

IASB Publishes IAS19 Exposure Draft

The IASB (International Accounting Standards Board) has published an Exposure Draft with proposed changes to the accounting standard IAS19 which deals with how companies should account for employee benefit schemes. The Exposure Draft is under consultation until September this year after which a revised standard will be published. A new 'final' standard is expected in the middle of 2011 but is unlikely to take effect until January 2013 at the earliest.

Whilst the Exposure Draft proposes a number of changes to IAS19, the IASB has stated that it does not intend at this stage to change how assets and liabilities are valued, in particular the choice of discount rate to be adopted.

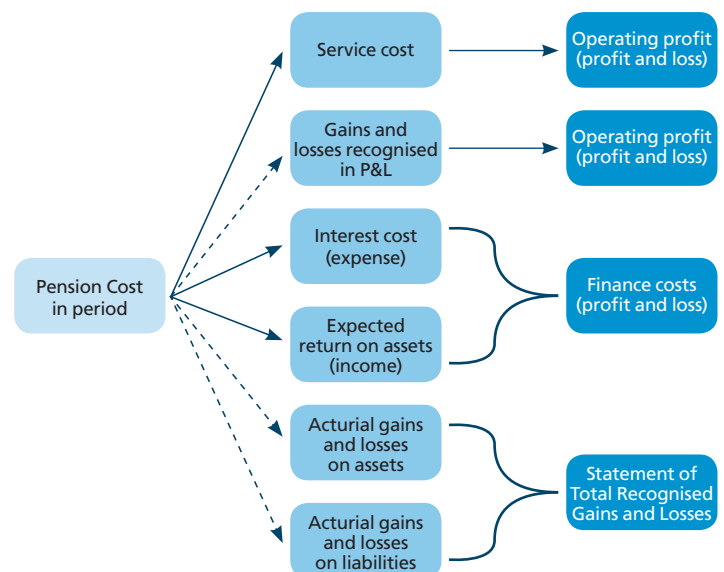
Deferred Recognition of gains and losses

Under the current version of IAS19 it is possible for companies to defer recognition of actuarial gains and losses using a method known as the corridor approach. This lead to variations in the way companies report pension costs since:

- elements of the pension costs can be recognised in different expense categories within the accounts
- gains and losses can be either recognised in the current period or alternatively in future periods (ie deferred) depending upon the approach taken
- there is no need for all companies to recognise deferred gains and losses over the same length of time

The diagram opposite shows the breakdown of the main elements of the pension cost under the current version of IAS19. The dashed lines illustrate how gains and losses can either go through P&L or through the Statement of Recognised Gains and Losses (STRGL).

The IASB has proposed that companies should no longer be allowed to defer recognition of actuarial gains and losses and they should instead be recognised immediately on the balance sheet through other comprehensive income. Therefore, all companies will now recognise the full deficit on their balance sheets.

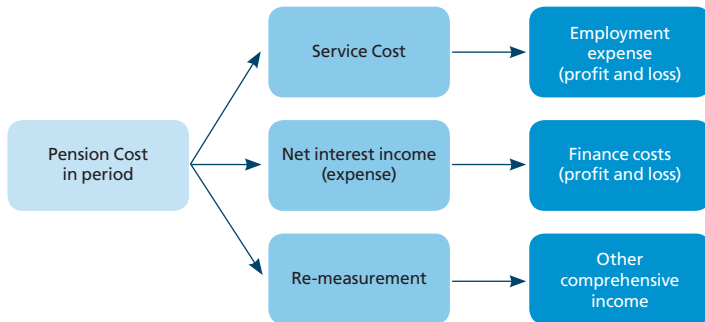


Finance Cost changes

The IASB has also proposed a change to the way the finance cost element is calculated. At present this should be the company's best estimate of the expected return on the scheme's assets less the interest on the liabilities, calculated using the discount rate for the period. In response to concerns that the expected return on assets was being manipulated the IASB has proposed that the finance cost should be calculated as the net interest on the scheme deficit (or surplus) using the discount rate for the period.

Pension Cost Impact

Under the proposals the pension expense items under IAS19 will be a lot simpler as shown in the diagram below:



The new “Re-measurement” item includes all fluctuations in the assets and liabilities that do not go through the profit and loss.

Other proposed changes

The new standard will also clarify that the present value of administration expenses should be included within the liabilities if they are paid through defined benefit plans whereas it was possible to in the past to allow for these expenses in the expected return on assets or within the service cost.

The Exposure Draft also proposes a number of changes to the required disclosures. These include disclosures about the risks associated with defined benefit plans and will require a sensitivity analysis to be given for the key actuarial assumptions.

Implications

The proposals, if implemented, could have a significant effect on the reporting of pension costs. In particular:

- The finance cost is likely to increase as the expected return on assets normally exceeds the discount rate - this will reduce reported profits
- Companies with schemes in deficit that currently defer recognition of actuarial gains and losses are likely to see an increase in the liabilities recognised on their balance sheets. This figure will also be more volatile from year to year than is currently the case

The changes will mean that the way in which employee benefit costs are reported is more consistent from company to company and also removes some of the potential for manipulation. It remains to be seen whether other standard setters will also review their standards (eg FRS17 and FAS158) as a result.

Further information

If you have any queries or would like an indication of how these changes could affect your company's accounts please contact your usual Barnett Waddingham consultant.

Alternatively, please contact either:

Paul Hubbard

Email: paul.hubbald@barnett-waddingham.co.uk
or telephone: 01527 559111

Nick Griggs

Email: nick.griggs@barnett-waddingham.co.uk
or telephone: 01242 538500

Barnett Waddingham - MAY 2010

Chalfont Court
Hill Avenue
Amersham
HP6 5BB
Tel: 01494 788100
Fax: 01494 788800

Rigby Hall
Rigby Lane
Bromsgrove
B60 2EW
Tel: 01527 559111
Fax: 01527 559222

St James's House
St James's Square
Cheltenham
GL50 3PR
Tel: 01242 538500
Fax: 01242 538501

163 West George Street
Glasgow
G2 2JJ
Tel: 0141 243 4400
Fax: 0141 243 4432

West Riding House
67 Albion Street
Leeds
LS1 5AA
Tel: 0113 394 3700
Fax: 0113 394 3760

Port of Liverpool Building
Pier Head
Liverpool
L3 1BW
Tel: 0151 235 6600
Fax: 0151 235 6640

Cheapside House
138 Cheapside
London
EC2V 6BW
Tel: 020 7776 2200
Fax: 020 7776 3800

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