IAS19 Changes

"new volatility and extra complexity"

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Summary of changes

The International Accounting Standards Board ("the IASB") recently issued amendments to IAS 19 Employee Benefits, which will affect the accounting treatment of certain "Special Events" (amendments, settlements and curtailments) in defined benefit pension plans.

The amendments relate to the assumptions used to quantify the impact of a Special Event itself, together with the interaction of the impact of the Special Event with the asset ceiling requirements.

Background

Currently under IAS 19, if a Special Event occurs, entities should not adjust the assumptions used to calculate the current service cost and net interest during the remainder of the relevant reporting period, even if an entity remeasures the net defined benefit liability/asset as a result of that Special Event. However the IASB has now concluded that this approach is inappropriate.

Determining current service cost and net interest

At present the current service cost and net interest are calculated using actuarial assumptions determined at the start of the annual reporting period. However, in future when a Special Event occurs, an entity will need to:

- Determine the current service cost, for the remainder of the period after the Special Event, using the actuarial assumptions used to remeasure the net defined benefit liability asset after the Special Event

- Determine the net interest for the remainder of the period after the Special Event using:

  (i) the net defined benefit liability/asset reflecting the benefits offered under the plan and the plan assets after that Special Event; and

  (ii) the discount rate used to remeasure that net defined benefit liability/asset

The IASB expects that using updated assumptions will provide useful information to users of financial statements.

Effect on asset ceiling requirements

Where the defined benefit plan has a surplus, the net defined benefit asset is measured as the lower of the surplus and the asset ceiling.

Accounting for a Special Event may reduce or eliminate any surplus, which may then cause the effect of the asset ceiling to change.

The IAS 19 amendments clarify that any past service cost, or a gain or loss on settlement, should be determined first without considering the effect of the asset ceiling. This amount is recognised in profit or loss.

The effect of the asset ceiling after the Special Event should then be determined. Any change in that effect (excluding amounts included in net interest) is recognised in Other Comprehensive Income ("OCI"). This means that entities might have to recognise a past service cost, or loss on settlement, which reduces a surplus that was not previously recognised. This could lead to some unusual situations, such as the position illustrated in the following example.

Example

Consider a company with a defined benefit plan, with assets of 100 and a defined benefit obligation (DBO) of 90. Due to the impact of the asset ceiling the company is not able to recognise the surplus of 10.

The company then settles the plan. However, the amount of plan assets it transfers to settle its DBO is 100.

As a result, the company would need to record a loss of 10 on settlement in the profit or loss account. The assessment of the asset ceiling is then carried out as a separate step from the calculation of the settlement loss. The company reverses the effect of the asset ceiling separately through the OCI.

Effect on Company Accounts

These changes have the potential to introduce new volatility and extra complexity to company accounts. Even small changes to a pension plan could trigger a major knock-on effect on the profit and loss account. The effect on profit could be positive or negative and will depend on market conditions at the time the Special Event occurs, making results unpredictable.

Transition and effective date

The IAS 19 changes must be applied prospectively to Special Events occurring on or after the beginning of the first annual reporting period commencing on or after 1 January 2019. While earlier application is permitted, companies do not need to take any action until next year. However, where a Special Event may be on the horizon sometime over the next year, it would be worth considering if it would be preferable, from an accounting perspective, if it were to occur before or after 1 January 2019.

Jargon Buster

Current service cost
The increase in the present value of the defined benefit obligation resulting from employee service in the current period

Curtailment
A significant reduction by the entity in the number of employees covered by a plan

Defined Benefit Obligation (DBO)
The present value of the accrued scheme liabilities at the measurement date

Net Interest Cost
The change during the period in the net defined benefit liability/asset that arises from the passage of time

Past service cost
The change in the present value of the defined benefit obligation for employee service in prior periods, resulting from a Special Event

Settlement
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.

Special Event
A plan amendment, curtailment or settlement