

This Agenda Paper:

- (a) discusses the current treatment of past service cost under AASB 119 *Employee Benefits* and the proposed treatment in the IASB's Discussion Paper *Preliminary Views on Amendments to IAS 19 Employee Benefits*;**
- (b) discusses the treatment of past benefit costs under AAS 25 *Financial Reporting by Superannuation Plans*; and**
- (c) considers how past benefit costs should be treated under a replacement Standard for AAS 25.**

Background

1. Paragraphs 38 – 40 of draft Exposure Draft 16X *Superannuation Plans and Approved Deposit Funds* (Agenda Paper 3.10) outline the proposed treatment of past benefit costs.
2. Past benefit costs of a superannuation plan are equivalent to past service costs attributable to an employer's defined benefit obligation. Paragraph 97 of AASB 119 states, in part, that:

“Past service cost arises when an entity introduces a defined benefit plan or changes the benefits payable under an existing defined benefit plan. Such changes are in return for employee service over the period until the benefits concerned are vested...”
3. In accordance with paragraph 96 of AASB 119, past service cost is:
 - (a) recognised as an increase in the defined benefit obligation of an employer sponsor in the period in which the change occurs when the benefits vest immediately; or
 - (b) deferred and expensed on a straight-line basis over the average period until the benefits become fully vested.
4. Consistent with the Board's decision to use the requirements in AASB 119 in respect of defined benefit obligations as a basis for equivalent requirements for superannuation plans, staff have incorporated an amended version of the AASB 119 requirements in relation to past benefit costs in draft ED 16X. The amendments to the AASB 119 wording shown in paragraphs 38 – 40 of draft ED 16X reflect changes staff consider necessary to ensure the proposals are meaningful in a superannuation context. However, in light to the proposals in the IASB's Discussion Paper *Preliminary Views on Amendments to IAS 19 Employee Benefits* (Employee Benefits DP), and the nature of defined benefit arrangements in Australia, staff are not convinced that draft ED 16X should permit a 'defer and expense' treatment in respect of past benefit costs. Accordingly, this Agenda Paper:
 - (a) briefly outlines the proposals in the IASB's Employee Benefits DP in respect of past benefit costs (paragraphs 5 – 7);
 - (b) discusses the treatment of past benefit costs under AAS 25 (paragraph 8 – 10); and
 - (c) considers the arguments for and against a superannuation plan applying a 'defer and expense' approach under a replacement Standard for AAS 25 (paragraphs 11 – 14).

IASB's proposals in respect of past benefit costs

5. In its Employee Benefits DP, the IASB notes the following arguments in favour of retaining the 'defer and expense' treatment for past service costs.
 - (a) Entities amend or introduce defined benefit plans to remunerate employees for future service, not for service already rendered, even if the terms of those amendments attribute benefits to past service periods. Accordingly, a defer and expense approach could facilitate a more accurate measure of employees'

- remuneration for a period than the immediate recognition of past benefit costs (paragraph 2.17).
- (b) Attributing changes in unvested benefits arising from plan amendments to future service from employees is consistent with IFRS 2 *Share-based Payment* and the proposed treatment of unvested termination benefits in the exposure draft of amendments to IAS 19 published in June 2005 (paragraph 2.19).
6. In its Employee Benefits DP, the IASB also notes the following arguments against retaining the defer and expense approach under IAS 19.
- (a) The ‘defer and expense’ approach results in deferred recognition of an amount that is regarded as a liability under IAS 19 (paragraph 2.20). Paragraph 69 of IAS 19 states, in part, that:
- “Employee service gives rise to an obligation under a defined benefit plan even if the benefits are conditional on future employment (in other words they are not *vested*). Employee service before the vesting date gives rise to a constructive obligation because, at each successive reporting date, the amount of future service that an employee will have to render before becoming entitled to the benefit is reduced...”
- (b) The defer and expense approach is inconsistent with the IASB’s preference for the immediate recognition of all gains and losses arising from defined benefit plans (paragraph 2.20) and the approach under SFAS 158 *Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans* (paragraph 2.17).
7. While the IASB notes in its Employee Benefits DP that the current approach in IAS 19 is consistent with what it considers to be the best conceptual answer for liabilities that are subject to a vesting scale, the Employee Benefits DP confirms that the IASB’s preliminary view is that entities should recognise all past service costs as an increase in the defined benefit obligation in the period in which the plan’s formal terms are amended.

Treatment of past benefit costs by a superannuation plan

8. AAS 25 is silent on the treatment of past benefit cost. In addition, there appears to be some uncertainty among constituents in relation to how a superannuation plan might account for past benefit costs. This uncertainty is attributable, at least in part, to the nature of defined benefit arrangements in Australia.
9. From discussions with members of the Project Advisory Group, staff understand that:
- (a) no new defined benefit plans have been established in recent times and it is unlikely that any new defined benefit plans will be established in the future; and
- (b) employer sponsors are generally reticent to enhance the benefits payable under an existing defined benefit plan because an increase in benefits will generally lead to inequitable outcomes, such as older members and members with longer periods of service being treated relatively more favourably in comparison to younger members or members with shorter periods of service.

10. From discussions with members of the Project Advisory Group, staff also understand that most, if not all, of the obligations for accrued benefits reported by Australian superannuation plans comprise little, if any, past benefit costs.

Arguments for and against proposing that a superannuation apply the defer and expense approach

11. The main argument in favour of proposing that a superannuation plan treat past benefit costs in a manner consistent with the approach under AASB 119 in respect of past service cost is to facilitate consistency between the accrued benefits figure reported by the plan and the defined benefit obligation reported by the employer sponsor.
12. There are a number of arguments against a superannuation plan accounting for past benefit costs in accordance with the defer and expense approach, including it is inconsistent with:
 - (a) the proposals made by the IASB in its Employee Benefits DP in respect of past service cost;
 - (b) the proposed treatment of unvested accrued benefits as a liability of a superannuation plan in draft ED 16X (see paragraph 22 of draft ED 16X, which corresponds to paragraph 69 of AASB 119); and
 - (c) the proposed treatment of changes in the carrying amounts of assets and liabilities in draft ED 16X (see paragraph 45 of draft ED 16X).
13. In addition, while the deferred recognition approach might be justified on the basis that it provides a more accurate measure of employee remuneration expenses, the corresponding argument does not apply in the context of a superannuation plan.
14. A defined benefit member does not provide benefits to a superannuation plan in the same way as they provide service to their employer. An increase in a superannuation plan's obligation for a defined benefit member's accrued benefits will not be offset in the future by inflows of benefits to the plan in the form of services from the member. In addition, any increase in benefit payments in the future as a consequence of a plan amendment would not necessarily give rise to an asset of the superannuation plan in the form of contributions receivable. As agreed by the Board at its June 2008 meeting, unless there is a specific contractual agreement between a superannuation plan and its sponsoring employers, the superannuation plan does not control future contributions.

Staff view

On balance, staff consider that draft ED 16X should propose that a superannuation plan recognise all past benefit costs in the period in which the amendment to the plan's trust deed occurs.