# Exposure Draft of a Proposed

# AMENDMENT TO IAS 19, EMPLOYEE BENEFITS: THE ASSET CEILING

*Comments to be received by 25 March 2002*

This Exposure Draft is published by the International Accounting Standards Board (IASB) for comment only. The recommendations in the draft may be modified in the light of the comments received before being issued in the form of an International Financial Reporting Standard.

Comments should be submitted in writing so as to be received by **25 March 2002**. All replies will be put on public record unless confidentiality is requested by the commentator. If commentators respond by fax or email, it would be helpful if they could also send a hard copy of their response by post. Comments should preferably be sent by email to: **CommentLetters@iasb.org.uk** or addressed to:

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# Invitation to comment

The International Accounting Standards Board (IASB) has published this exposure draft for public comment.

Comments should be submitted in writing so as to be received by **25 March 2002**. Depending on the comments received, the Board hopes to consider a standard based on this exposure draft at its meeting in April 2002.

## Background

1 IAS 19 'Employee Benefits' was issued by the International Accounting Standards Committee in 1998 (and last revised in 2000). IAS 19 allows deferred recognition of actuarial gains and losses.[1] It also imposes an upper limit on the amount that can be recognised as an asset (the asset ceiling). An issue has arisen on the interaction of deferred recognition and the asset ceiling. The issue affects only those entities that have, at the beginning or end of the accounting period, a surplus in a defined benefit plan that, based on the current terms of the plan, the entity cannot fully recover through refunds or reductions in future contributions.

2 The issue is that the wording of the asset ceiling has the following consequence: sometimes deferring the recognition of an actuarial loss (gain) leads to a gain (loss) being recognised in the income statement. The issue is described in more detail in the exposure draft in the proposed new Appendix C.

3 This exposure draft proposes a limited amendment to IAS 19 that would prevent gains (losses) from being recognised solely as a result of past service cost or actuarial losses (gains) arising in the period. No change is proposed to the general approach of allowing deferral of actuarial gains and losses. The Board will consider the general approach to recognition of actuarial gains and losses as part of a future convergence project.

[1] Actuarial gains and losses include changes in the fair value of the plan assets, other than the expected return.

## Draft amendment to IAS 19

4 The exposure draft is set out in the following order, for ease of understanding the issue:

(a) a new Appendix C to be added to IAS 19 illustrating the issue and the effect of the proposed amendment

(b) the amendment to the standard itself

(c) new paragraphs to be added to the Basis for Conclusions.

5 The Board invites comments on any aspect of this exposure draft. It would particularly welcome answers to the questions set out below, with reasons for those answers. Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, clearly explain the issue and, where applicable, provide a suggestion for alternative wording with supporting reasoning.

**Question 1**

Is the issue identified of sufficient importance to warrant a limited amendment to IAS 19?

**Question 2**

If so, does the proposed amendment to IAS 19 (paragraph 58A) appropriately address the issue? Does it create any anomalies? If the proposed amendment is inappropriate, can you suggest an alternative?

**Question 3**

Should the limited changes become effective for accounting periods ending on or after 31 March 2002, with earlier application encouraged (paragraph 159A)?

**Question 4**

Do you agree that there should be no specific transitional provisions for the limited changes proposed in this exposure draft? Consequently, IAS 8 'Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies' will apply to any changes in accounting policies that are made to comply with IAS 19 if amended as proposed (paragraph 160).

# Proposed amendments to IAS 19 (revised 2000)

| | |
|---|---|
| 1 | Add new Appendix C and retitle the Basis for Conclusions as Appendix D. |

# Appendix C: Illustration of the application of paragraph 58A

## The issue

Paragraph 58 of the standard imposes a ceiling on any defined benefit asset that can be recognised.

> ***58. The amount determined under paragraph 54 may be negative (an asset). An enterprise should measure the resulting asset at the lower of:***
>
> ***(a) the amount determined under paragraph 54*** [ie the surplus/deficit in the plan plus (minus) any unrecognised losses (gains)]; ***and***
>
> ***(b) the net total of:***
>
> ***(i) any [cumulative] unrecognised [net] actuarial losses and past service cost (see paragraphs 92, 93 and 96); and***
>
> ***(ii) the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan. The present value of these economic benefits should be determined using the discount rate specified in paragraph 78.***

Without paragraph 58A (see below), paragraph 58(b)(i) has the following consequence: sometimes deferring the recognition of an actuarial loss in determining the amount specified by paragraph 54 leads to a gain being recognised in the income statement.

 

## Draft amendment to IAS 19

The following example illustrates the effect of applying paragraph 58 without paragraph 58A. The example assumes that the entity's accounting policy is not to recognise actuarial gains and losses within the 'corridor' and to amortise actuarial gains and losses outside the 'corridor'. (Whether the 'corridor' is used or not is not significant. The issue can arise whenever there is deferred recognition under paragraph 54.)

*Example 1*

| | **A** | **B** | **C** | **D =A+C** | **E =B+C** | **F =lower of D and E** | **G** |
|---|---|---|---|---|---|---|---|
| Year | Surplus in plan | Economic benefits available (paragraph 58(b)(ii)) | Losses (gains) unrecognised under paragraph 54 | Paragraph 54 | Paragraph 58(b) | Recognised asset | Gain recognised in year 2 |
| 1 | 100 | 0 | 0 | 100 | 0 | 0 | |
| 2 | 70 | 0 | 30 | 100 | 30 | 30 | 30 |

At the end of year 1, there is a surplus of 100 in the plan (column A in the table above), but no economic benefits are available to the entity either from refunds or reductions in future contributions[⊕] (column B). There are no unrecognised gains and losses under paragraph 54 (column C). So, if there were no asset ceiling, an asset of 100 would be recognised, being the amount specified by paragraph 54 (column D). The asset ceiling in paragraph 58 restricts the asset to nil (column F).

In year 2 there is an actuarial loss in the plan of 30 that reduces the surplus from 100 to 70 (column A) the recognition of which is deferred under paragraph 54 (column C). So, if there were no asset ceiling, an asset of 100 (column D) would be recognised. The asset ceiling without paragraph 58A would now amount to 30 (column E). The recognised asset has increased by 30 (column F), giving rise to a gain in income (column G) even though all that has happened is that a surplus from which the entity cannot benefit has decreased.

A similarly counter-intuitive effect could arise with actuarial gains (to the extent that they reduce cumulative unrecognised actuarial losses).

[⊕] based on the current terms of the plan.

**Paragraph 58A (proposed)**

Paragraph 58A prohibits the recognition of amounts as gains (losses) that arise solely from past service cost and actuarial losses (gains).

***58A. The application of paragraph 58 should not result in a gain being recognised solely as a result of an actuarial loss or past service cost in the current period or in a loss being recognised solely as a result of an actuarial gain in the current period. The enterprise should therefore recognise immediately under paragraph 54 the following to the extent that they arise while the defined benefit asset is determined in accordance with paragraph 58(b):***

***(a) net actuarial losses and past service cost to the extent that they exceed any reduction in the present value of the economic benefits specified in paragraph 58(b)(ii) and***

***(b) net actuarial gains to the extent that they exceed any increase in the present value of the economic benefits specified in paragraph 58(b)(ii).***

## Examples

The following examples illustrate the result of applying paragraph 58A. As above, it is assumed that the entity's accounting policy is not to recognise actuarial gains and losses within the 'corridor' and to amortise actuarial gains and losses outside the 'corridor'.

*Example 1 continued – adjustment when there are actuarial losses and no change in the economic benefits available*

| | **A** | **B** | **C** | **D =A+C** | **E =B+C** | **F =lower of D and E** | **G** |
|---|---|---|---|---|---|---|---|
| Year | Surplus in plan | Economic benefits available (paragraph 58(b)(ii)) | Losses (gains) unrecognised under paragraph 54 | Para-graph 54 | Para-graph 58(b) | Recog-nised asset | Gain recog-nised in year 2 |
| 1 | 100 | 0 | 0 | 100 | 0 | 0 | |
| 2 | 70 | 0 | 0 | 70 | 0 | 0 | 0 |

The facts are as in example 1 above. Applying paragraph 58A, there is no reduction in the economic benefits available to the entity[∅] so the entire actuarial loss of 30 is recognised immediately under paragraph 54 (column D). The asset ceiling remains at nil (column F) and no gain is recognised.

In effect, the actuarial loss of 30 is recognised immediately, but is offset by the reduction in the effect of the asset ceiling.

| | **Balance sheet asset under paragraph 54** | **Effect of the asset ceiling** | **Asset ceiling** |
|---|---|---|---|
| Year 1 | 100 | (100) | 0 |
| Year 2 | 70 | (70) | 0 |
| Gain/(loss) | (30) | 30 | 0 |

In the above example, there is no change in the present value of the economic benefits available to the entity. The application of paragraph 58A becomes more complex when there are changes in present value of the economic benefits available, as illustrated in the following examples.

*Example 2 – adjustment when there are actuarial losses and a decrease in the economic benefits available*

| | **A** | **B** | **C** | **D =A+C** | **E =B+C** | **F =lower of D and E** | **G** |
|---|---|---|---|---|---|---|---|
| Year | Surplus in plan | Economic benefits available (paragraph 58(b)(ii)) | Losses (gains) unrecognised under paragraph 54 | Para-graph 54 | Para-graph 58(b) | Recog-nised asset | Gain recog-nised in year 2 |
| 1 | 60 | 30 | 40 | 100 | 70 | 70 | |
| 2 | 25 | 20 | 50 | 75 | 70 | 70 | 0 |

At the end of year 1, there is a surplus of 60 in the plan (column A) and economic benefits available to the entity of 30 (column B). There are unrecognised losses of 40 under paragraph 54 that arose before the asset ceiling had any effect[*] (column C). So, if there were no asset ceiling, an

[∅] The term ‘economic benefits available to the entity’ is used to refer to those economic benefits that qualify for recognition under paragraph 58(b)(ii).

[*] ie at some time when the amount determined by paragraph 54 was lower than the amount specified by paragraph 58(b).

asset of 100 would be recognised (column D). The asset ceiling restricts the asset to 70 (column F).

In year 2, an actuarial loss of 35 in the plan reduces the surplus from 60 to 25 (column A). The economic benefits available to the entity fall by 10 from 30 to 20 (column B). Applying paragraph 58A, the actuarial loss of 35 is analysed as follows:

| | |
|---|---|
| Actuarial loss equal to the reduction in the economic benefits | 10 |
| Actuarial loss that exceeds the reduction in the economic benefits | 25 |

In accordance with paragraph 58A, 25 of the actuarial loss is recognised immediately under paragraph 54 (column D). The reduction in the economic benefits of 10 is included in the cumulative unrecognised losses that increase to 50 (column C). The asset ceiling, therefore, also stays at 70 (column E) and no gain is recognised.

In effect, an actuarial loss of 25 is recognised immediately, but is offset by the reduction in the effect of the asset ceiling.

| | **Balance sheet asset under paragraph 54** | **Effect of the asset ceiling** | **Asset ceiling** |
|---|---|---|---|
| Year 1 | 100 | (30) | 70 |
| Year 2 | 75 | (5) | 70 |
| Gain/(loss) | (25) | 25 | 0 |

*Example 3 – adjustment when there are actuarial gains and a decrease in the economic benefits available to the entity*

| | **A** | **B** | **C** | **D =A+C** | **E =B+C** | **F =lower of D and E** | **G** |
|---|---|---|---|---|---|---|---|
| Year | Surplus in plan | Economic benefits available (paragraph 58(b)(ii)) | Losses (gains) unrecognised under paragraph 54 | Para-graph 54 | Para-graph 58(b) | Recog-nised asset | Gain recog-nised in year 2 |
| 1 | 60 | 30 | 40 | 100 | 70 | 70 | |
| 2 | 110 | 25 | 40 | 150 | 65 | 65 | (5) |

At the end of year 1 there is a surplus of 60 in the plan (column A) and economic benefits available to the entity of 30 (column B). There are unrecognised losses of 40 under paragraph 54 that arose before the asset ceiling had any effect (column C). So, if there were no asset ceiling, an asset of 100 would be recognised (column D). The asset ceiling restricts the asset to 70 (column F).

In year 2, an actuarial gain of 50 in the plan increases the surplus from 60 to 110 (column A). The economic benefits available to the entity decrease by 5 (column B). Applying paragraph 58A, there is no increase in the economic benefits available to the entity. Therefore, the entire actuarial gain of 50 is recognised immediately under paragraph 54 (column D) and the cumulative unrecognised loss under paragraph 54 remains at 40 (column C). The asset ceiling falls to 65 because of the reduction in economic benefits. That reduction is not an actuarial loss as defined by IAS 19 and therefore does not qualify for deferred recognition.

In effect, an actuarial gain of 50 is recognised immediately, but is (more than) offset by the increase in the effect of the asset ceiling.

| | **Balance sheet asset under paragraph 54** | **Effect of the asset ceiling** | **Asset ceiling** |
|---|---|---|---|
| Year 1 | 100 | (30) | 70 |
| Year 2 | 150 | (85) | 65 |
| Gain/(loss) | 50 | (55) | (5) |

*Example 4 – adjustment in a period in which the asset ceiling ceases to have an effect*

| | **A** | **B** | **C** | **D =A+C** | **E =B+C** | **F =lower of D and E** | **G** |
|---|---|---|---|---|---|---|---|
| Year | Surplus in plan | Economic benefits available (paragraph 58(b)(ii)) | Losses (gains) unrecognised under paragraph 54 | Para-graph 54 | Para-graph 58(b) | Recog-nised asset | Gain recog-nised in year 2 |
| 1 | 60 | 25 | 40 | 100 | 65 | 65 | |
| 2 | (50) | 0 | 115 | 65 | 115 | 65 | 0 |

At the end of year 1 there is a surplus of 60 in the plan (column A) and economic benefits available to the entity of 25 (column B). There are unrecognised losses of 40 under paragraph 54 that arose before the asset ceiling had any effect (column C). So, if there were no asset ceiling, an asset of 100 would be recognised (column D). The asset ceiling restricts the asset to 65 (column F).

In year 2, an actuarial loss of 110 in the plan reduces the surplus from 60 to a deficit of 50 (column A). The economic benefits available to the entity decrease from 25 to 0 (column B). To apply paragraph 58A it is necessary to determine how much of the actuarial loss arises while the defined benefit asset is determined in accordance with paragraph 58(b). Once the surplus becomes a deficit, the amount determined by paragraph 54 is lower than the net total under paragraph 58(b). So, the actuarial loss that arises while the defined benefit asset is determined in accordance with paragraph 58(b) is the loss that reduces the surplus to nil, ie 60. The actuarial loss is, therefore, analysed as follows:

| | |
|---|---|
| Actuarial loss that arises while the defined benefit asset is measured under paragraph 58(b): | |
| Actuarial loss that equals the reduction in economic benefits | 25 |
| Actuarial loss that exceeds the reduction in economic benefits | 35 |
| | 60 |
| Actuarial loss that arises while the defined benefit asset is measured under paragraph 54 | 50 |
| Total actuarial loss | 110 |

In accordance with paragraph 58A, 35 of the actuarial loss is recognised immediately under paragraph 54 (column D); 75 (25+50) of the actuarial loss is included in the cumulative unrecognised losses which increase to 115 (column C). The amount determined under paragraph 54 becomes 65 (column D) and paragraph 58(b) becomes 115 (column E). The recognised asset is the lower of the two, ie 65 (column F), and no gain or loss is recognised (column G).

In effect, an actuarial loss of 35 is recognised immediately, but is offset by the reduction in the effect of the asset ceiling.

| | **Balance sheet asset under paragraph 54** | **Effect of the asset ceiling** | **Asset ceiling** |
|---|---|---|---|
| Year 1 | 100 | (35) | 65 |
| Year 2 | 65 | 0 | 65 |
| Gain/(loss) | (35) | 35 | 0 |

**Draft amendment to IAS 19**

*Note*

In applying paragraph 58A in situations when there is an increase in the present value of the economic benefits available to the enterprise, it is important to remember that the present value of the economic benefits available cannot exceed the surplus in the plan.[2]

| | |
|---|---|
| 2 | In IAS 19 itself, amend paragraphs 58, 60, 92 and 96 and insert new paragraphs 58A and 58B. |

***58. The amount determined under paragraph 54 may be negative (an asset). An enterprise should measure the resulting asset at the lower of:***

***(a) the amount determined under paragraph 54; and***

***(b) the net total of:***

***(i) any cumulative unrecognised net actuarial losses and past service cost (see paragraphs 92, 93 and 96); and***

***(ii) the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan. The present value of these economic benefits should be determined using the discount rate specified in paragraph 78.***

***58A. The application of paragraph 58 should not result in a gain being recognised solely as a result of an actuarial loss or past service cost in the current period or in a loss being recognised solely as a result of an actuarial gain in the current period. The enterprise should therefore recognise immediately under paragraph 54 the following to the extent that they arise while the defined benefit asset is determined in accordance with paragraph 58(b):***

[2] The example following paragraph 60 of IAS 19 will be corrected so that the present value of available future refunds and reductions in contributions equals the surplus in the plan of 90 (rather than 100), with a further correction to make the limit 270 (rather than 280).

***(a) net actuarial losses and past service cost to the extent that they exceed any reduction in the present value of the economic benefits specified in paragraph 58(b)(ii) and***

***(b) net actuarial gains to the extent that they exceed any increase in the present value of the economic benefits specified in paragraph 58(b)(ii).***

58B. Paragraph 58A applies to an enterprise only if it has, at the beginning or end of the accounting period, a surplus[*] in a defined benefit plan and cannot, based on the current terms of the plan, recover that surplus fully through refunds or reductions in future contributions. In such cases, past service cost and actuarial losses that arise in the period, the recognition of which is deferred under paragraph 54, will increase the amount specified in paragraph 58(b)(i). If that increase is not offset by an equal decrease in the present value of economic benefits that qualify for recognition under paragraph 58(b)(ii), there will be an increase in the net total specified by paragraph 58(b) and, hence, a recognised gain. Paragraph 58A prohibits the recognition of a gain in these circumstances. The opposite effect arises with actuarial gains that arise in the period, the recognition of which is deferred under paragraph 54, to the extent that the actuarial gain reduces a cumulative unrecognised actuarial loss. Paragraph 58A prohibits the recognition of a loss in these circumstances. For examples of the application of this paragraph see Appendix C.

60. The limit in paragraph 58(b) does not over-ride the delayed recognition of certain actuarial losses (see paragraphs 92 and 93) and certain past service cost (see paragraph 96), other than as specified in paragraph 58A. However, that limit does over-ride the transitional option in paragraph 155(b). Paragraph 120(c)(vi) requires an enterprise to disclose any amount not recognised as an asset because of the limit in paragraph 58(b).

***92. In measuring its defined benefit liability under paragraph 54, an enterprise should, subject to paragraph 58A, recognise a portion (as specified in paragraph 93) of its actuarial gains***

[*] A surplus is an excess of the fair value of the plan assets over the present value of the defined benefit obligation.

***and losses as income or expense if the net cumulative unrecognised 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.***

***These limits should be calculated and applied separately for each defined benefit plan.***

***96. In measuring its defined benefit liability under paragraph 54, an enterprise should, subject to paragraph 58A, recognise past service cost as an expense on a straight-line basis over the average period until the benefits become vested. To the extent that the benefits are already vested immediately following the introduction of, or changes to, a defined benefit plan, an enterprise should recognise past service cost immediately.***

| | |
|---|---|
| 3 | Effective date – amend paragraphs 157 and 160 and insert new paragraph 159A. |

***157. This International Accounting Standard becomes operative for financial statements covering periods beginning on or after 1 January 1999, except as specified in paragraphs 159 and 159A. Earlier adoption is encouraged. If an enterprise applies this Standard to retirement benefit costs for financial statements covering periods beginning before 1 January 1999, the enterprise should disclose the fact that it has applied this Standard instead of IAS 19, Retirement Benefit Costs, approved in 1993.***

***159A. The amendment in paragraph 58A becomes operative for annual financial statements[ϕ] covering periods ending on or after 31 March 2002. Earlier adoption is encouraged. If***

[ϕ] Paragraph 159A refers to 'annual financial statements' in line with more explicit language for writing effective dates adopted in 1998. Paragraph 157 refers to 'financial statements'.

***earlier adoption affects the financial statements, an enterprise should disclose that fact.***

160. IAS 8, Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies, applies when an enterprise changes its accounting policies to reflect the changes specified in paragraphs 159 and 159A. In applying those changes retrospectively, as required by the benchmark and allowed alternative treatments in IAS 8, the enterprise treats those changes as if they had been adopted at the same time as the rest of this Standard.

| | |
|---|---|
| 4 | Basis for Conclusions – add paragraphs 78A-E after paragraph 78 |

## Asset ceiling – amendment adopted in [April 2002]

78A. [In April 2002], the Board agreed on a [proposed] amendment to the limit on the recognition of an asset (the asset ceiling) in paragraph 58 of the standard. The objective of the amendment was to prevent gains (losses) being recognised solely as a result of the deferred recognition of past service cost and actuarial losses (gains).

78B. The asset ceiling is specified in paragraph 58 of IAS 19, which requires a defined benefit asset to be measured at the lower of

(a) the amount determined under paragraph 54; and

(b) the net total of:

(i) any [cumulative] unrecognised [net] actuarial losses and past service cost; and

(ii) the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan.

78C. The problem arises when an entity defers recognition of actuarial losses or past service cost in determining the amount specified in paragraph 54 but is required to measure the defined benefit asset at the net total specified in paragraph 58(b). Paragraph 58(b)(i) could result in the entity recognising an increased asset because of actuarial losses or past service cost in the period. The increase in the asset would be reported as a gain in income. Examples illustrating the issue are given in Appendix C.

78D. The Board agreed that recognising gains (losses) arising from past service cost and actuarial losses (gains) is not representationally faithful. It considered whether such a result should, nonetheless, be regarded as an integral part of the deferred recognition approach for some past service cost and actuarial gains and losses. The Board concluded that limiting the asset that can be recognised is itself inconsistent with deferred recognition. However, both deferred recognition and the asset ceiling are part of IAS 19. The Board intends to undertake a comprehensive review of both aspects of the standard as part of a future convergence project. In the meantime, the Board regards a limited amendment to prevent their interaction giving rise to unfaithful representations of events as an improvement.

78E. Paragraph 58A, therefore, prevents gains (losses) from being recognised solely as a result of the deferred recognition of past service cost or actuarial losses (gains).