Session 063: Global Pension Accounting: Comparison and Critical Review

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Session 063: Global Pension Accounting—Comparison and Critical Review

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Agenda

- Globalization of Accounting/Financial Reporting
- Background: ASC 715 & IAS 19R & US GASB
- Key Similarities & Differences
  - ASC 715 vs. IAS 19R
  - ASC 715 vs. GASB
- Disclosure Requirements – ASC 715 and IAS 19R
- Current Accounting Discussion Topics
- Questions ?

Globalization of Accounting/Financial Reporting

- Global market for capital reinforces the need for a global set of accounting standards
- IFRS mission: to develop IFRS Standards that bring transparency, accountability and efficiency to financial markets around the world

Transparency

Enhance international comparability and quality of financial information

Enable investors and market participants to make informed economic decisions

Accountability

Reduce the information gap between providers of capital and people to whom they have entrusted their money

Vital importance to regulators around the world

Efficiency

Help investors to identify opportunities and risks around the world

For businesses, single accounting language lowers cost of capital and reduces international reporting

Source: https://www.ifrs.org/-/media/feature/around-the-world/adoption/use-of-ifrs-around-the-world-overview-sept-2018.pdf?la=en

Globalization of Accounting/Financial Reporting

- IFRS Statements are required for Domestic Listed Companies

Source: https://www.ifrs.org/use-around-the-world/use-of-ifrs-standards-by-jurisdiction

Globalization of Accounting/Financial Reporting

- Fun facts as of September 2018 taken from IFRS.org publication:
  - 15 of the G20 economies require the use of IFRS standards
    - Japan permits but does not require
    - China, India and Indonesia's standards are substantially in-line with IFRS and
    - US allows for non-US registrants but not for US registrants
  - 27,000 domestically listed companies on 88 major stock exchanges use IFRS standards
- IFRS acceptance around the world
  - EU requires publicly-traded European companies to follow IFRS
  - Australia endorsed adoption of IFRS in 2005
  - China "substantially converged" to IFRS in 2007
  - Brazilian banks and listed companies adopted IFRS in 2010
  - Canadian public companies adopted IFRS in 2011
  - Mexico required listed companies to follow IFRS beginning in 2012
  - South Africa adopted IFRS for all companies in 2013
  - Argentina, Korea, Russia and Saudi Arabia all fully adopted IFRS
  - Japan allows IFRS amongst other standards (companies not forced to use particular standard)

Background: U.S. GAAP vs. IFRS vs. US Governmental (GASB)

	US GAAP	IFRS (International GAAP)	GASB
Basic Premise	Viewed as "Rules-based" • More prescriptive • More detailed description of application of underlying principles	"Principles-based" • Less interpretive and implementation guidance • Focus on intent, rather than "rules"	Viewed as "Rules-based" • More prescriptive • More detailed description of application of underlying principles
Observations	• Less emphasis on judgment	• Increased emphasis on professional judgment and economic substance of transaction • Varying interpretations and levels of rigor in applying rules	• Designed to increase the transparency, consistency, and comparability of pension information across state and local governments • Different, but specific, guidance based on type of employer and plan (single/agent vs. cost-sharing, trust funded or not)

Background: Scope Comparison

	US GAAP	IFRS (International GAAP)	GASB

Accounting standard	• ASC 715-20 General
	• ASC 715-30 for pensions
	• ASC 715-60 for other postretirement benefits
	• ASC 712 (710 or 450) for post-employment benefits
		• IAS 19R for all benefits
		  • Short-term benefits: expected to be settled in full within 12 months of the end of the year in which service was provided
		  • Postemployment benefits: benefits payable after completion of employment
		  • Other long-term employee benefits: not expected to be settled in full within 12 months of the end of the year in which service was provided
		  • Termination benefits: benefits payable upon involuntary termination or voluntary termination pursuant to an open window
			• GASB 68 for pensions
			• GASB 75 for other postretirement benefits

Background: Balance Sheet

Area	ASC 715	IAS 19R	GASB
Balance Sheet Presentation	Funded status on balance sheet: benefit obligation less fair value of assets. Obligation = Projected Benefit Obligation (PBO)	Funded status on balance sheet or *net defined benefit liability (asset)*: obligation less fair value of assets, subject to the *asset ceiling* test*. Obligation = Defined Benefit Obligation (DBO)	Funded status or *net pension liability:* obligation less *plan's fiduciary net position.* *Obligation = Total pension liability* *Fiduciary net position is essentially the fair value of assets*

Background: Balance Sheet

Area	ASC 715	IAS 19R	GASB
Treatment of Gain/Loss	Options: 1) Immediate recognition in net periodic benefit cost (i.e., P&L) 2) Deferred recognition (the “corridor” approach), amortizing the excess over the corridor in net periodic benefit cost (or any systematic method that results in faster recognition than the corridor approach).	No options: Immediate recognition in Statement of Other Comprehensive Income (OCI).	No options: Deferred recognition: • Amortize **changes in obligation** over a closed period equal to average of expected remaining service lives of all employees that are provided with pensions/OPEB through the plan (active and inactive employees) as of the beginning of the measurement period • Amortize **investment gains/losses** over a closed period of 5 years
Other Comprehensive Income (OCI) or Deferred outflows/inflows of resources	G/L are immediately recognized in the OCI account and accumulated (AOCI) with recycling into P&L.	G/L are immediately recognized in the OCI account and are not recycled into net periodic benefit cost.	G/L are immediately recognized as deferred outflow or deferred inflow of resources with future recognition in expense

Background: Balance Sheet

Area	ASC 715	IAS 19R	GASB
Treatment of Plan Amendment	Deferred recognition - amortize impact on benefit obligation in net periodic benefit cost	Immediate recognition of impact to benefit obligation in service cost component	Immediate recognition of impact to benefit obligation in pension expense
Other Comprehensive Income (OCI) or Deferred outflows/inflows of resources	Prior service cost are immediately recognized in the OCI account and accumulated (AOCI) with recycling into P&L.	N/A	N/A

Background: Expense

Area	ASC 715	IAS 19R	GASB

Components of Expense	The *net periodic benefit cost** includes the following:
	
	– Service Cost
	– Interest Cost
	– Expected Return on Assets
	– Amortization of Net Gain or Loss
	– Amortization of Net Prior Service Cost
	– Amortization of Transition Obligation
	
	plus
	
	– Special events including curtailments and settlements
	
	* All P&L items
		The *defined benefit cost* is separated into three items which include the following:
		
		Profit & Loss:
		– Service Cost*
		– Net Interest on the Net Defined Benefit Liability (Asset)
		
		Statement of OCI
		– Remeasurement of net defined benefit liability (asset)
		
		* Service costs includes the impact due to plan amendments, curtailments and settlements
			The total collective pension expense includes the following:
			
			– Service Cost
			– Interest on total liability
			– Expected Return on Assets
			– Plan amendments
			– Recognition of deferred (inflows)/outflows related to:
			  – Liability experience
			  – Assumption changes
			  – Investments

Background: IAS 19R – MEPPs & Defined Contribution (DC) Plans

Area	ASC 715	IAS 19R
DB vs. DC Classification	DC must be funded and have individual accounts (otherwise, use DB accounting) **Expense equals cash contribution** No explicit guidance for unfunded DC plans • Consideration should be given to DC or DB accounting for unfunded DC-plans	DC plan must be funded but individual accounts not a requirement **Expense equals cash contribution** IFRIC D9 guidance for unfunded DC plans (never finalized)
Multi-Employer Plans	Generally accounted for as a DC plan Additional disclosures required	Accounting based on underlying plan (DC vs. DB), although may use DC accounting if sufficient information not available to do DB accounting

Observations: In most cases, accounting for participation in multi-employer plans in many jurisdictions is the same because there will not be sufficient information for a participating employer to account for its proportionate share of the plan.

Key Similarities & Differences – ASC 715 vs. IAS 19R

Balance Sheet Measurement generally aligned, with a few exceptio

- IAS 19 has potential for Asset Ceiling and/or additional liability if required contributions are not available to plan sponsor as a refund or reduction in future contributions
- Under IAS 19, reimbursement rights are treated as an asset
- In countries without deep corporate bond market, IAS 19 requires discount rate based on government bond

P&L Cost generally quite different

- IAS 19R uses discount rate on asset component to determine “net interest cost” versus a return assumption
- Gain/loss treatment: under IFRS, actuarial gains and loses are recognized in the Statement of Other Comprehensive Income and never flow through P&L
- Accounting for special events differs: IAS 19 recognizes immediate impact to DBO due to plan amendments, non-routine settlements and curtailments

Concept of Market-Related Value of Assets

- ASC 715 allows a smoothed MRVA for determining expected return on asset component of expense. This also impacts gain/loss amortization if using the corridor approach.

Key Similarities & Differences:
ASC 715 vs. IAS 19R — Defined Benefit Cost

	ASC 715	IAS 19R
Service Cost	• Cost of new benefits accruing • Administration costs (may also be reflected in expected return on assets)	• Cost of new benefits accruing • Administration costs (may also be reflected elsewhere in P&L) • Plan amendments • Curtailments • Non-routine settlements
Interest Cost	• Discount rate x PBO/APBO[1]	• Net Financing Cost: Discount rate x (DBO – FMV of assets)[1, 2]
(Expected Return on Assets)	• Expected rate of return on assets x "Market-Related" value of assets[1]	
Amortization of Gains and Losses[3]	• Amortizes amounts outside of a corridor[4] • Amortized amounts are part of P&L • Immediate recognition in P&L is allowed	• No corridor • All gains and losses are recognized immediately in OCI (no recycling)
Amortization of Prior Service Cost	• Amortizes new prior service cost over a period of years	• Recognized immediately as part of service cost
Settlements	• Triggered by lump sums/annuity purchases exceeding Service Cost plus Interest Cost • Accelerates recognition of past gains/losses	• Only triggered by non-routine lump sums/annuity purchases • Gain or loss due to the settlement itself is recognized in Service Cost

[1] Interest cost and expected return on assets also reflect adjustments for contributions and benefit payments.

[2] Further adjustments are required if the plan is overfunded and an "asset ceiling" applies.

[3] Gains and losses include variations from expected experience and the effect of changes in assumptions.

[4] The ASC 715 allowable corridor is up to 10% of the greater of the plan's PBO/APBO or the market-related value of plan assets.

Key Similarities & Differences – ASC 715 vs. IAS 19

Balance Sheet Recognition: Current versus Non-current Distinction

- ASC 715 mandates allocation between current and non-current liabilities or non-current assets whereas IAS 19R does not specify whether an entity should distinguish between current and non-current
- For ASC 715, current liability limited to next year's expected benefit payments not covered by plan assets

P&L Geography

- ASC 715 requires service cost to be recognized in Operating Cost. All other components are non-operating cost (ASU 2017-07).
- IAS 19 considerations between operating and financing cost

Administrative Expense Load (if paid by plan assets)

- Actual treatment of administrative costs is not specifically noted for in either ASC 715 or IAS 19R other than a statement in IAS 19 which requires that "administration costs be recognized when the administration services are provided" (BC 125)
- For ASC 715, common practice is to see in service cost or expected return on assets. For IAS 19, often a separate component as total service cost definition does not reference administrative cost
- For retiree medical plans, both standards generally have the claims handling cost be part of the per-capita claims assumption

Key Similarities & Differences – ASC 715 vs. GASB

Balance Sheet Measurement generally quite different

- Benefit obligation based on different **actuarial cost methods** (Entry Age Normal for GASB versus Projected Unit Credit for ASC 715)
- **Discount rate different –** GASB uses a blend of (a) expected return on plan assets, to the extent that projected fiduciary net position is expected to exceed future benefit payments and (b) 20-year tax exempt muni bond rated AA or higher rate, to the extent the conditions in (a) are not met

P&L Cost generally quite different

- GASB requires impact of plan amendments to be recognized in full in year they occur whereas ASC 715 requires recognition over a period of time
- Gain/loss treatment has different recognition period
  - GASB uses a closed period whereas ASC 715 remeasures each period
  - GASB recognizes asset gains/losses over different period of time than gains/losses on benefit obligations whereas ASC 715 considers gains/losses in total
  - GASB amortization periods differ to those required by ASC 715

Required Disclosures

- GASB has Required Supplementary Information (RSI) section that includes 10 years of information regarding (a) sources of changes in the components of net pension liability, (b) ratios to assess the magnitude of the net pension liability and (c) comparisons of actual employer contributions to the Actuarially Determined Contribution

Disclosure Considerations

Disclosure Requirements

IAS 19R disclosure requirements (¶135-147) are guided by three main objectives:

Explain the characteristics of an entity's Defined Benefit plans and the risks associated with them	¶135(a)
Identify and explain the amounts in an entity's financial statements arising from its Defined Benefit plans	¶135(b)
Describe how an entity's participation in Defined Benefit plans affects the amount, timing, and variability of the entity's future cash flows	¶135(c)

ASC 715 has similar overall disclosure objectives although some required disclosures differ

Comment
Judgment is required to determine the level of detail, amount of aggregation or disaggregation, and additional information required to meet the disclosure objectives

Disclosure Requirements – IAS 19R
Characteristics of Defined Benefit Plans (¶139)

- Information about the characteristics of the plan; including:
  - The nature of the benefits provided;
  - Details of the regulatory framework in which the plan operates and its effect on the plan; e.g., minimum funding requirements;
  - A brief description of any other entity's responsibilities for the governance of the plan
- A narrative description of any unusual risks specific to the plan or the entity
- Details of any plan amendments, curtailments, and settlements

Disclosure Requirements – IAS 19R
Explanation of Amounts in the Financial Statements (¶140-144)

- Separate reconciliations from the opening balance to the closing balance for the net defined benefit liability/asset, the plan assets, the DBO, and the effect of the asset ceiling **(¶140-141)**
  - IAS 19R details the line items to be provided in each reconciliation
- Disaggregation of the fair value of 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 and those that do not **(¶142)**
  - The standard provides a list of possible classes to disclose (cash, equity, debt, real estate, derivatives, investment funds, asset backed securities and structured debt)
- Fair value of the entity's own transferable instruments, property occupied by the entity, or other assets used by the entity which are included in plan assets **(¶143)**
- Significant actuarial assumptions used to determine the DBO **(¶144)**

Disclosure Requirements – IAS 19R
Amount, Timing & Uncertainty of Future Cash Flows (¶145-147)

- Sensitivity analysis of the significant actuarial assumptions used to determine the DBO, as well as the methods and assumptions used in creating the sensitivity analysis **(¶145)**
- Details of asset-liability matching strategies used to manage risk **(¶146)**
- A narrative description of any funding arrangements and policies that affect future contributions **(¶147(a))**
- Expected contributions for the next reporting period **(¶147(b))**
- Details regarding the maturity profile of the benefit obligation, including the weighted average duration of the DBO and possibly other information about the distribution of benefit payments **(¶147(c))**

Comments

- More disclosure requirements than ASC 715
- Several disclosure items may not change from year to year

Disclosure Requirements – IAS 19R Mandatory vs. Leading Practice

Requirements of standard	Mandatory	Leading practice
Nature of plan	Defined benefit or defined contribution	Detailed information on benefit structure
Description of the risks the plan exposes the company to	Brief description of key risks (e.g. interest rate) plus entity/scheme-specific risks	In-depth discussion of key risks and how they are being managed
Descriptions of any special events	Brief description of event	Detailed description of event and reason behind it
Reconciliation of balance sheet, etc	Reconciliations for each component	Same
Breakdown of assets	Split between major asset classes and quoted vs unquoted	More granular breakdown of asset classes, e.g. types & duration of bonds
Assumptions	All material assumptions	Additional information on assumptions
Sensitivity analysis	Impact of main assumptions on DBO	Impact of main assumptions / market movements on balance sheet
Description of asset-liability matching strategies used to manage risk	Describe how risks are being managed	Discuss rationale behind risk management approach and any strategies rejected
Indication of future cashflows	Brief summary of funding arrangement and next year's expected contributions	Summary of schedule of contributions; any non-cash funding agreed; more details of latest funding valuation
Information on maturity profile	Duration of scheme liabilities	Breakdown of liabilities by actives, deferreds and pensioners; chart showing expected future benefit payments

Disclosure Requirements

What would investors like to see included and what should be mandatory?

Disclosure Requirements - IASB Targeted Standards-level Review of Disclosures (Agenda Paper 11)

- May – July 2018: Board developed draft Guidance to develop and draft disclosure requirements
- Key element of draft Guidance is use of **specific disclosure objectives** based on the **needs of users of the financial statements**
- November 2018 – April 2019: Board Members and staff undertook a tailored used outreach program through a series of meetings/calls with users
- May 2019: Board met to hear a summary of feedback from stakeholders on
  - Disclosures about employee benefits and fair value measurements; and
  - To discuss proposed approaches to developing technical analysis and recommendations in light of the feedback
- Key message: today's employee benefit disclosures often **do not meet their primary objectives**
- The Board met on 24 July 2019 to discuss amendments to the disclosure objectives in IAS 19

Disclosure Requirements - IASB Targeted Standards

Other points to note from May meeting with stakeholders:

- Better information about the expected cash flow effects of a post-employment benefit plan would be more useful;
- Some information, e.g. detail on assumptions, is typically **only understandable to sophisticated investors** rather than a “normal” primary user
- Focus of users is primarily on **disclosures relating to defined benefit plans** as they consider other types of employee benefits, such as defined contribution plans, “harmless”
- Users want to know how DB plans impact financial performance, financial position and cash flows:
  - Are plan(s) in surplus or deficit and by how much
  - Impact of plan(s) on financial performance during the period
  - Actual cash flows for the plan(s) during the period
- Preparers noted that many of today’s disclosure requirements are difficult and onerous to prepare

Disclosure Requirements – Agenda Paper 11A
Staff Recommendations on disclosure objectives

Plan type	High-level catch-all disclosure objectives:
DB	Aggregation and disaggregation of information to meet disclosure objectives
DC	How plans affect entity's statements of financial performance and cash flows
Other	Nature of termination benefits, short-term and other long-term employee benefits and how these benefits affect the entity's statements of financial performance, position and cash flows

Plan type	Specific disclosure objectives:
DB	Understand amounts in statement of financial performance, financial position and cash flows
DB	Understand nature of benefits, types of risk to which plans expose entity and entity's strategy for managing the plans and associated risk
DB	Understand expected cashflows and time period over which payments will be made for closed plans
DB	Understand the significant assumptions used in the DBO
DB	Understand drivers of changes in the net defined benefit liability or asset during period
Multi-employer	Follow the DB or DC disclosure guidance based on how account for plan. If a DB multi-er plan is accounted for as DC, then specific objective on nature of benefits and related risk and strategies

Disclosure Requirements – ASU 2018-14, Disclosure Framework

ASC 715 Changes to the Disclosure Requirements for Defined Benefit Plans

Remove	Add
Amounts in AOCI expected to be recognized as components of net benefit cost over the next fiscal year	Weighted average interest crediting rate for cash balance plans
The effects of a 1% change in assumed health care cost trend rates (previously only required for public companies)	Narrative description of the reasons for significant gains and losses affecting obligation or assets
For non-public companies, the reconciliation of the opening balances to the closing balances of plan assets measured on a recurring basis in Level 3 fair value hierarchy	
Related party disclosures on amount of future annual benefits covered by insurance and annuity contracts and significant transactions between the plan and employer or related parties	
Amount & timing of plan assets expected to be returned to entity	
Disclosures related to June 2001 amendments to Japanese Welfare Pension Insurance Law	

Effective for public companies in 2020 and 2021 for all others. Early adoption allowed.

Current Discussion Points

- Decrease in the discount rate during 2019, impact on obligations
  - What happens when the discount rate falls below 0%?
- Lump sum windows in US to capture arbitrage on lump sum rate versus ASC 715 discount rate
  - If lump sums are not normally offered in Plan, may result in an immediate P&L income under IAS 19R
- Annuity buy-out settlement timing when convert from a buy-in contract
- Timing of settlement calculation when plan termination date / payout date span fiscal years

Questions