Current accounting issues

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ACA Members' Gatwick Conference 2016

Willis Towers Watson

Agenda

- Asset ceilings
- Remeasurements
- Discount rates
- Comprehensive review of IAS 19
- Pension scheme accounts

Asset Ceilings – IAS 19 / IFRIC 14

Background

- Paragraph 64 of IAS19 Employee Benefits limits the measurement of the net defined benefit asset to the lower of the surplus in the defined benefit plan and the asset ceiling

The principle is that it should not be possible to take credit for a pension scheme surplus in the company balance sheet that cannot be utilised by that company at some point.

- Asset ceiling is the ‘present value of any economic benefits available in the form of:
  - refunds from the plan or
  - reductions in future contributions to the plan’
- IFRIC 14 confirms an additional liability arises if a company is required to:
  - pay contributions in respect of past service into the plan which would result in an IAS19 surplus and
  - this surplus cannot be utilised

Asset Ceilings – IAS 19 / IFRIC 14 – Refunds from the plan

June 2015 exposure draft

IFRIC 14
“Unconditional right
to a refund”

Will be
affected by

Third party unilateral right
to wind-up the plan or affect
benefits for plan members

Potential for impact on the balance sheet is significant

- **Loss of ability of recognise a surplus**
- **Recognise an additional liability reflecting the deficit funding agreed with trustees**

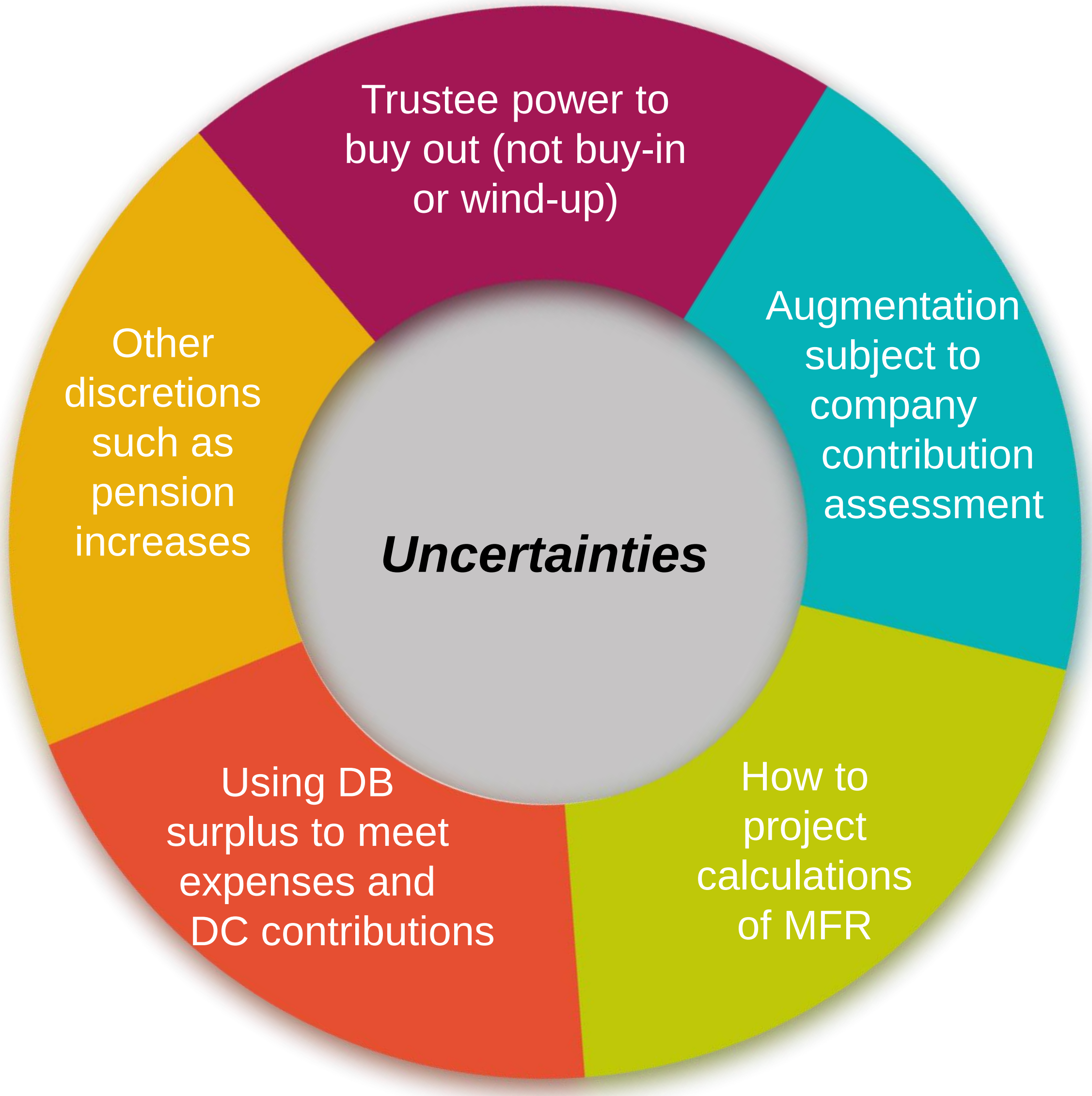
Asset Ceilings – IAS 19 / IFRIC 14 – Refunds from the plan

June 2015 exposure draft

- Plan closed to future accruals
- Trustee has the right to wind up the plan unilaterally
- Company has unconditional right to refund assuming run-off is complete
- Funding valuation recently completed, which showed a deficit of £20 million. The company has agreed to contribute £20m through the Schedule of Contributions
- Company has examined rights to surplus after run-off, per paragraph 11b

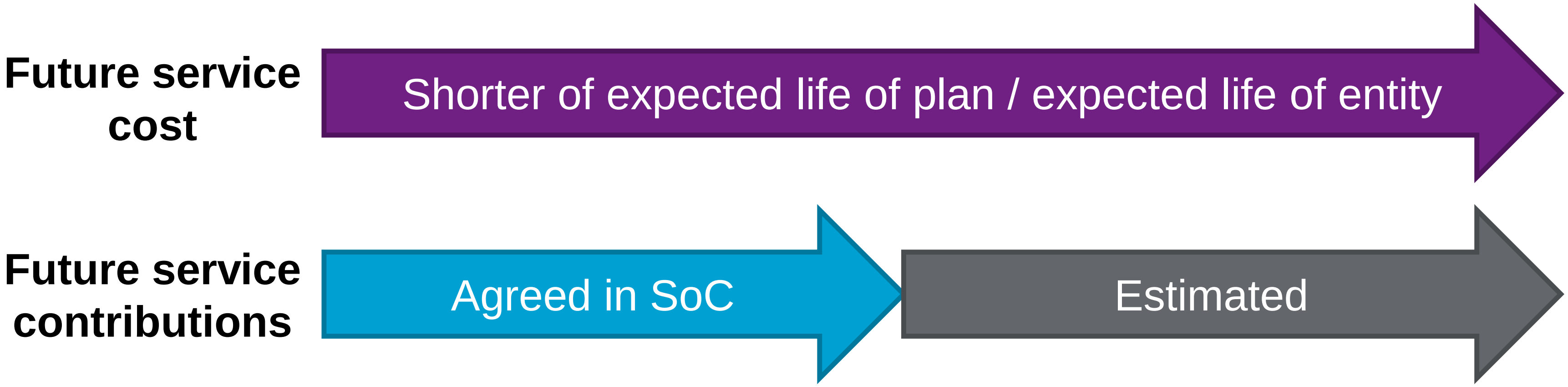
	Current position	Revised position after IFRIC 14 amendment
DBO	(100)	(100)
Assets	110	110
Funded status	10	10
Impact of asset ceiling	0	(10)
Additional liability	0	(20)
Balance sheet asset / (liability)	10	(20)

Asset Ceilings – IAS 19 / IFRIC 14 – Refunds from the plan



Asset Ceilings – IAS 19 / IFRIC 14 – Reduction in future contributions

July 2015 IFRS IC agenda decision



- "…when the entity estimates the future minimum funding requirement contributions, it should
  - (i) include the amounts in the schedule of contributions for the fixed period specified by the schedule; and
  - (ii) beyond that period, make an estimate that assumes a continuation of those factors establishing the minimum funding basis as determined by the pension trustees."

Asset ceilings – FRS 102

February 2015 amendment

New paragraph 28.15A

“Where an entity has measured its defined benefit obligation using the projected unit credit method (including the use of appropriate actuarial assumptions), as set out in paragraph 28.18, it shall not recognise any additional liabilities to reflect differences between these assumptions and those used for the most recent actuarial valuation of the plan for funding purposes. For the avoidance of doubt, no additional liabilities shall be recognised in respect of an agreement with the defined benefit plan to fund a deficit (such as a schedule of contributions).”

Additional text in paragraph 28.41(a)

28.41(a) A general description of the type of plan, including funding policy. This includes the amount and timing of the future payments to be made by the entity under any agreement with the defined benefit plan to fund a deficit (such as a schedule of contributions).

Remeasurements – IAS 19

June 2015 exposure draft

IAS 19 pension cost in the part period after a plan amendment, curtailment or settlement

Will be affected by

Updated financial conditions at the date the DBO is remeasured

Pensions P&L charge will be less predicable in periods where there is an event requiring the Defined Benefit Obligation (DBO) to be remeasured

Remeasurements

Pensions flexibility

How would you describe the allowance your clients make for transfer values in their accounting assumptions?

No assumption

Explicit assumption of no transfers

Explicit assumption of some transfers

Remeasurements

Pensions flexibility

- Issues with increased level of transfer activity

Will it increase or decrease the DBO?	Are transfers a settlement or an experience item?
Are bulk exercises treated differently?	What if there is an incentive to transfer?

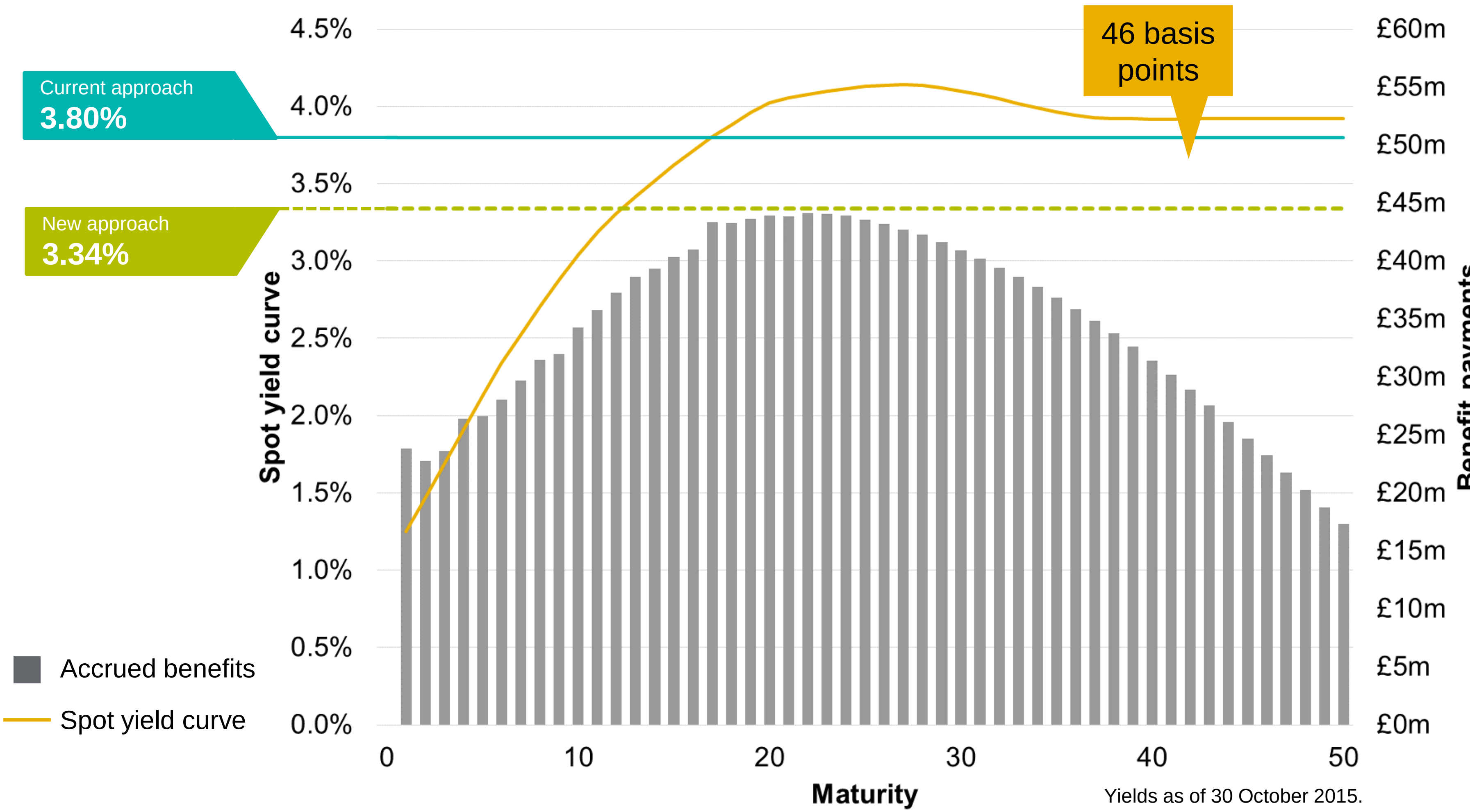
Discount rates

Alternative approach under ASC 715

Around September 2015, SEC staff told the Big-4 accounting firms they will not object to registrants adopting an approach for measuring service cost and interest cost that applies individual spot rates to each year's cash flows when a yield curve is used to develop discount rates

Disaggregating the interest cost

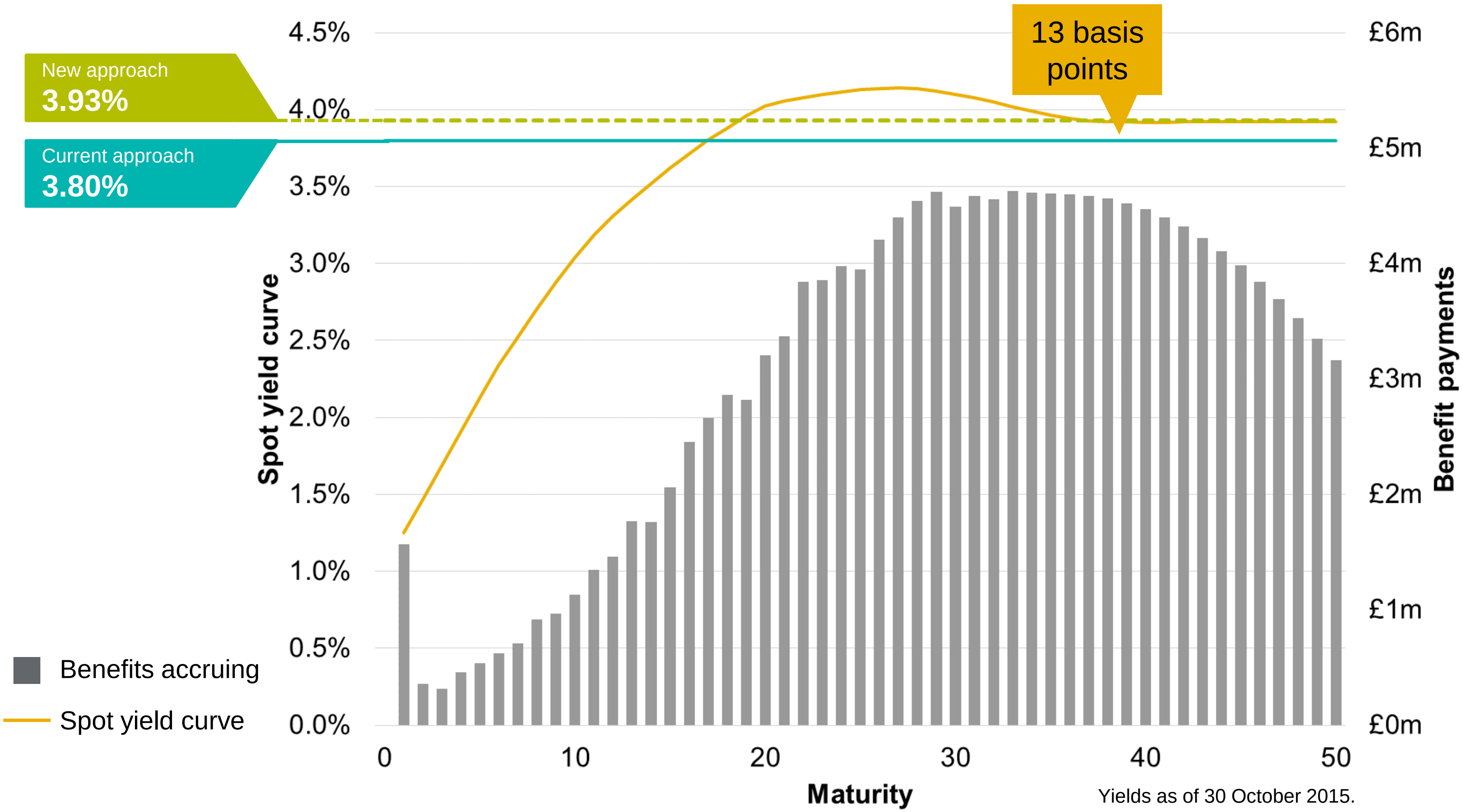
Interest cost



Yields as of 30 October 2015.

Disaggregating the service cost

Service cost



Yields as of 30 October 2015.

Discount rates

IASB research project

IASB staff have identified a number of financial reporting problems, including:

- Inconsistent use of other comprehensive income and profit or loss relating to present value measurements makes comparisons difficult
  - Changes in discount rates and changes in cash flows are recognised inconsistently between pensions, provisions and insurance contracts

- Inconsistent disclosure requirements hamper comparisons

- There is a lack of clarity of measurement objectives in individual Standards
  - There is no specific objective of discounting stated in IAS 19, nor is there an explanation of what the discount rate aims to represent
  - The lack of a fully described objective shifts the focus to the detailed discount rate guidance, resulting in rules-based accounting and an inability to apply judgement

Comprehensive review of IAS 19

IASB is seeking to identify a conceptually sound and robust model for accounting for post-employment benefits

- Concern about whether relevant information is provided for hybrid plans
- Various different models are being discussed…
  - Current IAS 19 model
  - Fair value model
  - Customised fulfilment value model
  - D9 model
  - Bifurcation model
  - Mirroring model
  - ‘Capped’ ultimate costs adjustment model

Pension scheme accounts

Impact of FRS 102

- Valuation of scheme annuities
- Disclosure of investment risks
- Allocation of assets to the investment hierarchy
  - Likely to be varied by FRED 62 to be consistent with IFRS 13

Pension scheme accounts

FRED 62 – published November 2015

Current hierarchy in FRS 102		Proposed hierarchy under FRED 62	
Category	Description	Level	Description
(a)	The best evidence of fair value is a quoted price for an identical asset in an active market. Quoted in an active market in this context means quoted prices are readily and regularly available and those prices represent actual and regularly occurring market transactions on an arm's length basis. The quoted price is usually the current bid price.	1	The unadjusted quoted price in an active market for identical assets or liabilities that the entity can access at the measurement date.
(b)	When quoted prices are unavailable, the price of a recent transaction for an identical asset provides evidence of fair value as long as there has not been a significant change in economic circumstances or a significant lapse of time since the transaction took place. If the entity can demonstrate that the last transaction price is not a good estimate of fair value (e.g. because it reflects the amount that an entity would receive or pay in a forced transaction, involuntary liquidation or distress sale), that price is adjusted.	2	Fair value is determined using some inputs other than quoted prices included within Level 1 but which are observable (i.e. developed using market data) either directly or indirectly.
(c)(i)	If the market for the asset is not active and recent transactions of an identical asset on their own are not a good estimate of fair value, an entity estimates the fair value by using a valuation technique which relies significantly on observable market data The objective of using a valuation technique is to estimate what the transaction price would have been on the measurement date in an arm's length exchange motivated by normal business considerations.	3	Fair value is determined using at least some inputs that are unobservable (i.e. for which market data is unavailable).
(c)(ii)	As (c)(i) but using a valuation technique that uses non-observable market data.		

Questions

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Thank you

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