Project **Post-employment benefits**

Topic **Disclosure: response to proposals in the ED**

Objective

1. This paper describes responses to the Board's proposals on disclosures received in the comment letters. This paper is structured as follows:
   (a) Feedback on the Board's approach to disclosures (paragraphs 3 - 8)
   (b) Disclosure objectives (paragraphs 9 - 14)
   (c) Information about risk, including sensitivity analysis (paragraphs 15 - 24)
   (d) Explanation of amounts in the financial statements (paragraphs 25 - 34)
   (e) Further information about the amount, timing and uncertainty of future cash flows (paragraphs 35 - 39)
2. Many respondents were concerned with the ED proposal to eliminate the distinction between post-employment benefits and other long-term employee benefits and require the proposed defined benefit disclosures to be applied to all long-term employee benefits. We intend to ask the Board to consider separately the issue of whether the proposed disclosures should apply to other long-term employee benefits. For the purposes of this paper, we ask that members consider the disclosures as they apply to defined benefit plans only.

This paper has been prepared by the technical staff of the IASB for the purposes of discussion at a public meeting of the IASB working group identified in the header of this paper.

The views expressed in this paper are those of the staff preparing the paper and do not purport to represent the views of any individual members of the Board or the IASB.

The meeting at which this paper is discussed is a public meeting but it is not a decision-making meeting of the Board. Official pronouncements of the IASB are published only after the Board has completed its full due process, including appropriate public consultation and formal voting procedures.

Feedback on the Board's approach to disclosures

3. One challenge in assessing the appropriate level of disclosure about defined benefit plans is that they have differing levels of importance for different entities. The Board has heard many concerns that the volume of disclosures about defined benefit plans risks obscuring important information. In the ED, the Board sought an approach that:

   (a) provides sufficient disclosures about defined benefit plans when those plans are material to the operations of the entity.

   (b) provides users of financial statements with relevant information that is not obscured by excessive detail.

4. The Board considered whether to provide specific guidance in the ED on how to apply the general notion of materiality in this context. However the Board concluded that entities should apply the general materiality guidelines in IAS 1, because there is no reason why entities should apply materiality in the case of defined benefit plans differently to other items. The general materiality requirements in IAS include:

   (a) paragraph 31: 'An entity need not provide a specific disclosure required by an IFRS if the information is not material'; and

   (b) paragraph 17(c): 'A fair presentation ... requires an entity ... to provide additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance.'

5. Accordingly, the Board proposed not to provide guidance in IAS 19 on materiality, nor to require disclosures that cover all possible circumstances of every entity with a defined benefit plan. Rather, the Board proposed to articulate objectives for disclosures about defined benefit plans so that entities would have the flexibility to decide on an appropriate level of disclosure that

enables users to see the overall picture without combining information that has different characteristics.

6. Many respondents to the ED are concerned that the Board's approach will continue to result in voluminous disclosure, and not achieve the goals set out above. While many respondents supported the inclusion of disclosure objectives, they believed that supplementing the objectives with an extensive list of disclosure requirements would not achieve the result that the Board intended. Some respondents noted that this approach leads to 'one-size fits all' requirements that may not be flexible enough to adjust to each entity's individual circumstances.

7. Many supported a more principles based approach to disclosure that would put more emphasis on meeting the disclosure objectives. Some suggested that it would be better if the Board supported the disclosure objectives through the use of 'encouraged but not required' disclosures or by including examples illustrating the application of the disclosure objectives in different circumstances. Others suggested that guidance or some discussion is provided on the application of materiality to disclosures.

8. Many were concerned that some of the proposed disclosures are very broad and would result in boilerplate disclosures or would create diversity in practice through differing interpretation.

Discussion questions
How should the Board modify its approach to disclosures in order to meet the objectives in paragraph 3(a) and 3(b)?

Disclosure objectives

The ED proposals

9. In selecting the disclosure objectives, the Board considered the following:

   (a) Defined benefit obligations have characteristics similar to some long-term financial instruments and long-term insurance contracts. Both expose the entity to similar risks, including risks that the ultimate cost of settling the liability may vary from the amount estimated, and risks arising from the complexity of measuring the liability.

   (b) Plan assets are not equivalent in every respect to assets held directly by the entity. Moreover, an entity may have limited information about them.

10. The Board considered whether it should require the same disclosure objectives for defined benefit plans as for long-term financial instruments (in IFRS 7) and insurance contracts (in IFRS 4). Many interested parties have commented that the disclosures in IAS 19 do not provide users of financial statements with the information about risk that is provided for other assets and liabilities. However, the Board concluded that much of the information required for assets by IFRS 7 and IFRS 4 would be unnecessary in depicting an entity's involvement with a defined benefit plan because:

    (a) the entity may not manage plan assets directly and may not have an unrestricted ability to access the economic benefits from those assets. Thus, disclosures about market risk and credit risk of plan assets are less relevant than when an entity holds those assets directly.

    (b) liquidity risk arises from the timing and amount of contributions the entity is required to make to the plan and not from the need to meet directly the payments required by the defined benefit obligation.

11. Furthermore, defined benefit plans create greater exposure to some risks, for example demographic risks that are not dealt with in IFRS 7. Accordingly, the

Board focused the disclosure objectives in IAS 19 on the matters most relevant to users of the employer's financial statements.

12. The ED proposed the following disclosure objectives:

> 125A An entity shall disclose information that:
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> (a) explains the characteristics of its defined benefit plans (see paragraph 125C);
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> (b) identifies and explains the amounts in its financial statements arising from its defined benefit plans (see paragraphs 125D-125H); and
>
> (c) describes how its defined benefit plans may affect the amount, timing and uncertainty of the entity's future cash flows (see paragraphs 125I-125K).

Feedback received

13. Many respondents stated that the objectives proposed by the Board were appropriate for defined benefit plans and that they reflected the objectives of financial reporting. Some respondents state the Board should make more specific mention of risk in the objectives. A few respondents did not believe that the Board had made an adequate case for requiring less information on plan assets than other standards, those with this view noted that in some jurisdictions entities have a high level of control over their plan assets.

14. Consistent with the views on the Board's approach to disclosure above, many commented that their support of the disclosure objectives was conditional on the information only being required when material, indicating that they had not appreciated how the notion of materiality applies to disclosure requirements.

Information about risk, including sensitivity analysis

The ED proposals

15. To meet the disclosure objectives, the ED proposed that an entity should provide a narrative description of exposure to risk arising from its involvement with the plan including sensitivity analyses about actuarial assumptions used to

determine the defined benefit obligation. This disclosure proposal responds to the view that entities should provide more disclosures about the risks inherent in a defined benefit plan and the risks associated with plan assets held to fund the benefits.

16. Specifically, the ED proposed that entities should disclose how the effect of reasonably possible changes to significant actuarial assumptions affect the defined benefit obligation and service cost. Users of financial statements have consistently emphasised the fundamental importance of sensitivity analyses to their understanding of the risks underlying amounts included in the financial statements.

17. The Board considered whether to require entities to provide sensitivity analyses of the effect of changes in actuarial assumptions on the net defined benefit liability (asset). However, the Board concluded that this would be difficult to do because:

    (a) it is unclear how a change in market interest rates would apply to plan assets. If plan assets were invested in equities and in bonds, an analysis showing only direct effects of changes in market interest rates would show the effect on the bonds, but show no effects on the equities. This might not provide very meaningful information. On the other hand, a more complex sensitivity analysis showing the effect of changes in interest rates on equity investments would be difficult to perform because there may be no reasonable basis on which to estimate the interrelationships between interest rates, inflation rates and equity values.

    (b) the net defined benefit liability (asset) includes the effect of the asset ceiling. It would be difficult to determine how changes in the assumptions change the effect of the asset ceiling.

18. Because these issues relate to the plan assets, which are measured at fair value, the ED proposed to require sensitivity analyses only for the defined benefit obligation and not for the net defined benefit liability (asset).

19. The Board intends that the sensitivity analyses for service cost should give an indication of the variability of the service cost recognised in the statement of

comprehensive income. However, service cost is determined at the beginning of the period. Some might therefore argue that there is no effect from changes in assumptions at the end of the period. Consequently the ED proposed that entities should perform the sensitivity analyses for service cost using changes in assumptions that were reasonably possible at the start of the reporting period.

20. Accordingly, the ED proposed the following additional disclosures to the current requirements:

> 125C An entity shall disclose:
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> …
>
> (b) a narrative description of the extent of the risks to which the plan exposes the entity and of any concentrations of risk. For example, if plan assets are invested primarily in one class of investments, eg property, the plan may expose the entity to a concentration of property market risk.
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> 125I An entity shall disclose:
>
> (a) how the effect of a change to each significant actuarial assumption that:
>
> (i) is reasonably possible at the end of the reporting period would have affected the defined benefit obligation at the end of the reporting period; and
>
> (ii) was reasonably possible at the beginning of the reporting period would have affected current service cost that was determined for the reporting period
>
> (b) the methods and assumptions used in preparing the sensitivity analyses required by (a) and the limitations of those methods.
>
> (c) changes from the previous period in the methods and assumptions used in preparing the sensitivity analyses, and the reasons for such changes.

Feedback received

21. There was much support for including disclosures about exposure to risk, however there was a mixed response for the specific sensitivity requirements proposed by the board.

22. Some noted that the narrative disclosure about risk should be limited to any risks that are unusual or specific to the entity so that it does not include risks that all entities are exposed to in general (such as equity investments being exposed to market risk).

23. There were varying levels of support for the sensitivity analysis requirements, from those that supported the requirements in full, supported part of the requirements, would prefer if the requirements were permitted but not required or would prefer if the requirements would be deleted. One respondent noted that sensitivity analysis is suggested as a disclosure in paragraph 129(b) of IAS 1 as an example of the type of disclosure to help a user understand the 'judgments that management makes about the future and about other sources of estimation uncertainty'. This respondent supported the proposed disclosure in the ED on the basis that it was additional guidance in applying the requirements in IAS 1 to defined benefit plans.

24. Respondents noted the following concerns regarding the sensitivity disclosures:

    (a) It is unclear whether the requirement is to disclose:

        (i) The effect of other reasonably possible assumptions that might have been selected (ie measurement uncertainty); or

        (ii) How the assumptions might reasonably change due to market movements or if unanticipated events were to occur (ie risk)

    (b) Not providing a sensitivity analysis of plan assets will reduce the usefulness of the disclosure. There is potentially greater variability in plan assets than for the DBO and the sensitivity analysis for the DBO would provide more useful information if the sensitivity of plan assets to the same variables were also disclosed.

(c) The sensitivity disclosure would be misleading as it would not take into account the correlations between various actuarial assumptions. A few suggested that a scenario analysis would be more useful, however this would be more costly to produce.

(d) Some did not believe that requirement to show the sensitivity of service cost to assumptions at the beginning of the period was particularly useful. It would have limited predictive value with respect to future cash flows given that it is derived based on past information.

(e) Some noted that variations in the discount rate would affect service cost and interest cost in opposite directions, and therefore suggested that the analysis be limited to the DBO.

(f) Many believed that the disclosure should be more specific to increase comparability and reduce the range and amount of sensitivities disclosed.

   (i) Some requested that the sensitivity analysis should be limited to the assumptions that have a significant effect on the financial statements.

   (ii) Some requested that sensitivity of the DBO to the discount rate should be required because this assumption is market-based, affects both service and interest cost and has the greatest effect on the value of the DBO in most, if not all, plans. Others suggested that sensitivity analysis should be limited to the sensitivity of the DBO to the discount rate for similar reasons.

   (iii) Some suggest that prescribing the quantifiable change of the amount of sensitivity (such as 1%) would provide more comparability than allowing preparers to determine what is reasonably possible.

(g) Some are concerned about the role of sensitivity analyses:

(i) in financial reporting in general, because they believe sensitivity should be disclosed outside the financial statements; and

(ii) in defined benefit plan accounting specifically, because the measurement of the DBO is based on management's best estimate and is not a range of possible values.

Explanation of amounts in the financial statements

25. The disclosures about the characteristics of defined benefit plans and the amounts in the financial statements arising from defined benefit plans are based on those in the existing version of IAS 19. In addition, the Board proposed additional disclosures, as follows:

    (a) Actuarial assumptions (paragraphs 26 – 30)

    (b) Alternative measure of the long-term employee benefit liability (paragraphs 31 – 34)

Actuarial assumptions

The ED proposals

26. The Board decided that it would not specify particular assumptions for which disclosure is required because particular disclosures may not be needed to meet the underlying objectives in every case. Accordingly, the ED proposed an approach in which entities will use their judgement to determine which actuarial assumptions require disclosure. In particular, the Board proposed not to require specific disclosures about mortality rates. Instead, entities would use judgment to determine whether assumptions about mortality rates require disclosure.

27. The Board proposed to retain the requirement in IAS 19 for entities to provide quantified disclosures about actuarial assumptions (paragraph 125G(a)). However, the Board acknowledges that such quantified disclosures could be difficult to interpret without extensive supplementary information that would be impracticable to provide. For example, disclosure of mortality rates without

supporting information could be misleading and it is not practicable for entities to provide users with the detailed knowledge about the demographic profile of a plan that would be needed to make a meaningful assessment of the information provided by disclosures of mortality rates. Therefore, the ED also proposed that in those circumstances, the entity should explain how it determined those actuarial assumptions (paragraph 125G(b)). For example, if an entity has developed mortality assumptions using a standard table, it could disclose the source of that table and when it was compiled. Similarly, the entity could disclose its estimate of the expected mortality rates of plan members.

28. Accordingly, the ED included the following:

> 125G An entity shall disclose:
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> (a) Quantitative information about actuarial assumptions used to determine the defined benefit obligation (see paragraph 73). Such disclosure shall be in absolute terms (eg as an absolute percentage, and not just as a margin between different percentages and other variables). When an entity provides disclosures in total for a grouping of plans, it shall provide such disclosures in the form of weighted averages or relatively narrow ranges.
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> (b) A brief description of the process used to determine demographic actuarial assumptions to supplement the disclosures provided in accordance with (a).

Feedback received

29. There was much support for the Board's replacement of the current list of actuarial assumptions that require disclosure with an approach requiring entities to use their judgment in determining which actuarial assumptions to disclose.

30. There was much less support for the requirement to disclose the process used to determine demographic assumptions. Respondents noted the following concerns:

(a) The requirement may lead to boilerplate disclosure that would not be particularly useful. The process often consists of experts performing experience studies and making professional assessments.

(b) It is not clear what the objective of the requirement is and how this information would be used. For instance, without understanding the demographics of the members it is difficult to see a user benefiting from the disclosures.

(c) Disclosure of the assumptions should be adequate. Evaluating the process to determine the appropriate assumptions would be a normal part of an audit, and users rely on the entity, its actuaries and auditors to ensure the demographic assumptions are reasonable.

Alternative measure of the long-term employee benefit liability

The ED proposals

31. The Board proposed that entities should disclose the defined benefit obligation, excluding projected growth in salaries (sometimes referred to as the 'accumulated benefit obligation', though this term has a specific meaning in some jurisdictions that may not be equivalent to the proposed disclosure). In some circumstances, this amount is similar to the amount of the entity's obligation if the plan were to be terminated, and some users believe that is relevant additional information. Moreover, this amount is relevant to some who believe that the measurement of these liabilities should exclude projected salary growth. The Board does not think this information would be costly to provide because it uses inputs that are needed to determine the defined benefit obligation.

32. Accordingly, the ED included the following:

> 125H An entity shall disclose the present value of the defined benefit obligation, adjusted to exclude the effect of projected growth in salaries.

Feedback received

33. Most respondents to this proposal did not support the proposal. Many felt that the proposal was not fully justified by the Board, with many noting that it would be inappropriate to require a disclosure only because it would be relevant to some users in limited circumstances. Many noted that the relevance of such a disclosure would depend on the nature of the benefits upon termination which would vary by country and by plan and commented that it would not be relevant in many jurisdictions. Others believed that disclosing an alternative measure of the liability would contradict the measurement requirement of IAS 19. Many were not convinced that the albeit low cost of this benefit is outweighed by the limited user benefit, noting that this would apply to many other similarly low cost requirements that would just add to the volume of disclosures and only be useful in limited circumstances.

34. Some suggested that instead of the proposed disclosure, a disaggregation of the DBO would be better as it would break the amount down into parts such as the vested benefits, accrued but not unvested benefits, future salary increases and other constructive obligations.

Further information about the amount, timing and uncertainty of future cash flows

The ED proposals

35. The Board proposes to require entities to provide improved information about the amount, timing and uncertainty of future cash flows to the plan as follows:

    (a) *Asset-liability matching strategies (paragraph 125J)*: The ED proposed a requirement to disclose information about an entity's use of asset-liability matching investment strategies or the use of techniques, such as annuities or longevity swaps, to manage longevity risk. The Board considered a broader requirement for all entities with defined benefit plans to disclose a discussion of their strategies for mitigating risks arising from defined benefit plans. However, because many

entities would mitigate risks arising from defined benefit plans through their investment strategies, the Board concluded that such a requirement would result in generic disclosure that would not provide enough specific information to be useful to users of financial statements.

(b) *Factors that could cause contributions to differ from service cost (paragraph 125K):* The Board considered disclosure of information about an entity's best estimate of the contributions it expects to pay to the plan during the next year, distinguishing between required contributions, discretionary contributions and non-cash contributions. However, the Board believes that information is useful if it highlights possible differences between current service cost and cash contributions in the near future. This might be the case if a surplus or deficit affects the level and timing of an entity's contributions. Therefore the ED proposed disclosure of factors that could cause contributions over the next five years to differ from current service cost. The Board believes that this is more useful than merely disclosing expected payments in the next year because those payments depend partly on estimated service cost and also because mere disclosure of the amount would not indicate likely trends beyond the following year.

36. Accordingly, the ED included the following:

> 125J An entity shall disclose details of any asset-liability matching strategies used by the plan, including the use of annuities and other techniques, such as longevity swaps, to manage longevity risk.
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> 125K An entity shall provide a narrative discussion of factors that could cause contributions over the next five years to differ significantly from current service cost over that period. For example, an entity shall disclose how it expects any surplus or deficit to affect the level and timing of its contributions over the next five years, and the period over which it expects the surplus or deficit to disappear.

Feedback received

37. Views on the proposals regarding asset-liability matching strategies were mixed. Some supported the disclosure, others felt that it should be part of a broader disclosure regarding risk management and investment strategy and many felt that it should be removed. Those that felt it should be part of a broader discussion about risks suggested linking the disclosure with the requirement to describe the nature of risks that the plan exposes the entity to, by requiring the entity to describe how it manages those risks.

38. Respondents that did not support the asset-liability matching disclosure were concerned that:

    (a) Any disclosure of strategy would be generic and boilerplate.

    (b) A user will be able to perform a better assessment using the disclosures on plan assets and on the DBO (ie the results of such a strategy are more relevant than a narrative discussion).

    (c) The requirement may imply that an entity should be doing asset-liability matching.

39. Many did not support the disclosure of factors that could cause contributions to differ significantly from current service cost. Respondents noted the following:

    (a) There are many arbitrary factors why contributions would differ from service cost. In some jurisdictions, contributions are not regulated and are totally discretionary.

    (b) The disclosure would need to be prepared based on assumptions on the future (such as the volatility of the plan assets).

    (c) There is often no direct relationship between contributions and service cost. Contributions are usually determined based on local funding requirements. The DBO is measured using a different basis under funding requirements.

(d) This disclosure only considers funded plans and does not consider plans that are closed (ie where service cost is zero). Disclosure about future cash flows is also relevant for unfunded plans.

(e) Respondents suggested that disclosure of the maturity of the DBO is more relevant for both funded and unfunded plans, as would disclosure about the effect of regulatory funding deficits and any commitment the entity has under local law. One respondent suggested requiring disclosure of the factors, other than service cost, that an entity expects to affect contributions.

Discussion questions
Given the responses to the proposed disclosures in the comment letters, should the Board keep the following disclosure requirements? If so, how can the Board improve the disclosure requirements? a) information about risk, including sensitivity analyses b) information about the processes used to determine demographic assumptions c) the present value of the DBO, modified to exclude future salary increases d) information about asset-liability matching strategies e) information about factors that could cause contributions to differ from service cost Do members have any other comments on the proposed disclosures?