

# accounting for pensions

## Pam Atherton looks at the impact of IAS19 on pension accounting

■ **International Accounting Standards Board (IASB) amendments to IAS19, the International Accounting Standard for Employee Benefits, published in December last year, clarified many issues for listed EU companies needing to comply with the new standard.**

The changes introduced by IAS19 were the result of a limited scope project on post-employment benefits, in particular pension and post-retirement medical plans.

The changes are mandatory for IFRS/IAS financial statements for years commencing on or after 1 January 2006, but may also be adopted earlier on a voluntary basis. In this way, listed companies throughout the EU who are adopting IFRS in 2005 as a result of EU regulation may move immediately to using the new rules, rather than being faced with a change after just one year.

### all or nothing adoption of the standard

Those adopting it voluntarily must do so in respect of all the changes it introduces. Although this represents a final standard from the IASB (as opposed to an exposure draft), its adoption by listed European companies for their consolidated accounts is dependent on its approval by the EU.

It is expected that this process will take between six and nine months, and whilst there is no reason to believe there will be major difficulties, the outcome cannot be taken for granted. This is demonstrated by experience of IAS39 where, following intense lobbying by certain financial institutions, the EU gave approval for companies not to use the full requirements of that standard.

The changes introduced by the IASB have been well trailed and contain no particular surprises. They are:

- the introduction of an option to take actuarial gains and losses – that is the combined effect of experience in the pension scheme differing from that assumed, and changes in the assumptions themselves – to the balance sheet through a separate statement, rather than through the profit and loss account
- some clarification of the requirements relating to group and multi-employer pension arrangements
- an increase in the disclosure requirements.

Partial early adoption is not possible, so any company wishing to use the option to recognise gains and losses immediately outside profit and loss must also comply with the new requirements on group and multi-employer plans, and provide the additional disclosure information.

### IAS19 as it stands

The existing IAS19 allows companies to delay the recognition in their balance sheet of the effect of actuarial gains and losses. Under the current standard, gains and losses need not be recognised at all, if they have accumulated less than 10% of the greater of assets and liabilities.

To the extent they exceed this 10% corridor, they need only be recognised through the profit and loss account over a spreading period equal to the expected future working lifetime of members of the plan.

Use of this spreading option means that the provision or prepayment recognised in a company's balance sheet under IAS19 is essentially a heavily smoothed version of the deficit or surplus in the benefit plan, as measured by IAS19. In other words,

substantial accumulated gains or losses may be left off the balance sheet, and disclosed as 'unrecognised' – an approach very similar to the US standard FAS87. UK standard FRS17 has a rather different approach, whereby gains and losses are not kept off the balance sheet, but are recognised in it at the end of each accounting year.

However, they are not taken through the headline profit and loss account, but through the Statement of Recognised Gains and Losses, which can be viewed as a supplementary profit and loss account. Whilst IAS19 has always permitted such immediate recognition of gains and losses, until now this would have required taking them through the headline profit and loss account each year.

### changes to IAS19

This has not been a popular approach given the volatility in the profit and loss account that would arise. The recent change to IAS19 introduces an option for an FRS17-style treatment, whereby gains and losses are taken to the balance sheet through a Statement of Recognised Income and Expense. If used, it must be applied consistently for all gains and losses in all plans. The introduction of this option in IAS19 can be seen as a stop-gap measure to accommodate UK and Irish companies which have already adopted or disclosed results on the FRS17 standard.

It permits them to continue on essentially the same approach. The IASB is not in favour of the ability to spread gains and losses, and seems to have felt that not introducing this option would have pushed some UK and Irish companies to revert to an approach it regards as inferior to the FRS17 approach. The exposure draft proposing this change did

---

not receive strong support from outside the UK and Ireland, as commentators felt it was unhelpful to introduce more options into a standard which already has considerable choice for companies in its application, and that any changes should await a more comprehensive overhaul.

#### **group plans**

Part of the consultation on amendments to IAS19 covered so-called 'group plans,' namely, those where different related entities participate in the same benefit arrangement.

A typical example would be the pension plan of a UK group, in which a number of subsidiaries participate. At much the same time the International Financial Reporting Interpretations Committee published exposure draft guidance on the treatment of multi-employer plans, in which unrelated entities participate but share actuarial experience.

Related companies participating in a defined benefit group plan where risks are shared should account on a defined benefit basis in such a way that, in aggregate, the participants recognise the total cost of the plan as measured under IAS19.

The participants may enter into an agreement as to how that cost is shared, but in the absence of such agreement, all but one of the participants will account on the basis solely of the contributions they pay.

The remaining participant, being that one which is 'legally the sponsoring employer for the plan', will account for the difference between the aggregate IAS19 cost of the entire plan, and the aggregate contributions paid by the other participants.

All together this is a much simpler approach than that proposed earlier in 2004, and will enable most companies participating in group plans to account solely on the basis of the contributions they pay, although they will still be required to disclose the IAS19 position of the plan as a whole, as well as other information, including the policy for determining the contributions to be paid.

#### **multi-employer plans**

In relation to multi-employer plans, the principle remains that a company should account for its share in the multi-employer plan on a defined benefit basis unless this is not possible, in which case, it may account on the basis of the contributions paid.

The IASB has clarified that should there be a contractual agreement on how a surplus is distributed or a deficit funded, an asset or liability would be recognised. Furthermore, contingent commitments arising from participation in the plan must be disclosed.

#### **disclosure requirements**

The IASB has generally overhauled what were previously rather limited disclosure requirements. The changes largely follow those already included in US GAAP, and can be seen as a step on the way towards an ultimate convergence of these standards.

The main additions are:

- the development over the year of the assets and liabilities must be analysed
- information is required about the breakdown of the assets by class and how the overall expected return on assets is derived
- a requirement to show key historic information over a five year period
- various other miscellaneous information designed to assist users of accounts.

Generally these new requirements are not particularly onerous for companies who are already using FRS17 or FAS87, but will require some further information to be shown. Information on future benefit payments, a recent introduction to US GAAP disclosures, is not required under IAS19.

Dr Deborah Cooper of actuarial firm, Mercers, comments: "The additional disclosures will provide useful information to shareholders. However, letting companies decide whether to recognise gains and losses immediately, as FRS17 requires, or to spread them, like FAS87, means it is no longer straightforward to make direct comparisons of accounts across all firms. We expect that in a few years the IASB will move all the way to immediate recognition." ■

Pam Atherton is a freelance journalist

