

**REGULATION IMPACT
STATEMENT**

AASB 119
December 2004

Employee Benefits



Australian Government

**Australian Accounting
Standards Board**

Regulation Impact Statement
AASB 119 Employee Benefits (December 2004)

Background

The Australian Accounting Standards Board (AASB) is implementing the Financial Reporting Council's (FRC) strategic directives to adopt International Financial Reporting Standards [the Standards and Interpretations of the International Accounting Standards Board (IASB)] for application to reporting periods beginning on or after 1 January 2005 and to harmonise the requirements applicable to general purpose financial reports of public sector entities and those applicable to Government Finance Statistics. To put the first of the FRC directives into effect the AASB is issuing Australian equivalents to IASB Standards and has undertaken a separate project in respect of harmonising financial reporting requirements and Government Finance Statistics. Implementation of the FRC's Year 2005 strategic directive does not, of itself, cause a change in the underlying economic circumstances of an entity but at times results in events and transactions being portrayed differently so as to achieve improvements in the transparency and quality of Australian financial reports.

The AASB has decided to continue to issue one series of sector-neutral Standards, that is, Standards applicable to both for-profit and not-for-profit entities, including public sector entities. The AASB has regard to the Standards of the International Public Sector Accounting Standards Board (IPSASB) in respect of issues affecting not-for-profit entities. The PSC is using the IASB's Standards, to the extent possible, as the basis for International Public Sector Accounting Standard (IPSAS). Accordingly, adopting IASB Standards simultaneously helps convergence with existing and future IPSASs. Except for Standards that are specific to the not-for-profit or public sectors or that are purely of a domestic nature, the AASB is using the IASB Standards as the "foundation" Standards to which it adds material detailing the scope and applicability of a Standard in the Australian environment. Additions are made, where necessary, broadening the content to cover sectors not addressed by an IASB Standard and domestic, regulatory or other issues. The AASB also retains guidance from superseded AASB Standards in an Appendix to the new Standards where it considers that guidance to be important to facilitate implementation and compliance with a Standard. In addition, in respect of optional treatments included in IASB Standards, the AASB decided it would generally require only one treatment in order to facilitate comparability of financial reports in Australia.

Under section 227(1) of the *Australian Securities and Investments Commission Act 2001* (ASIC Act), the functions of the AASB are to:

- develop a conceptual framework, not having the force of an accounting standard, for the purpose of evaluating proposed accounting standards and international standards;
- make accounting standards under section 334 of the *Corporations Act 2001* for the purposes of the corporations legislation;
- formulate accounting standards for other purposes; and
- participate in and contribute to the development of a single set of accounting standards for world-wide use having regard to the interests of Australian corporations that raise or propose to raise capital in major international financial centres.

Functions of the FRC include determining the AASB's broad strategic direction, monitoring the development of international standards and the accounting standards that apply in major international financial centres, to further the development of a single set of standards for world-wide use with appropriate regard to international developments and to promote the adoption of international best practice in the Australian accounting standard-setting process.

Both the AASB and the FRC are required to advance the main objects of Part 12 of the ASIC Act, Section 224, to:

- facilitate the development of accounting standards that require the provision of financial information that allows users to make and evaluate decisions about allocating scarce resources, assists directors to discharge their obligations in relation to financial reporting, is relevant to assessing performance, financial position, financing and investment, is relevant and reliable, facilitates comparability and is readily understandable;
- facilitate the Australian economy by reducing the cost of capital, enabling Australian entities to compete effectively overseas and having accounting standards that are clearly stated and easy to understand; and
- maintain investor confidence in the Australian economy (including its capital markets).

It is in this context that the FRC has decided to direct the AASB to:

- adopt IASB Standards with effect from 1 January 2005; and

- harmonise the requirements applicable to general purpose financial reports of public sector entities and those applicable to Government Finance Statistics.

AASB 119 *Employee Benefits* is part of the set of Australian equivalents to IASB Standards, and is the Australian equivalent of the IASB's IAS 19 *Employee Benefits*, as amended in December 2004.

1. Problem

The IASB is amending IAS 19 *Employee Benefits* by introducing an additional option in accounting for actuarial gains and losses relating to employer-sponsored defined benefit superannuation plans and certain other amendments relating to multi-employer group plans and disclosures with effect for annual reporting periods beginning on or after 1 January 2006. Australian Accounting Standard AASB 119 *Employee Benefits* specifies a single method of accounting for actuarial gains and losses of defined benefit plans: namely immediate recognition in the profit for the period. The AASB based its decision to require this treatment on the belief that the IASB would work towards removing the other option (the corridor approach) from IAS 19. Instead, the IASB has introduced a third option into IAS 19 (immediate recognition after profit for the period directly to retained earnings) and the AASB considers that it needs to provide Australian entities with the ability to adopt any one of these three options as it is now likely to be some time before the IASB undertakes a fundamental review of IAS 19.

2. Objectives

The AASB's objectives in addressing the problem are to improve the quality and usefulness of financial reporting in Australia in respect of both for-profit and not-for-profit reporting entities in the private and public sectors and to implement the FRC's directives.

3. Options

Option 1

Adopt all of the optional methods of accounting for actuarial gains and losses in relation to post-employment benefit plans that are defined benefit plans and the other amendments to IAS 19.

Option 2

Adopt immediate recognition in profit for the period and the corridor approach of accounting for actuarial gains and losses in relation to post-

employment benefit plans that are defined benefit plans and the other amendments to IAS 19.

Option 3

Adopt immediate recognition in profit for the period and immediate recognition after profit for the period directly in retained earnings in accounting for actuarial gains and losses in relation to post-employment benefit plans that are defined benefit plans and the other amendments to IAS 19.

Option 4

Only amend AASB 119 for the changes relating to multi-employer group plans and disclosures.

Option 5

Do not amend AASB 119.

4. Impact Analysis

4.1 Affected Parties

Parties likely to be most directly affected by the Standard are:

- (a) reporting entities required to prepare general purpose financial reports and that sponsor defined benefit plans or participate in multi-employer plans;
- (b) users of reports identified in (a) such as:
 - (i) resource providers (including fund managers, investors, creditors and employees);
 - (ii) recipients of goods and services;
 - (iii) parties performing a review or oversight function (including ASIC and ASX); and
 - (iv) management and governing bodies (including use of these reports in the discharge of accountability).

Parties likely to be indirectly or less directly affected by the Standard include:

- (a) participants in the Australian capital markets; and
- (b) the wider community affected by the efficiency of the Australian capital markets and their reputation inside Australia and overseas.

It is expected that many entities will adopt the new option in AASB 119 to recognise actuarial gains and losses directly in retained earnings. Accordingly, it is expected that comparability of Australian financial reports will not be significantly affected. It is also expected that many international entities will adopt the new option in IAS 19. Therefore it is expected that the inclusion of the option in AASB 119 will improve comparability of Australian and international financial reports because the majority of international entities generally do not immediately recognise actuarial gains and losses in the income statement in the period incurred, which was the treatment mandated by AASB 119 as issued in July 2004.

The changes to AASB 119 are unlikely to have a significant impact on small business as small business entities are not likely to be sponsors of defined benefit superannuation plans.

4.2 *Effect on Existing Regulations*

The impact of issuing a revised Australian Accounting Standard AASB 119 *Employee Benefits* to include amendments made to IAS 19 *Employee Benefits* by the IASB and to reinstate the “corridor approach” of accounting for actuarial gains and losses of defined benefit plans is that Australian reporting entities will be able to choose from three methods of accounting in determining their policy on accounting for actuarial gains and losses of defined benefit plans.

4.3 *Costs and Benefits*

When issuing Exposure Drafts of Australian equivalents of IASB Standards, the AASB specifically sought comment from constituents on whether the proposals are in the best interests of the Australian economy and on whether there are regulatory or other issues that may affect the implementation of the proposals. The AASB assesses from a public interest perspective whether the costs of providing certain financial information exceed the benefits to be derived from its provision. There is no universally accepted methodology for quantitatively measuring costs and benefits of information presented in financial reports. The costs of providing financial information are incurred, in the main, by reporting entities, but extend in various direct and indirect ways to the users of general purpose financial reports. There is no guarantee that the costs are borne ultimately by those who derive the benefits. The AASB considers the benefits and costs for individual Standards in the context of the Year 2005 strategic directive as a whole.

IAS 19 includes a number of optional treatments of accounting for the actuarial gains and losses relating to an employer-sponsored defined benefit plan. Consistent with the need for comparability in financial reports, and the emphasis on comparability in the main objects of Part 12 of the *ASIC Act*, the AASB has a strong preference for not including optional treatments in its

Standards. The AASB when making AASB 119 in July 2004 decided to mandate a single method of accounting on grounds of comparability for reporting entities in Australia and the likely future direction of the IASB. The inclusion by the IASB of a third option in IAS 19 has increased the level of uncertainty about its future direction on this topic such that the uncertainties outweighed the AASB's emphasis on comparability.

While Options 1, 2, 3 and 4 enable compliance with the FRC directive the effect on entities and their financial reports will depend on the accounting choices included under each option. The impact of adopting Option 1 is that an entity is able to choose to apply one of three approaches to accounting for actuarial gains and losses of defined benefit plans. When an entity chooses to apply the approach of immediate recognition in profit for the period it is likely that there will be increased volatility in reported profits compared to applying the corridor approach under which the effects of actuarial gains and losses on reported profits can be smoothed over many years. Under the approach of immediate recognition directly in retained earnings the effect of economic events is not recognised in the reported profit of the period and hence does not impact on the amount and volatility of reported profit. Whether entities incur increased costs is likely to depend on the method they choose to adopt. While the costs of implementing either of the immediate recognition approaches is likely to be similar, applying the "corridor approach" will require more detailed information to be maintained in order to determine the amounts charged to profit and loss in each period. Whether the financial reports of Australian entities are more comparable with international reports will depend on the method chosen by the entity under AASB 119 and the methods applied by overseas companies under their national requirements. Under Option 2 an entity would be able to choose between the immediate recognition in the profit for the period and the corridor approach. Under Option 3 an entity would be able to choose between immediate recognition in the profit for the period and immediate recognition directly in retained earnings. Under Option 4 an entity would be required to apply the approach of immediate recognition in profit with the effect that there is likely to be increased volatility in reported profit compared to overseas companies that do not choose to apply this method under their national requirements. Option 5 would mean that the Australian Accounting Standard would not be equivalent to IAS 19 and this would be inconsistent with the FRC's policy directive relating to adoption of IASB Standards thus excluding Australian entities from the benefits flowing from the FRC's policy directive.

5. Consultation

Exposure Draft ED 131 *Request for Comment on IASB ED: Amendments to IAS 19 Employee Benefits: Actuarial Gains and Losses, Group Plans and Disclosures* was issued in April 2004 as part of the AASB's due process in implementing the FRC's directives. When issuing ED 131 the AASB

requested comment on whether the proposed adoption of the amendments to IAS 19 is appropriate and workable and whether the proposals are in the best interests of the Australian economy. The Board also indicated that it did not support the proposals by the IASB to include a further optional treatment of actuarial gains and losses by defined benefit plans in AASB 119. Seventeen submissions were received in respect of the proposals relating to IAS 19 in ED 131. There was substantial support for adopting an Australian equivalent to IAS 19 as amended, however, there were mixed views on whether the optional treatments of accounting for actuarial gains and losses by defined benefit plans should be included in the Australian equivalent to IAS 19. Some respondents expressed the view that the method mandated under the existing AASB 119 is a conceptually superior approach under which the relevant effects of economic events are recognised in the period in which they occur and the additional option should not be adopted for Australian entities because the availability of choice of treatment is inconsistent with achieving comparability. Other respondents expressed the view that inclusion of the additional option proposed by the IASB in addition to including the “corridor approach” permitted under IAS 19 would mean that Australian entities would have the same choices available to them as overseas entities and would be able to choose to apply a method that would reduce volatility in reported profit because the effect of actuarial gains and losses can be smoothed over many years rather than recognised in profit and loss in the year of incurrence.

6. Conclusion and Recommendation

The adoption of the IAS 19 changes relating to multi-employer group plans and disclosures is not controversial and the AASB agreed to make these changes to AASB 119. In complying with the FRC directive in relation to IASB Standards the AASB decided to follow Option 1 and adopt IAS 19 inclusive of all optional treatments for recognising actuarial gains and losses by defined benefit plans, by making amendments to AASB 119 *Employee Benefits*, the Australian equivalent to IAS 19. In forming its conclusion, the AASB considered that, on balance, the benefits of permitting the options outweighed the costs.

7. Implementation and Review

AASB 119 will be subject to review and revision taking account of international developments, particularly the processes for review and revision undertaken by the IASB, and the experience of constituents in implementing the Standard.