users of GPFRs for accountability purposes and for decision-making purposes”.
21. Staff is of the view that eliminating the corridor approach would meet the objectives of public sector financial reporting because:

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<sup>5</sup> BC70 of IAS 19, *Employee Benefits*

<sup>6</sup> BC71 of IAS 19, *Employee Benefits*

<sup>7</sup> BC70 of IAS 19, *Employee Benefits*

- (a) It would enhance accountability about the changes in the fair value of plan assets and in the employee benefits obligation in the period in which those changes occur; and,
- (b) It would enable better decision-making about the management of pension plan resources.

#### Qualitative characteristics of public sector financial reporting

22. Staff is of the view that the elimination of the corridor approach would benefit the following qualitative characteristics:
- (a) Understandability – because the full financial consequences of any changes to the plan assets and employee benefits obligation would be immediately recognized in the statement of financial performance and is easier to understand by users of financial statements;
  - (b) Comparability – the elimination of options increases comparability of entities;
  - (c) Faithful representation – allows a more faithful representation of the financial effect of defined benefit plans;
  - (d) Relevance – provides more relevant information for decision-making and accountability purposes.

#### Undue cost or effort in applying the requirements of the IASB

23. Staff did not identify any undue cost or effort in removing the corridor approach from IPSAS 25. Staff notes that the revised accounting treatment does not require further actuarial calculations.

#### Government finance statistics

24. GFS reporting guidelines<sup>8</sup> do not have the corridor approach. This means that the actuarial gains or losses are fully recognized in the financial statements and there is no deferral in the recognition of actuarial gains or losses<sup>9</sup>.
25. In conclusion, staff did not identify any public sector specific reason that warrant departure from IAS 19. Therefore, staff recommends IPSASB to eliminate the corridor approach in IPSAS 25.

#### Matter(s) for Consideration

1. The IPSASB is asked to **indicate** whether it agrees with the staff recommendation to eliminate the corridor approach in IPSAS 25 or provide alternative directions.

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<sup>8</sup> System of National Accounts, 2008 (2008 SNA), Government Finance Statistics 2014 (GFSM 2014) and European System of Accounts (ESA 2010).

<sup>9</sup> Staff notes that according to paragraph 20.272 of ESA 2010, the pension entitlements of government sponsored unfunded employment-related defined benefit schemes are to be recorded only in supplementary accounts and not in the core accounts. However, according to paragraph 7.193 of GFSM 2014 the liabilities of unfunded pension schemes should also be included in pension entitlements. This distinction in the treatment of unfunded pension liabilities in the two GFS manuals is particularly relevant for European countries that apply ESA 2010 and non-European countries that apply GFSM 2014.

(B) Disaggregation of defined benefit cost into components

(i) Service cost

26. The IASB decided to exclude changes in the defined benefit obligation that result from changes in demographic assumptions from the service cost component, which includes current service cost, past service cost and any gain or loss on settlement. Changes in demographic assumptions are included in the remeasurements component together with other actuarial gains and losses.
27. The IASB took the view that, “including the effect of changes in demographic assumptions in the service cost component would combine amounts with different predictive values and, consequently, the service cost component is more relevant for assessing an entity’s continuous operational costs if it does not include changes in past estimates of service cost”<sup>10</sup>.

(ii) Net interest approach

28. IPSAS 25 recognizes the interest costs and the expected return on plan assets in surplus and deficit<sup>11</sup>. When no market price is available, the fair value of plan assets is estimated, for example, by discounting expected future cash flows using a discount rate that reflects both the risk associated with the plan assets and the maturity or expected disposal date of those assets (or, if they have no maturity, the expected period until the settlement of the related obligation).
29. IAS 19 adopts the net interest approach. Net interest expense (income) represents the change in the defined benefit obligation and the plan assets as a result of the passage of time. It is calculated as the product of the net balance sheet defined benefit liability (asset) and the discount rate used to measure the employee benefit obligation, each as at the beginning of the annual period.
30. If this approach is to be adopted in IPSAS 25, it would remove the concept of expected return on plan assets that is now recognised in surplus and deficit under IPSAS 25 (See Appendix B) because:
- (a) There would be one single discount rate (the same discount rate used to measure the defined benefit obligation); and,
  - (b) There would be one single recognition of the net interest.
31. According to IASB, “a net interest approach provides more understandable information than would be the case if finance income and expenses were to be determined separately on the plan assets and defined benefit obligation that combine to make a net defined benefit liability (asset). The net interest approach results in an entity recognising interest income when the plan has a surplus, and interest cost when the plan has a deficit”<sup>12</sup>.
32. As the defined benefit obligation arises from the passage of time and the plan assets also has an amount that arises from the passage of time, the IASB was of the view that the “net interest component of defined benefit cost should include not only the interest cost on the defined benefit obligation, but also the part of the return on plan assets that arises from the passage of time”<sup>13</sup>.

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<sup>10</sup> Paragraph BC73 of IAS 19

<sup>11</sup> Paragraph 74(b) and (c)

<sup>12</sup> Paragraph BC76 of IAS 19

<sup>13</sup> Paragraph BC77 of IAS 19

(iii) Remeasurements

33. As a consequence of the net interest approach and the decisions on the service cost, remeasurements would comprise:
- (a) Actuarial gains and losses on the defined benefit obligation;
  - (b) Return on plan assets, excluding amounts included in net interest on the defined benefit liability (asset); and,
  - (c) Any change in the effect of the asset ceiling, excluding amounts included in net interest on the defined liability (asset).
34. The defined benefit liability (asset) in IAS 19 is now measured at the lower of:
- (a) The surplus in the defined benefit plan; and
  - (b) The asset ceiling, determined using the discount rate specified in paragraph 83<sup>14</sup>.
35. The asset ceiling is now a defined term in IAS 19 as the present value of any economic benefits available in the form of refunds from the plan.
- (iv) Recognition of defined benefit cost components
36. According to paragraph 74 of IPSAS 25, the net total of components of defined benefit cost is recognized in surplus or deficit.
37. IAS 19 has a new presentation approach for changes in defined benefit obligations and the fair value of plan assets. According to IAS 19, entities split changes in the defined benefit obligation and the fair value of plan assets into service cost, finance cost and remeasurement components and present:
- (a) The service cost component in profit or loss;
  - (b) The finance cost component, i.e., the net interest on the net defined benefit liability or asset, as part of finance costs in profit or loss;
  - (c) The remeasurement component in other comprehensive income.
38. IAS 19 does not allow the remeasurement component to be reclassified to profit and loss in a subsequent period. However, the entity is allowed to transfer those amounts recognized in other comprehensive income within equity<sup>15</sup>.
39. If the IPSASB accepts staff's proposal to include the net interest approach in IPSAS 25, this would imply that the recognition of the net interest would be in the finance costs of the Statement of Financial Performance.
40. Regarding the recognition of remeasurements in other comprehensive income, staff notes that IPSAS 1, *Presentation of Financial Statements* does not require the separate presentation of other comprehensive income either on the face or as additional statements. In fact, the notion of "other comprehensive income" is not recognized or used in IPSASB's literature and the Conceptual

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<sup>14</sup> Staff notes that the discount rate used in IPSAS 25 is different from IAS 19. Staff will bring this subject to the December 2015 IPSASB meeting.

<sup>15</sup> Paragraph 122 of IAS 19

Framework confirmed this. Currently the IPSASB approach is to take transactions directly to net assets/equity.

41. Staff notes that the IASB “concluded that the most informative way to disaggregate the components of defined benefit cost with different predictive values is to recognise the remeasurements component in other comprehensive income”<sup>16</sup>.
42. The following table provides a summary of staff’s assessment of the applicability of IAS 19’s new requirements to IPSAS 25.

Criteria to meet public sector financial reporting	Service cost component – Exclusion of changes in demographic assumptions	Net interest approach	Recognition of defined benefit cost components – Finance costs	Remeasurements – Net assets/equity
<b>Objectives</b>				
Accountability	Reinforces accountability by not mixing amounts with different predictive values	Reinforces accountability because the net interest is the cost of financing owed by the entity to the plan or to the employees		Reinforces accountability because different predictive values are not mixed
Decision-making	Enables a more focused decision-making in the management of employee benefits			Informs about components with different predictive values
<b>Qualitative characteristics</b>				
Relevance	Not mixing amounts with different predictive values provides more relevant information about an entity’s continuous operational costs	Has a confirmatory value about the cost that arises from the passage of time.		Financial information with different predictive values
Faithful Representation	Provides a more complete evidence about the changes in employee benefits due to demographic changes and the continuous operational costs	Provides a more complete evidence of the time value of money		Provides a more complete evidence of financial information with different predictive values.
Understandability	Enhances the understandability about the service cost component	Enhances the understandability about the cost of the employee benefits		
Timeliness	No foreseen effect			
Comparability	Enables the comparability between service cost component of several years	Increased comparability between the cost of the financial obligation from employee benefits and other financial obligations		No foreseen effect
Verifiability	Enables to demonstrate the continuous operational costs without changes in past estimates of service cost	Enables to demonstrate the cost that arises from the passage of time		No foreseen effect
<b>Undue cost or effort</b>				
	No foreseen undue cost or effort			

43. The table above shows that the IASB amendments meet the objectives and qualitative characteristics of public sector financial reporting without any foreseen undue cost or effort. Furthermore, staff did not identify a public sector specific reason that warrants not excluding the changes in demographic assumptions from the service cost component and not adopting the net interest approach, the recognition of the finance cost component in finance costs, and the recognition of the actuarial gains or losses in net assets/equity.

<sup>16</sup> Paragraph BC90 of IAS 19



Government finance statistics

44. Regarding the net interest approach that currently exists in IAS 19, GFSM 2014 does not record the interest cost on the defined benefit obligation in an interest account. GFSM 2014 records the increase in liability for benefit entitlements due to the passage of time in *property expense for investment income disbursements* in the case of:
- (a) The Government operates a funded non-autonomous pension fund for its employees (i.e., a separate reserve is maintained in the government account but it is not an institutional unit); and,
  - (b) The Government operates an unfunded non-autonomous pension fund for its employees (i.e., there are no actual contributions and no separate reserve is maintained in the government account).
45. Changes that are due to price escalation clause, changes in the formula used to determine benefits and demographic assumptions about life length are recorded in the Statement of Other Economic Flows as follows:
- (a) The change in the interest rate used to discount the future benefits (holding gain or losses);
  - (b) The change in the liability resulting from a change in the benefit structure through an unilateral change brought about by the employer (other volume changes);
  - (c) The change in the price escalation (holding gain or losses); and,
  - (d) The impact of promotions, merit increases, and other real salary increases on entitlements (holding gain or losses).
46. Because the above changes are recorded in the statement of other economic flows, the statement of operations is not affected. Consequently, net lending/net borrowing is not affected.
47. GFSM 2014 does not have specific requirements about which discount rate should be used to calculate the present value of the defined benefit obligation. On the other hand, GFS reporting guidelines are not explicit on using the same discount rate for the determination of the net defined benefit liability (asset) as for measurement of the defined benefit obligation.
48. Staff is of the view that these different approaches to disclosure, recognition and measurement between IPSASs and GFS might be related to the different objectives of both accounting systems. Therefore, staff recommends referring this issue to the statistical community for consideration of a possible GFS change on the disclosure of actuarial assumptions, on the net interest approach and the discount rate.
49. Staff notes that the GFSM 2014 recognition approach to the items in the paragraph 44 is similar to IAS 19 because by recognizing remeasurements in other comprehensive income it affects net assets/equity and not profit and loss (surplus and deficit in IPSAS 25).
50. Staff is of the view that recognition of the remeasurement components in net assets/equity in IPSAS 25 would have the same accounting consequences as in IAS 19 and GFSM 2014.
51. In summary, staff proposes:
- (a) The exclusion of changes in demographic assumptions from the service cost component;
  - (b) The net interest approach;

- (c) The recognition of the finance cost component to be recognized in finance costs and the recognition of remeasurements in net assets/equity; and
- (d) That the IPSASB considers referral to the statistical community for consideration of a possible change to GFS about the disclosures on employee benefits and the net interest approach. (step 3/A2 of the *Process for Considering Differences between IPSASs and GFS Reporting Guidelines*).

**Matter(s) for Consideration**

2. The IPSASB is asked to **indicate** whether it agrees with the staff recommendation to:
- (a) Exclude changes in demographic assumptions from the service cost component;
  - (b) Adopt the net interest approach;
  - (c) Recognize the finance cost component in finance costs;
  - (d) Recognize the remeasurements in net assets/equity; and,
  - (e) Consider referring the issues of (i) disclosures on employee benefits and (ii) the net interest approach to the statistical community; or **provide** alternative directions.

*Plan amendments, curtailments and settlements*

52. IPSAS 25 requires immediate recognition of *unvested*<sup>17</sup> past service costs as an expense on a straight-line basis over the average period until the benefits become vested<sup>18</sup> while the *vested* past service costs are recognized immediately.
53. IAS 19 requires immediate recognition of both *vested* and *unvested* past service cost in the period of the plan amendment that gives rise to the past service cost. IAS 19 amended the definitions of past service cost, curtailments and settlements.
54. The IASB decided to recognize immediately the *unvested* past service costs because it is more consistent with the recognition of *unvested* current service cost that IAS 19 treats as an obligation in paragraph 72<sup>19</sup>.
55. IPSAS 25 also recognizes the *unvested* current service cost<sup>20</sup>.
56. Staff is of the view that recognizing immediately both *vested* and *unvested* past service cost would:
- (a) Meet the objectives of public sector financial reporting because it enables to make accountable the entity's management for the decision to assign benefits related to past service; and,

<sup>17</sup> Unvested employee benefits are employee benefits conditional on future employment.

<sup>18</sup> Vested employee benefits are employee benefits not conditional on future employment.

<sup>19</sup> Paragraph 72 of IAS 19 states that: *Employee service gives rise to an obligation under a defined benefit plan even if the benefits are conditional on future employment (in other words they are not vested). Employee service before the vesting date gives rise to a constructive obligation because, at the end of each successive reporting period, the amount of future service that an employee will have to render before becoming entitled to the benefit is reduced. In measuring its defined benefit obligation, an entity considers the probability that some employees may not satisfy any vesting requirements. Similarly, although some post-employment benefits, for example, post-employment medical benefits, become payable only if a specified event occurs when an employee is no longer employed, an obligation is created when the employee renders service that will provide entitlement to the benefit if the specified event occurs. The probability that the specified event will occur affects the measurement of the obligation, but does not determine whether the obligation exists.*

<sup>20</sup> See paragraph 82 of IPSAS 25.

- (b) Reinforce the internal consistency within IPSAS 25 because *unvested* current service cost is already recognized in IPSAS 25.
57. Staff did not identify a public sector specific reason that warrant a different recognition from IAS 19.
58. Staff notes that if the IPSASB agrees with the staff proposal to recognize immediately the unvested past service cost, the definitions of plan amendments and curtailments need to be amended because unvested past service cost will have the same accounting as curtailments – immediate recognition in surplus or deficit.
59. Currently, IPSAS 25 defines curtailments as follows:
- “A curtailment occurs when an entity either:
- (a) Is demonstrably committed to make a significant reduction in the number of employees covered by a plan; or
- (b) Amends the terms of a defined benefit plan so that a significant element of future service by current employees will no longer qualify for benefits, or will qualify only for reduced benefits.”<sup>21</sup>
60. If the staff proposal is adopted, there is no longer any reason to distinguish past service cost and the second part of the definition of curtailments because past service cost will include amounts attributed to past service resulting from any plan amendment with the same accounting – immediate recognition in surplus or deficit.
61. The new definition of a curtailment would be as follows:
- A curtailment occurs when an entity significantly reduces the number of employees covered by a plan.
62. Staff notes that the current service cost definition and past service cost definition in IPSAS 25 would be included in a new definition of *service cost* in the revised IPSAS 25 as follows:
- Service cost comprises:
- (a) Current service cost, which is the increase in the present value of the defined benefit obligation resulting from employee service in the current period;
- (b) Past service cost, which is the change in the present value of the defined benefit obligation for employee service in prior periods, ~~resulting in the current period from the introduction of, or changes to, post-employment benefits or other long-term employee benefits~~ from a plan amendment (the introduction or withdrawal of, or changes to, a defined benefit plan) or a curtailment (a significant reduction by the entity in the number of employees covered by a plan). ~~Past service cost may be either positive (when benefits are introduced or changed so that the present value of the defined benefit obligation increases) or negative (when existing benefits are changed so that the present value of the defined benefit obligation decreases).; and~~
- (c) Any gain or loss on settlement.
63. The new definition of a settlement in IAS 19 clarifies that it is a payment of benefits that is not set out in the terms of the plan. The payment of benefits that are in the terms of the plan are included in the actuarial assumptions.

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<sup>21</sup> Paragraph 131 of IPSAS 25

64. "Settlement" is not a defined term in IPSAS 25. Paragraph 132 of IPSAS has a description of a settlement, but this does not provide the clarification that the IAS 19 now does.
65. Therefore, staff proposes to include a new defined term about settlements as follows:
- A settlement is a transaction that eliminates all further legal or constructive obligations for part or all of the benefits provided under a defined benefit plan, other than a payment of benefits to, or on behalf of, employees that is set out in the terms of the plan and included in the actuarial assumptions.
66. Staff notes that if the IPSASB agrees with the above proposed definition there will be consequential amendments to paragraphs 132-134 of the section on settlements.

#### Government finance statistics

67. GFS reporting guidelines are not explicit about the accounting treatment of *vested* and *unvested* past service cost, curtailments and settlements.
68. Nevertheless, staff notes that according to GFS reporting guidelines if the employer makes a unilateral structural change in pension entitlements, i.e., imposed without negotiation, it is recorded as other changes in the volume of assets. If it the change is negotiated it is considered as a capital transfer and, therefore, affects net lending/net borrowing.
69. Staff recommends that the IPSASB considers referral to the statistical community for consideration of a possible change to GFS about plan amendments, curtailments and settlements (step 3/A2 of the *Process for Considering Differences between IPSASs and GFS Reporting Guidelines*).

#### Matter(s) for Consideration

3. The IPSASB is asked to **indicate** whether it agrees with the staff recommendation to:
- (a) Recognize *unvested* past service cost in the period of the plan amendment that gives rise to the past service cost;
  - (b) Adopt a new definition of service cost, curtailment and settlement; and,
  - (c) Consider referring the issues of the accounting treatment of *vested* and *unvested* past service cost, curtailments and settlements to the statistical community; or **provide** alternative directions

#### Disclosures

70. The changes to disclosures made by the IASB to IAS 19 (2004) are related to:
- (a) State plan and group plan; and,
  - (b) Defined benefits plans.

#### State plan and group plan

71. IAS 19 now requires disclosures about "entities that participate in state plans or defined benefit plans that share risks between various entities under common control, to be consistent with the disclosure requirements for multi-employer plans and defined benefit plans"<sup>22</sup> with a permission to insert a cross-

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<sup>22</sup> Paragraph BC51 of IAS 19

reference to required disclosures in another group entity's financial statements, if specified conditions are met.

72. Staff did not identify a public sector specific reason not to adopt the above disclosure in a revised version of IPSAS 25. Therefore, staff recommends that the IPSASB to adopt the same disclosure on state plan and group plan as in IAS 19.

#### Defined benefits plans

73. There was a major revision of the disclosures about defined benefits plans including:
- (a) Disclosure objectives;
  - (b) The characteristics of the defined benefit plan and the amounts in the financial statements resulting from those plans;
  - (c) The amount, timing and uncertainty of the entity's future cash flows; and,
  - (d) Multi-employer defined benefit plan.
74. Due to the deletion of the corridor approach in IAS 19, the disclosures about the deferred recognition of actuarial gains and losses were deleted.
- (A) Disclosure Objectives
75. IPSAS 25 has two disclosure objectives related to information that enables users of financial statements to evaluate the nature of its defined benefit plans and the financial effects of changes in those plans during the period.
76. IAS 19 now has three disclosure objectives related to defined benefit plans about the:
- (a) The characteristics of its defined benefit plans and risks associated with them;
  - (b) The amounts in its financial statements arising from its defined benefit plans;
  - (c) How the defined benefit plans may affect the amount, timing and uncertainty of the entity's future cash flows.
77. The IASB introduced these three disclosure objectives in IAS 19 because it wanted to focus "on the matters most relevant to users of the employer's financial statements"<sup>23</sup>.
78. IAS 19 also included a requirement for entities to disclose additional information if required to meet the disclosure objectives.
79. Staff did not identify a public sector specific reason not to adopt the same disclosure objectives in a revised version of IPSAS 25. Therefore, staff recommends that the IPSASB to adopt the same disclosure objectives as in IAS 19.

#### Government finance statistics

80. GFS reporting guidelines do not require disclosures about employee benefits, which probably reflects the different objectives of both accounting systems. Staff recommends that the IPSASB considers referral to the statistical community for consideration of a possible change to GFS about the

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<sup>23</sup> Paragraph BC213 of IAS 19

disclosures on employee benefits (step 3/A2 of the *Process for Considering Differences between IPSASs and GFS Reporting Guidelines*).

**Matter(s) for Consideration**

4. The IPSASB is asked to **indicate** whether it agrees with the staff recommendation:
- (a) To adopt disclosures about state plan and group plan consistent with multi-employer plans and defined benefit plans;
  - (b) To adopt the disclosure objectives of IAS 19; and,
  - (c) To consider referral to statistical community for consideration of a possible change to GFS on disclosures about employee benefits; or **provide** alternative directions

(B) Characteristics of defined benefit plans

81. In order to meet the financial objective of disclosing the characteristics of defined benefit plans, the IASB changed the disclosures about:

- (a) Additional information about exposure to risk – The IASB decided to focus the disclosure “on risks that the entity judges to be significant or unusual”<sup>24</sup>;
- (b) Distinguishing between actuarial gains and losses arising from demographic and financial assumptions – The IASB “observed that, in general, financial assumptions are less intertwined with demographic assumptions than with other financial assumptions and concluded that it would not be unduly difficult to distinguish the effects of changes in financial assumptions from the effects of changes in demographic assumptions”<sup>25</sup>. Therefore, IAS 19 now requires that disaggregation and disclose<sup>26</sup> to show the re-estimate of service cost;
- (c) Not requiring an entity to distinguish between plan amendments, curtailments and settlements if they occur together – The IASB was of the view that requiring entities to distinguish plan amendments, curtailments and settlements for disclosure would be excessive when they occur together<sup>27</sup>;
- (d) Stating a principle for the disaggregation of plan assets rather than listing the categories required – The IASB introduced the principle of disaggregating the plan assets into classes that distinguish the nature and risks of those assets, subdividing each class of plan asset into those that have a quoted market price in an active market<sup>28</sup>; and,
- (e) Stating a principle for the disclosure of significant actuarial assumptions rather than listing the assumptions required to be disclosed – The IASB is of the view that “disclosures may not be needed in every case to meet the disclosure objectives [as] such disclosures may obscure

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<sup>24</sup> Paragraph BC216 of IAS 19

<sup>25</sup> Paragraph BC219 of IAS 19

<sup>26</sup> Paragraph 141(c) of IAS 19

<sup>27</sup> See paragraph BC220 of IAS 19.

<sup>28</sup> See paragraphs BC221-226 of IAS 19.

important information with excessive detail”<sup>29</sup>. Therefore, when applying IAS 19 entities use judgement to determine which actuarial assumptions require disclosure.

- (C) The amounts in the financial statements resulting from plans objectives
- (f) Information about asset-liability matching strategies – The IASB was of the view “that disclosure about the asset-liability matching strategy may be more useful than disclosure about the general investment strategy because an asset-liability matching strategy aims to match the amount and timing of cash inflow from plan assets with those of cash outflow from the defined benefit obligation”<sup>30</sup>;
  - (g) Sensitivity analysis – IAS 19 requires an entity to disclose how the effect of reasonably possible changes to significant actuarial assumptions affect the defined benefit obligation to enhance the understandability of the risks underlying the amounts recognised in the financial statements<sup>31</sup>; and,
  - (h) Information about the funding and duration of the liability – The IASB concluded “that disclosing when, on average, the liabilities of a defined benefit plan mature would help users to understand the profile of cash flows required to meet the obligation”<sup>32</sup>.
- (D) Multi-employer plan
- (i) Qualitative information about any agreed deficit or surplus allocation on wind-up of a multi-employer plan, or the amount that is required to be paid on withdrawal of the entity from the plan – Among other reasons, the IASB was of the view that this information is useful in cases where the “entity is not committed to withdrawing from the plan, the plan is not committed to being wound up or a withdrawal liability has not been agreed between the entity and the plan, determining the withdrawal liability would be difficult”<sup>33</sup>; and,
  - (j) The level of participation in a multi-employer plan – The IASB was of the view that this information “provides information about the effect of any surplus or deficit on the amount, timing and uncertainty of an entity’s future cash flows”<sup>34</sup>.
82. Staff did not identify a public sector specific reason not to adopt the same disclosures on characteristics of the defined benefit plans and the amounts in the financial statements resulting from plans objectives in a revised version of IPSAS 25. Therefore, staff recommends IPSASB to adopt the same disclosures as in IAS 19.

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<sup>29</sup> Paragraph BC228 of IAS 19

<sup>30</sup> Paragraph BC223 of IAS 19

<sup>31</sup> See paragraphs BC235-239 of IAS 19.

<sup>32</sup> Paragraph BC243 of IAS 19

<sup>33</sup> Paragraph BC247(a) of IAS 19

<sup>34</sup> Paragraph BC251 of IAS 19

**Matter(s) for Consideration**

5. The IPSASB is asked to **indicate** whether it agrees with the staff recommendation to adopt the disclosures of IAS 19 about characteristics of defined benefit plans, the amounts in the financial statements resulting from plan objectives and multi-employer plan, or **provide** alternative directions

*Accounting for termination benefits*

83. IAS 19 introduced amendments to termination of benefits in the following areas:

- (a) Recognition; and,
- (b) Measurement.

(A) Recognition

84. Under the current requirements of IPSAS 25, an entity recognizes termination benefits as a liability and an expense when, and only when, the entity is *demonstrably committed* to provide those benefits<sup>35</sup>. However, currently under IPSAS 25<sup>36</sup> the employer can withdraw the commitment on the plan termination without communicating it to the employee. IAS 19 (2004) had a similar requirement to IPSAS 25.
85. When the IASB considered this subject it “decided that the factor determining the timing of recognition is the entity’s inability to withdraw the offer of termination benefits”<sup>37</sup>. This would occur when the employee accepts the offer or when the entity communicates a termination plan to the affected employees.
86. Therefore, the IASB “added a requirement specifying that an entity does not have a present obligation to provide termination benefits until it has communicated its plan of termination to each of the affected employees”<sup>38</sup>.
87. The IASB also added a requirement to recognise costs for a restructuring that is within the scope of IAS 37 and involves the payment of termination benefits.
88. Staff notes that IASB’s view is consistent with the discussion of liabilities arising from non-legally binding obligations in the Conceptual Framework chapter on Elements.
89. Staff did not identify a public sector specific reason not to adopt the same recognition requirements in a revised version of IPSAS 25. Therefore, staff recommends IPSASB to adopt the same recognition as in IAS 19.

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<sup>35</sup> Paragraph 155 of IPSAS 25

<sup>36</sup> Paragraph 156 of IPSAS 25

<sup>37</sup> Paragraph BC259 of IAS 19

<sup>38</sup> Paragraph BC260 of IAS 19



(B) Measurement

90. IPSAS 25 does not have measurement guidance on termination benefits, apart from stating that termination benefits that fall due more than 12 months after the reporting date should be discounted<sup>39</sup>. IAS 19 (2004) had a similar requirement.
91. The IASB “amended the standard to state explicitly that the measurement of termination benefits should be consistent with the measurement requirements for the nature of the underlying benefits”<sup>40</sup>.
92. Staff did not identify a public sector specific reason not to adopt the same measurement guidance in a revised version of IPSAS 25. Therefore, staff recommends that the IPSASB adopts the same measurement guidance as in IAS 19.

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93. GFS reporting guidelines are not explicit about recognition and measurement of termination benefits. Staff recommends that the IPSASB considers referral to the statistical community for consideration of a possible change to GFS about recognition and measurement of termination benefits (step 3/A2 of the *Process for Considering Differences between IPSASs and GFS Reporting Guidelines*).

**Matter(s) for Consideration**

6. The IPSASB is asked to **indicate** whether it agrees with the staff recommendations to amend IPSAS 25 in order to:
- (a) Recognize a present obligation to provide termination benefits when it has communicated its plan of termination to each of the affected employees;
  - (b) Add measurement guidance on termination benefits consistent with the measurement requirements for the nature of the underlying benefits; and,
  - (c) Consider a referral to statistical community for consideration of a possible GFS change; or **provide** alternative directions

*Classification of short-term employee benefits*

94. The IASB made amendments to clarify the classification of short-term employee benefits.
95. According to IAS 19, an employee benefit is classified as short-term if it is expected to be settled wholly before twelve months after the end of the annual reporting period in which the employees render the related services.
96. The IASB made this clarification because the basis of the timing of expected settlement would be most consistent with the measurement basis in IAS 19.
97. IPSAS 25 does not have this clarification.
98. Staff is of the view that applying a similar clarification would also increase the consistency within IPSAS 25. Staff did not identify a public sector specific reason not to apply this clarification in the revision of IPSAS 25.

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<sup>39</sup> See paragraph 161 of IPSAS 25

<sup>40</sup> Paragraph BC261 of IAS 19

99. GFS reporting guidelines are explicit about the classification of short-term employee benefits. Staff recommends that the IPSASB considers referral to the statistical community for consideration of a possible GFS change about the classification of short-term employee benefits (step 3/A2 of the *Process for Considering Differences between IPSASs and GFS Reporting Guidelines*).

**Matter(s) for Consideration**

7. The IPSASB is asked to **indicate** whether it agrees with the staff recommendation:
- (a) To clarify that employee benefits are short-term if it is expected to be settled wholly before twelve months after the end of the annual reporting period in which the employees render the related services; and,
  - (b) Consider a referral to statistical community for consideration of a possible GFS change; or **provide** alternative directions.

*Current estimates of mortality rates*

100. The amendments to IAS 19 “make explicit that the mortality assumptions used to determine the defined benefit obligation are current estimates of the expected mortality rates of plan members, both during and after employment”<sup>41</sup>. IPSAS 25 does not have this explicit requirement.
101. The IASB took the view “that current mortality tables might need to be adjusted for expected changes in mortality (such as expected mortality improvement) to provide the best estimate of the amount that reflects the ultimate cost of settling the defined benefit obligation”<sup>42</sup>.
102. Staff did not identify any public sector specific reason not to make an explicit statement in the revision of IPSAS 25 similar to IAS 19. Therefore, staff recommends IPSASB to add the following requirement in a new section in IPSAS 25 before the *Actuarial Assumptions–Discount rates*<sup>43</sup> section:

**“Actuarial assumptions: mortality**

An entity shall determine its mortality assumptions by reference to its best estimate of the mortality of plan members both during and after employment.

In order to estimate the ultimate cost of the benefit an entity takes into consideration expected changes in mortality, for example by modifying standard mortality tables with estimates of mortality improvements.”<sup>44</sup>

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103. GFS reporting guidelines are not explicit about the mortality rates. Staff recommends that the IPSASB considers referral to the statistical community for consideration of a possible GFS change about the clarification on mortality rates (step 3/A2 of the *Process for Considering Differences between IPSASs and GFS Reporting Guidelines*).

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<sup>41</sup> Paragraph BC142 of IAS 19

<sup>42</sup> Paragraph BC142 of IAS 19

<sup>43</sup> Paragraphs 91-95 of IPSAS 25

<sup>44</sup> Paragraphs 81-82 of IAS 19

**Matter(s) for Consideration**

8. The IPSASB is asked to **indicate** whether it agrees with the staff recommendation to:
- (a) Make an explicit requirement in the revision of IPSAS 25 about including the expected mortality improvement when estimating the ultimate cost of the benefit; and,
  - (b) Consider referral to the statistical community for consideration of a possible GFS change about the clarification on mortality rates; or **provide** alternative directions.

*Tax and administration costs*

104. IAS 19 clarifies that “the estimate of the defined benefit obligation includes the present value of taxes payable by the plan if they relate to service before the reporting date or are imposed on benefits resulting from that service”<sup>45</sup> and that “other taxes should be included as a reduction to the return on plan assets”<sup>46</sup>. IPSAS 25 does not include this clarification. An example of this clarification would be any taxes payable by the plan when an employer makes contributions related to service before the period in order to reduce a deficit.
105. Currently, IPSAS 25 requires any costs of administering the plan (other than those included in the actuarial assumptions used to measure the defined benefit obligation) to be deducted from the return on plan assets<sup>47</sup>. However, IPSAS 25 does not specify which costs should be included in those actuarial assumptions. IAS 19 now requires “administration costs to be recognised when the administration services are provided, with costs relating to the management of plan assets deducted from the return on plan assets”<sup>48</sup>.
106. This implies that costs of administering benefit payments that are unrelated to the plan assets are not to be deducted from the return on plan assets, but, instead, be included in the present value of the defined benefit obligation attributable to current or past service.
107. Staff did not identify any public sector specific reason not to adopt the clarifications on taxes and administration costs in the revision of IPSAS 25. Therefore, staff recommends IPSASB to adopt these clarifications in the revision of IPSAS 25.

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108. GFS reporting guidelines are not explicit about the treatment of tax and the distinction between administration costs and management of plan assets. Nevertheless, GFS reporting guidelines require that the cost of operating the scheme to be added to the pension entitlement and are considered in the employers’ imputed pension contributions<sup>49</sup>.
109. Staff recommends that the IPSASB considers referral to the statistical community for consideration of a possible GFS change to clarify the treatment of tax and the distinction between administration costs and management (step 3/A2 of *the Process for Considering Differences between IPSASs and GFS Reporting Guidelines*).

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<sup>45</sup> Paragraph 121 of IAS 19

<sup>46</sup> Paragraph 121 of IAS 19

<sup>47</sup> See paragraph 127 of IPSAS 25

<sup>48</sup> Paragraph BC125 of IAS 19

<sup>49</sup> Paragraph 6.22 of GFSM 2014

### Matter(s) for Consideration

9. The IPSASB is asked to **indicate** whether it agrees with the staff recommendation to clarify that:
- (a) Taxes on contributions related to service before the reporting date or are imposed on benefits resulting from that service should be included in the present value of defined benefit obligation;
  - (b) Only costs of managing plan assets should be deducted in determining the return on plan assets; and,
  - (c) Consider referral to the statistical community for consideration of a possible GFS change to clarify the treatment of tax and the distinction between administration costs and management of plan assets; or **provide** alternative directions.

## Shared Risk Plans

### Introduction

110. The following paragraphs provide a brief explanation of the main issues that shared risk plans raises within the current classification of IPSAS 25 and IAS19. Afterwards, it is presented the issues that IASB has been addressing regarding the shared risk plans. Finally, paragraphs 133-138 discusses the future revision of IAS 19 in order to fully address the issues raised by shared risk plans. In this context staff notes that at the March 2015 meeting, the IPSASB considered the issue of shared risk plans and decided not to include them within the scope of this project.
111. Shared risk plans have been emerging in the public sector and private sector of several countries<sup>50</sup>.
112. IPSAS 25 and IAS 19 categorizes pension plans according to two types:
- (a) Defined contributions plans – are post-employment benefit plans under which an entity pays fixed contributions into a separate entity (fund) and will have no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods; and,
  - (b) Defined benefit plans – are post-employment benefit plans other than defined contribution plans.
113. Therefore, the main distinction between these two types of pension plans is whether the employer's contribution is fixed (defined contributions plans) or not (defined benefit plans). In a defined contribution plan the employer does not bear the actuarial and investment risks because the employer's sole obligation is to make the fixed contributions to the fund. On the contrary, in a defined benefit plan the employer bears the actuarial and investment risks in order to settle pension obligations according to the defined benefit plan.
114. Shared risk plans allow for both employers and employees to adjust contributions and benefits, up or down, in times of surplus or deficit. Under current IPSAS 25 and IAS 19 requirements, the employer would have to assess whether the shared risk plan meets the definition of a defined benefit plan or a defined contribution plan. If the shared risk plan implies employer's contributions that are not fixed and that the employer has a legal or non-legally binding obligation to pay additional contributions to

<sup>50</sup> Canada (Federal Government, New Brunswick and Nova Scotia provinces), Netherlands, Sweden, United States, Japan and Germany.

the fund, so that the fund can pay benefits related to current and past service, then the pension plan would be classified as a defined benefit plan.

115. Staff acknowledges that in some cases the classification might not be straightforward<sup>51</sup> and the measurement of the liability with these hybrid plans might raise additional issues to be addressed in a future revision of IAS 19. This issue will be discussed in the section on *IAS 19 future revision*.
116. The employer's cost can be affected by certain risk-sharing features in a plan:
- (a) Member contributions: The benefits of a plan surplus or the cost of a plan deficit may be shared by the employer and current and/or former employees, including retirees.
  - (b) Contribution limits: There may be limits on the plan sponsor's obligation to make additional contributions for past service.
  - (c) Conditional indexation: Benefit increases may be conditioned on a plan's funded status.
117. The IASB has made limited amendments to IAS 19 on certain features of risk sharing. However, the subject of shared-risk plans is not yet fully addressed in IAS 19.
118. This section of the issues paper presents the issues already addressed by IASB regarding shared risk and conditional indexation in order to ensure full convergence with the latest version of IAS 19 and, secondly, the issues identified by IASB staff for a future revision of IAS 19.

*IAS 19 (2011 revision and 2013 revision)*

119. The amendments to IAS 19 made in 2011 clarify that:
- (a) "The effect of employee and third-party contributions should be considered in determining the defined benefit cost, the present value of the defined benefit obligation and the measurement of any reimbursement rights"<sup>52</sup>;
  - (b) "The benefit to be attributed to periods of service in accordance with paragraph 70 of IAS 19 is net of the effect of any employee contributions in respect of service."<sup>53</sup>
  - (c) "Any conditional indexation should be reflected in the measurement of the defined benefit obligation, whether the indexation or changes in benefits are automatic or are subject to a decision by the employer, the employee or a third party, such as trustees or administrators of the plan."<sup>54</sup>
  - (d) "If any limits exist on the legal and constructive obligation to pay additional contributions, the present value of the defined benefit obligation should reflect those limits."<sup>55</sup>

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<sup>51</sup> At present, most shared risk plans would be defined benefit plans under the existing definitions in IPSAS 25 and IAS 19.

<sup>52</sup> Paragraph BC143(a) of IAS 19.

<sup>53</sup> Paragraph BC143(b) of IAS 19. "*Defined Benefit Plans: Employee Contributions*, issued in November 2013, clarified the requirements that relate to how contributions from employees or third parties that are linked to service should be attributed to periods of service. In addition, it permits a practical expedient if the amount of the contributions is independent of the number of years of service. See paragraphs BC150G–BC150Q."

<sup>54</sup> Paragraph BC143(c) of IAS 19

<sup>55</sup> Paragraph BC143(d) of IAS 19

#### Effect of employee and third-party contributions

120. In order to reflect the effect of employee and third-party contributions in a defined benefit plan the IASB added paragraphs 87(d) and 92 to IAS 19 in the section of *Actuarial assumptions: salaries, benefits and medical costs*, as follows:

**87 An entity shall measure its defined benefit obligations on a basis that reflects:**

...

**(d) contributions from employees or third parties that reduce the ultimate cost to the entity of those benefits;**

...

- 92 Some defined benefit plans require employees or third parties to contribute to the cost of the plan. Contributions by employees reduce the cost of the benefits to the entity. An entity considers whether third-party contributions reduce the cost of the benefits to the entity, or are a reimbursement right as described in paragraph 116. Contributions by employees or third parties are either set out in the formal terms of the plan (or arise from a constructive obligation that goes beyond those terms), or are discretionary. Discretionary contributions by employees or third parties reduce service cost upon payment of these contributions to the plan.

121. The above paragraphs clarifies an important component in the measurement of the defined benefit obligation.

#### Benefits to be attributed to periods of service

122. Requirements and guidance on the attribution of benefits to periods of service were amended in 2011 and 2013. Revised paragraphs 93 and 94 of IAS 19 in the section, *Actuarial assumptions: salaries, benefits and medical costs*, clarify the impact of linked service contributions from employees or third parties on service cost, as follows:

- 93 Contributions from employees or third parties set out in the formal terms of the plan either reduce service cost (if they are linked to service), or affect remeasurements of the net defined benefit liability (asset) (if they are not linked to service). An example of contributions that are not linked to service is when the contributions are required to reduce a deficit arising from losses on plan assets or from actuarial losses. If contributions from employees or third parties are linked to service, those contributions reduce the service cost as follows:

- (a) if the amount of the contributions is dependent on the number of years of service, an entity shall attribute the contributions to periods of service using the same attribution method required by paragraph 70 for the gross benefit (ie either using the plan's contribution formula or on a straight-line basis); or
- (b) if the amount of the contributions is independent of the number of years of service, the entity is permitted to recognise such contributions as a reduction of the service cost in the period in which the related service is rendered. Examples of contributions that are independent of the number of years of service include those that are a fixed percentage of the employee's salary, a fixed amount throughout the service period or dependent on the employee's age.

Paragraph A1 provides related application guidance.

- 94 For contributions from employees or third parties that are attributed to periods of service in accordance with paragraph 93(a), changes in the contributions result in:
- (a) current and past service cost (if those changes are not set out in the formal terms of a plan and do not arise from a constructive obligation); or
  - (b) actuarial gains and losses (if those changes are set out in the formal terms of a plan, or arise from a constructive obligation).

123. The IASB concluded that “contributions from employees can be viewed as a negative benefit”<sup>56</sup> and, therefore, they can reduce service cost (if they are linked to service), or affect remeasurements of the net defined benefit liability (asset) (if they are not linked to service).

#### Conditional indexation

124. Some defined benefit plans provide conditional indexation, i.e., additional benefits are contingent on returns on plan assets or provide benefits that are conditional to some extent on whether there are sufficient assets in the plan to fund them<sup>57</sup>.

125. The IASB was of the view that “an entity should estimate the likely conditional indexation of benefits based on the current funding status of the plan, consistently with how financial assumptions are determined in accordance with paragraph 80 [of IAS 19]”<sup>58</sup> and that “projecting the benefit on the basis of current assumptions of future investment performance (or other criteria to which the benefits are indexed) is consistent with estimating the ultimate cost of the benefit, which is the objective of the measurement of the defined benefit obligation, as stated in paragraph 76 [of IAS 19]”<sup>59</sup>.

126. Therefore, the IASB added paragraph 88 (c) to address the conditional indexation issue, as follows:

- 88 Actuarial assumptions reflect future benefit changes that are set out in the formal terms of a plan (or a constructive obligation that goes beyond those terms) at the end of the reporting period. This is the case if, for example:

...

- (c) benefits vary in response to a performance target or other criteria. For example, the terms of the plan may state that it will pay reduced benefits or require additional contributions from employees if the plan assets are insufficient. The measurement of the obligation reflects the best estimate of the effect of the performance target or other criteria.

127. This new requirement would be added to the actual paragraph 98 of IPSAS 25.

#### Limits on the legal or constructive obligation to pay additional contributions

128. The IASB added paragraph 87(c) to clarify the measurement of an entity’s defined benefit obligations with limits on the legal and constructive obligation to pay additional contributions, as follows:

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<sup>56</sup> Paragraph BC150(a) of IAS 19

<sup>57</sup> Paragraph BC144 of IAS 19

<sup>58</sup> Paragraph BC149 of IAS 19

<sup>59</sup> Paragraph BC148 of IAS 19. Paragraph 76 of IAS 19 is equal to paragraph 86 of IPSAS 25.

**87 An entity shall measure its defined benefit obligations on a basis that reflects:**

...

**(c) the effect of any limit on the employer's share of the cost of the future benefits;**

129. These paragraphs addresses partially a risk-sharing pension plan through limits to an employer's contributions.

IPSAS 25 convergence assessment with IAS 19

130. The following table summarizes staff's assessment on whether there is a public sector specific reason(s) that warrant(s) a departure from IAS 19.

Criteria to meet public sector financial reporting	Effect of employee and third-party contributions	Benefits to be attributed to periods of service	Conditional indexation	Limits on the legal or constructive obligation to pay additional contributions
Objectives				
Accountability	Reinforces accountability by showing the impact of risk sharing in employee benefits			
Decision-making	Enables a more focused decision-making in the management of employee benefits			
Qualitative characteristics				
Relevance	Provides confirmatory value about the impact on the measurement of the defined benefit obligation			
Faithful Representation	Provides more complete evidence about the changes in the defined benefit obligation			
Understandability	Enhances understandability about the changes in employee benefits			
Timeliness	No foreseen effect			
Comparability	No foreseen effect			
Verifiability	Helps to assure that an appropriate measurement method of the defined benefit obligation has been used			
Undue cost or effort				
	No foreseen undue cost or effort			

131. As the table above shows, staff did not identify any public sector specific reason for not including these new requirements in the revision of IPSAS 25. Therefore, staff recommends that the IPSASB includes these new requirements in the scope of IPSAS 25 revision.

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132. GFS reporting guidelines acknowledges the existence of hybrid schemes and they are grouped with defined benefit pension schemes<sup>60</sup>. However, GFS is not explicit about the effect of employee and third-party contributions, the benefits to be attributed to periods of service, conditional indexation and limits on the legal and constructive obligation to pay additional contributions.

133. Staff recommends that the IPSASB considers a referral to the statistical community for consideration of a possible GFS change to clarify the effect of employee and third-party contributions, the benefits to be attributed to periods of service, conditional indexation and limits on the legal and constructive obligation to pay additional contributions (step 3/A2 of the *Process for Considering Differences between IPSASs and GFS Reporting Guidelines*).

<sup>60</sup> Paragraph A2.59 of GFSM 2014



**Matter(s) for Consideration**

10. The IPSASB is asked to **indicate** whether it agrees with the staff recommendation to include in the scope of IPSAS 25 revision the IASB amendments in the following issues:
- (a) The effect of employee and third-party contributions;
  - (b) The benefits to be attributed to periods of service;
  - (c) Conditional indexation;
  - (d) Limits on the legal or constructive obligation to pay additional contributions; and,
  - (e) Consider a referral to statistical community for consideration of a possible GFS change; or provide alternative directions.

*IAS 19 future revision*

134. The amendments that IASB has made to IAS 19 are not considered to be sufficient to address shared risk plans. Currently the IASB has a research project on post-employment benefits on its work plan.<sup>61</sup> However, because of its nature and complexity the IASB does not plan to issue a discussion or research document within the next three years. This project would have to be included on the IASB's active agenda prior to development of an exposure draft, so while the project may lead to revisions to IAS 19, this is unlikely for a number of years.
135. According to IASB staff "the measurement in IAS 19 does not properly reflect differences of risks among plans, because the present value of the DBO [defined benefit obligation] does not fully reflect the value of risk relating to future cash flows from the DBO<sup>62</sup>. In contrast, the fair value of the plan assets reflects the value of risk relating to future cash flows from the plan assets, as market prices."<sup>63</sup>
136. The IASB staff paper acknowledges the following problem with IAS 19:
- "In CBPs<sup>64</sup>, investment risk on plan assets does not fall entirely on the entity. If the assets perform less well than expected, the benefits for the employees will generally also be reduced in some manner. However, this is not currently reflected in the accounting and, hence, an entity could show an excessive plan deficit (i.e. the present value of DBO is much higher than the fair value of the plan assets), as a consequence of the projected higher return on plan assets compared to the discount rate."<sup>65</sup>
137. It has been raised also other conceptual problems in IAS 19, such as:
- (a) A proper explanation on the kind of measurement basis used in IAS 19;

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<sup>61</sup> <http://www.ifrs.org/Meetings/MeetingDocs/IASB/2014/September/AP08C-Research%20project.pdf>

<sup>62</sup> Paragraph 115 of IAS 19 provides a limited exemption from measurement in IAS 19. The paragraph states that where plan assets include qualifying insurance policies that exactly match the amount and timing of some or all of the benefits payable under the plan, the fair value of those insurance policies is deemed to be the present value of the related obligations (subject to any reduction required if the amounts receivable under the insurance policies are not recoverable in full).

<sup>63</sup> Paragraph 14 of IASB staff paper

<sup>64</sup> CBP means post-employment benefit promises under which the amount of benefits to be received by the employee depends on the contributions plus a promised return.

<sup>65</sup> Paragraph 18 of IASB staff paper

- (b) Difficulty to explain the current requirement to reflect unvested benefits and future salary increases in obligations, from the viewpoints of definition and recognition of liabilities in the current IASB *Conceptual Framework*; and,
  - (c) The net presentation of plan assets and defined benefit obligations in IAS 19 could also involve conceptually challenging problems.
138. According to the IASB staff assessment, a revision of IAS 19 “could involve fundamental reviews of measurement, or classification or both in IAS 19.”<sup>66</sup>
139. As stated in paragraph 111 shared risk plans exist in both public and private sectors. Given that this project is a convergence project and shared risks plan are not public sector specific, staff recommends that the IPSASB does not address shared risk plans in this project and defers consideration of additional work until the IASB publishes revisions to IAS 19 on shared risk plans.

**Matter(s) for Consideration**

11. The IPSASB is asked to **confirm** its previous decision not to address the subject of shared risk plans in this project and wait until IASB publishes a revised IAS 19 or **provide** alternative directions.

Composite social security programs

140. IPSAS 25 has a section<sup>67</sup> regarding *Composite Social Security Programs*. Staff is aware that some stakeholders do not find useful the description about this type of employee benefits. Staff notes that this section is specific to IPSAS 25.
141. Staff seeks views from the IPSASB on how to improve the section on *Composite Social Security Programs*.

**Matter(s) for Consideration**

12. The IPSASB is asked to **indicate** views on how to improve the section on *Composite Social Security Programs* of IPSAS 25.

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<sup>66</sup> Paragraph 42 of IASB staff paper

<sup>67</sup> Paragraphs 47-49

## Appendix A

### Elimination of the corridor (simplified example)

(UA'000)		Scenario 1	Scenario 2
Fair value plan assets	1	10.000	8.000
Defined benefit obligation	2	8.000	10.000
Cumulative unrecognized actuarial gains (losses)	3	1.250	-1.250
Net balance sheet defined benefit asset (liability)			
Current IPSAS 25	1-(2+3)	750	-750
Revised IPSAS 25	1-2	2.000	-2.000

*Note: assumes no unrecognised past service costs on transition and ignores the impact of any asset ceiling limits.*

## Appendix B

### Net interest calculation (simplified example)

(UA'000)

Assumptions at beginning of the annual period

Plan assets

Fair value	2.000
Expected return	4%

Defined benefit

Obligation	1.250
Discount rate	5%

Net defined benefit asset 750

Current IPSAS 25

Expected return	[2.000*4%]	80
<u>Defined benefit interest costs</u>		<u>62.5</u>
Net		17.5

IPSAS 25 Revised

Net interest income [750\*5%] 37.5