# International Public Sector Accounting Standard 25 Employee Benefits

## IPSASB Basis for Conclusions



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## Basis for Conclusions

*This Basis for Conclusions accompanies, but is not part of, IPSAS 25.*

**Development of IPSAS 25 based on the IASB's revised version of IAS 19 issued in 2004**

*Introduction*

BC1. The IPSASB's IFRS Convergence Program is an important element in the IPSASB's work program. The IPSASB's policy is to converge the accrual basis IPSASs with IFRSs issued by the IASB where appropriate for public sector entities.

BC2. The labor-intensive character of the operations of very many public sector entities means that expenses and liabilities related to employee benefits are likely to be particularly significant in evaluating the financial performance and financial position of those entities. It is therefore essential that the general purpose financial statements of public sector entities report expenses and liabilities related to employee benefits, and that these should be determined on a systematic and consistent basis. It is also important that relevant disclosures are provided to users.

BC3. Development of a standard on employee benefits has previously been deferred for two reasons. First, the IPSASB decided to prioritize resources on public sector-specific projects, including projects on social benefits provided by public sector entities in non-exchange transactions and revenue from non-exchange transactions. Second, in the earlier part of this decade it appeared possible that there might have been very significant changes to IAS 19. The IPSASB notes that the IASB currently has a project on postretirement benefits under way. The project is being conducted in two phases, which involve a fundamental review of all aspects of post-employment benefit accounting. Phase One is part of the short-term convergence project of the IASB and the Financial Accounting Standards Board. While this project may identify issues that can be resolved relatively quickly, the IPSASB considers that the development of proposals for fundamental changes to accounting for post-employment benefits is not sufficiently advanced to justify deferral of this Standard. The IPSASB will continue to monitor developments in the IASB's project.

*Composite Social Security Programs and State Plans*

BC4. In many jurisdictions, post-employment benefits are paid through composite social security programs. Composite social security programs also provide benefits that are not consideration in exchange for service rendered by employees or past employees. The IPSASB concluded that, because they are particularly significant in some jurisdictions, including a number of European countries, composite social security programs should be defined and requirements provided for their treatment. This Standard includes in paragraph 10 a definition of composite social security programs that encompasses both components of such programs.

BC5. This Standard does not deal with all potential obligations of public sector entities under composite social security programs. As this Standard deals with employee benefits of reporting entities, only benefits payable under composite social security programs as consideration in exchange for service rendered by employees of the reporting entity are within its scope. The IPSASB is addressing certain other benefits payable under composite social security schemes in a separate project dealing with social benefits.

BC6. This Standard retains the requirement in IAS 19 that an entity accounts for a state plan in the same way as for a multi-employer plan. The IPSASB concluded that it should provide further commentary to clarify the approach to accounting for state plans by public sector entities. Paragraph 46 provides a rebuttable presumption that the state plan will be characterized as a defined benefit plan by the controlling entity. Only where that presumption is rebutted is the state plan accounted for as a defined contribution plan.

*Defined Benefit Plans with Participating Entities under Common Control*

BC7. In the public sector, there are likely to be many cases where entities under common control participate in defined benefit plans. IAS 19 includes commentary on defined benefit plans that share risks between entities under common control. The IPSASB considered that the requirements in IAS 19 are appropriate in the public sector. The IPSASB also considered it appropriate to emphasize that, unless there is a contractual agreement, binding arrangement, or stated policy for charging the net defined benefit cost for the plan as a whole to an individual entity, it is inappropriate for controlled entities to account on a defined benefit basis. In such cases, the controlling entity should account for such plans on a defined benefit basis in its consolidated financial statements. Controlled entities (a) account on a defined contribution basis, (b) identify the controlling entity, and (c) disclose that the controlling entity is accounting on a defined benefit basis in its consolidated financial statements. This is reflected in paragraph 41. Controlled entities also make the disclosures specified in paragraph 42.

*Discount Rates*

BC8. IAS 19 requires adoption of a discount rate based on the market yields at the reporting date on high quality corporate bonds. The IPSASB decided that the discount rate should reflect the time value of money, and considered that entities should be left to determine the rate that best achieves that objective. The IPSASB considered that the time value of money may be best reflected by reference to market yields on government bonds, high quality corporate bonds, or any other financial instrument. The discount rate used is not intended to incorporate the risk associated with defined benefit obligations or entity-specific credit risk. There is an additional disclosure requirement at paragraph 141(n)(ii) informing users of the basis on which the discount rate has been determined.

BC9. The IPSASB considered whether it should provide guidance to assist entities operating in jurisdictions where there is neither a deep market in government bonds nor a deep market in high quality corporate bonds to determine a discount rate that reflects the time value of money. The IPSASB acknowledges that determination of an appropriate discount rate is likely to be a difficult issue for entities operating in such jurisdictions, and that such entities may be in the process of migrating, or have recently migrated, to the accrual basis of accounting. However, the IPSASB concluded that this is not an issue that applies only in the public sector, and that there is an insufficiently clear public sector-specific reason to provide such guidance.

*Actuarial Gains and Losses—the Corridor*

BC10. The IPSASB considered accounting requirements for actuarial gains and losses. In particular, the IPSASB considered whether the approach in IAS 19 known as the corridor, whereby actuarial gains and losses only have to be recognized immediately if they fall outside predetermined parameters, related to the fair value of plan assets and the carrying amount of defined benefit obligations at the last reporting date, should be adopted in this Standard. The IPSASB recognized the view of those who argue that that the corridor approach is conceptually unsound and leads to an unjustifiable deferral of revenue and expenses. However, the IPSASB concluded that there is no public sector-specific reason to remove the corridor provisions and require the immediate recognition of all actuarial gains and losses. The IPSASB therefore decided to retain the corridor approach in this Standard, and to allow entities to select any of the three options permitted by IAS 19 for dealing with actuarial gains and losses that are within the “corridor.” These are:

(a) Non-recognition;

(b) Recognition on a systematic and consistent basis of actuarial gains and losses related to all defined benefit plans in the statement of financial performance; and

(c) Recognition on a systematic and consistent basis of actuarial gains and losses related to all defined benefit plans outside the statement of financial performance.

*Actuarial Gains and Losses: Presentation where Recognition is Outside the Statement of Financial Performance*

BC11. When the IPSASB developed ED 31, *Employee Benefits*, IAS 19 (2004) and IAS 1 required “the statement of changes in equity” to be re-termed “the statement of recognized income and expense,” where an entity adopted a policy of recognizing actuarial gains and losses for all its defined benefit plans outside the income statement. The suite of financial statements in IPSAS 1, *Presentation of Financial Statements*, does not include a “statement of recognized revenue and expense.” The IPSASB therefore considered whether IPSAS 1 should be amended to re-term the “statement of changes in net assets/equity” the “statement of recognized revenue and expense” under certain circumstances, or whether entities should be permitted to recognize actuarial gains and losses in the existing “statement of changes in net assets/equity,” which is required by IPSAS 1. The IPSASB initially concluded that, consistent with its objective of promoting convergence with IFRSs, it should effect a consequential amendment to IPSAS 1 to re-term “the statement of net assets/equity” as the “statement of recognized revenue and expense” when it only includes certain line items, including actuarial gains and losses. This approach was generally supported at consultation.

BC12. The IASB has subsequently issued a revised IAS 1 that includes a consequential amendment to IAS 19. This deletes references to the statement of recognized income and expense, and requires actuarial gains and losses recognized outside profit or loss to be presented as a component of other comprehensive income. The IPSASB has not yet considered the revised IAS 1. Rather than adopt a treatment that aims to converge with an approach in IFRSs that has already been superseded, the IPSASB decided to adopt a requirement that, where actuarial gains and losses are recognized outside the statement of financial performance, they should be presented in the statement of changes in net assets/equity.

*Reimbursements*

BC13. Although the requirement in relation to reimbursements in IAS 19 is general, the commentary is written from the perspective of insurance policies that are not qualifying insurance policies, and are therefore not plan assets. The IPSASB considered whether there may be cases in the public sector where another public sector entity may enter into a legally binding commitment to provide part or all of the expenditure required to settle a defined benefit obligation of the reporting entity. The IPSASB considered that there may be such circumstances. ED 31 therefore included expanded commentary to acknowledge that such circumstances may arise. Some submissions considered that this revised commentary was confusing. Acknowledging this view the IPSASB decided to use the same commentary as in IAS 19, and to put the onus on entities to determine whether they have an asset arising from a right to reimbursement by reference to the definition of an asset in the IPSASB literature.

*Other Long-Term Employee Benefits: Long-Term Disability Benefits*

BC14. IAS 19 lists long-term disability benefits as an example of an "other long-term employee benefit." IAS 19 states that "the measurement of other long-term employee benefits is not usually subject to the same degree of uncertainty as the measurement of post-employment benefits," and that "the introduction of, or changes to, other long-term employee benefits rarely causes a material amount of past service cost." In the public sector, disability benefits related to certain areas of service provision, such as the military, may be financially highly significant, and related actuarial gains or losses volatile.

BC15. IPSAS 25 therefore provides a rebuttable presumption that long-term disability payments are not usually subject to the same degree of uncertainty as the measurement of post-employment benefits. Where this presumption is rebutted, the entity considers whether some or all long-term disability payments should be accounted for using the same requirements as for post-employment benefits.

*Other Long-Term Employee Benefits: Compensation Payable by the Reporting Entity until an Individual Enters New Employment*

BC16. Although it does not consider it likely that such circumstances are widespread, the IPSASB acknowledged that there may be cases where a reporting entity is contractually bound to make compensation payments separate from a termination benefit to a past employee until he/she enters new employment. The list of other long-term benefits in paragraph 147 was therefore amended to include such circumstances.

*Implementation Arrangements*

BC17. The IPSASB acknowledged that applying the requirements of this Standard in relation to liabilities relating to obligations arising from defined benefit plans may prove challenging for many public sector entities. Currently, many public sector entities may not be recognizing liabilities related to such obligations, and may therefore not have the systems in place to provide the information required for reporting under the requirements of this Standard. Where entities are recognizing liabilities relating to obligations arising from defined benefit plans, this may be on a different basis to that required by this Standard. In some cases, adoption of this Standard might give rise to tensions with budgetary projections and other prospective information.

BC18. IAS 19 requires entities adopting that Standard to determine a transitional liability. Where the amount of the transitional liability is more than the liability that would have been recognized at the same date under the previous accounting policy, IAS 19 permits entities to expense that difference on a straight-line basis over a period up to five years from the date of adoption.

BC19. The impact on financial performance and financial position of increases in liabilities arising from adoption of this Standard will be an issue for many public sector entities. However, as indicated in paragraph BC17, a more immediate issue may be obtaining the information in the first place. The IPSASB therefore concluded that, in order to give public sector entities the time to develop new systems and upgrade existing systems, this Standard should become effective for reporting periods commencing on or after January 1,

2011. Consistent with this objective, in the first year of adoption comparative information is not required. Earlier adoption is encouraged.

BC20. In paragraph 166, this Standard requires entities to determine an initial liability for defined benefit plans. Because entities do not have to adopt the Standard until reporting periods commencing on or after January 1 2011, the IPSASB concluded that it is not necessary to introduce a transitional provision permitting entities to expense over a period any difference between the initial liability and the liability that would have been recognized under the previous accounting policy. In order to avoid a potential distortion of financial performance in the first year of adoption, and, for consistency with IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, this Standard requires the difference between the initial liability and the liability that would have been recognized at the same date under the previous accounting policy to be taken to opening accumulated surpluses or deficits.

BC21. The IPSASB also considered whether, in the light of possible difficulties for reporting entities in assembling information, it would be appropriate to provide relief from certain disclosure requirements in paragraph 141 of this Standard. These disclosures require opening balances relating to a number of components of obligations and plan assets or trend information covering the current reporting period and previous four reporting periods. The IPSASB concluded that, because some entities may require the full lead-in period to develop systems, such relief is appropriate. It is therefore included in the Standard in paragraphs 173 and 175.

**Revision of IPSAS 25 as a result of the IASB's Improvements to IFRSs issued in 2008**

BC22. The IPSASB reviewed the revisions to IAS 19 included in the *Improvements to IFRSs* issued by the IASB in May 2008 and generally concurred with the IASB's reasons for revising the standard. The IPSASB concluded that there was no public sector specific reason for not adopting the amendments.