Trends

ACCOUNTING FOR CHANGE

How the amended IAS 19 will affect plan sponsors

BY FRANK D'ANDREA

For years, investors and other stakeholders have called for greater transparency in the accounting standards for employee benefits, since current standards obscure the true cost of providing those benefits. In an effort to address this issue, the International Accounting Standards Board's IAS 19 standard—which sets out regulations for the accounting treatment and disclosure of employee benefits—was updated in June 2011.

The amendments were borne of a goal to achieve greater transparency in three areas of DB accounting: recognition, presentation and disclosure. They will bring to an end such thorny accounting intricacies as smoothing and expected return on assets (EROA), providing investors, regulators and plan members with a clearer picture of the financial risks associated with DB commitments.

Recognition

The most significant amendment is the requirement to immediately recognize all actuarial gains and losses. This will affect organizations differently depending on their plan's maturity and funding strategy. Plans that previously smoothed their gains and losses will find increased volatility in their financial results. Any metrics tied to operating results should be reassessed by a plan sponsor's corporate management if they could be affected.

Presentation

The amended standard should increase consistency and comparability among plans, insofar as each would be required to classify the following elements of employee benefits cost in the same way:

- service cost - which includes the current cost of benefits and past service cost from amendments to benefits plans;
- net interest - which requires entities to apply a single discount rate to the net DB asset or liability (i.e., to the real plan deficit or surplus); and
- remeasurement - which requires each entity to immediately recognize the full change in the plan deficit or surplus, since the ability to defer and amortize actuarial gains and losses would be eliminated.

The "net interest" concept is new and removes a plan sponsor's previous requirement to estimate the EROA. But does it change the risk appetite of the plan sponsor?

Under the amendments, financing costs will not reflect the higher long-term returns expected through equity investment. Since plan assets are no longer linked to the return recognized in net income, this could have an impact on a plan sponsor's asset allocation.

Disclosure

The amended IAS 19 expands disclosure requirements around plan characteristics and risks, financial amounts arising from DB plans and future cash flows. Plan sponsors will still have some flexibility over the disaggregation of disclosure information—for example, by plan type, regulatory environment and funding arrangements—and should be taking steps now to determine how best to meet the new disclosure objectives.

Amended IAS 19 is effective for fiscal years beginning on or after Jan. 1, 2013, and prior years' financial statements would need to be restated to comply with the new rules. Plan sponsors should also consider early adoption of the new IAS 19—especially publicly accountable organizations that adopted IFRS in 2011 (using the current IAS 19), since these organizations will otherwise have to restate results after the amendments become effective.

Finally, plan sponsors should partner with their auditors and actuaries to develop an IAS 19 implementation plan. They should also consider a communication strategy aimed at plan members. While investors will understand some of the accounting complexities, plan sponsors will need to reassure plan members that the implementation of this new standard will not affect the amount or security of their benefits.

Fact File

Frank D'Andrea is director, corporate accounting and reporting, with Hydro One
frank.dandrea@hydroone.com

EDUCATION
University of Toronto

PAST EMPLOYER
PwC

EXTRA-CURRICULAR
Chair, employee benefits advisory group, Canadian Institute of Chartered Accountants