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QAU

Alert

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IMPACT FROM THE APPLICATION OF REVISED PAS 19

In July 2011, the Financial Reporting Standards Council (FRSC) approved the adoption of revised IAS 19, *Employee Benefits*. This revised standard will be effective for periods beginning on or after January 1, 2013 with early application permitted. The following are the major changes introduced by the revised standard:

Remeasurement and the Removal of Corridor Approach

The revised standard mandated that actuarial gains and losses should be recognized immediately in **Other Comprehensive Income (OCI)** under the new term "Remeasurements". Component of gains and losses as to changes in demographic and financial assumptions under remeasurements should be distinguished and shown separately in the respective reconciliation in the Notes to Financial Statements. Such gains and losses are recognized in OCI and shall not be reversed in profit or loss (P/L) or retained earnings. This guideline eliminated the concept of the corridor approach wherein cumulative actuarial gains and losses in excess of the 10% of the greater between the present value of the defined benefit obligation and fair value of any plan assets were amortized over the expected average remaining working lifetime of the employees.

QAU Opinion

- *Entities under the full PFRS framework would definitely incur additional cost in applying this revised guideline as it would change the way the employee benefits is computed. Entities that cannot compute the benefits on their own will need the services of an actuary to comply with the requirements. However, we expect that this cost will be immaterial since entities under this framework are the ones that are considered as large corporation that are expected to have enough funds for such additional cost. In the Philippines, large Corporation are those entities that are within the criteria set by the SEC and is required to prepare financial statements under full PFRS.*

- *The corridor approach in the previous guideline was used as a shield by entities since it limited and allowed the staggered recognition of actuarial gains and losses in the financial statements. Thus, the full recognition of actuarial gains and losses will have a material impact on the financial statements, especially on the statement* *financial position, because it will now be shown in the statement of financial position under OCI.*

Net Interest and the Removal of Expected Return

Concept on the expected return was eliminated in computing for the defined benefit cost and defined benefit obligation (DBO). However, this was replaced by the new method in computing for the defined benefit cost and DBO using the net interest concept. Net interest is computed based on the net defined benefit asset/liability. In the previous standard, expected return is computed based on the plan assets expected rate of return, while interest cost is computed based on the DBO discount rate. In the revised standard, the expected return is computed using the discount rate and should be presented as net of interest cost under net interest income/expense.

QAU Opinion

- *This new method will ease the computation of defined benefit cost since entities will not have to determine the expected return and will result to a simpler approach. However, knowing that the expected rate of return and the discount rate are normally different and the fact that the related actuarial gains and losses from changes in financial assumptions in computing for the interest income on plan assets against the actual return will now be presented in OCI under remeasurements, there could be an impact on the amounts that will be recognized as defined benefit cost in the statements of comprehensive income compared to the previous method. With regards to the statement of comprehensive income as a whole, such impact will have a nil effect.*

Immediate Recognition of Past Service Cost

The revised standard eliminated the recognition of past service cost over the vesting period. Past service cost will now be recognized as expense immediately in profit or loss. It provides a clearer guidance on the distinction between past service cost and curtailment gains and losses. Curtailments are now accounted under past service cost while settlements are accounted separately from curtailments. Thus, past service cost can now be positive or negative as a result of curtailments.

QAU Opinion

- *Entities that keep past service costs off-books because of the vesting period condition will now be required to recognize them in the financial statements as part of the adjustment to the retained earnings as a result of the transition. Entities that will be introducing a new plan and upgraded plan should expect to have a higher benefit cost.*

- *The revision eliminated the need to distinguish the negative past service cost from curtailment which makes the computation of benefit cost easier and less time consuming.*

Improved Disclosure Requirements

The enhanced disclosure in defined benefit plan was the result of IASBs objective to provide investors and other users of financial statements with a much clearer picture of an entity's obligations resulting from the provision of defined benefit plans and how those obligations will affect its financial position, financial performance and cash flow. It is also part of the IFRS and US GAAP alignment project of the IASB and FASB. Below is the comparison of the disclosure requirements before and after the revision:

<table>
<tr><th>Before the Revision</th><th>PAS 19 (Revised)</th></tr>
<tr><td>Requires a general description of the type of plan.</td><td>Requires a detailed description of the plan which include:
The description of the regulatory framework in which the plan operates
Description of the responsibilities of trustees or board members of the plan
Description of the plan specific risks and any concentration risk (e.g. concentration of investment market risk.)
A description of any plan amendments, curtailments and settlements</td></tr>
<tr><td>Requires the disclosure of major class of plan assets which constitute the fair value of plan assets which could either be in percentage or in amounts.</td><td>Requires to disaggregate the fair value of the plan assets into classes that distinguish the nature and risks of those assets subdivided by each class that have quoted market price in an active market. It also include the segregation of each class of plan assets as to industry type, issuer, geography, type of fund etc.</td></tr>
<tr><td>Provides limited disclosure requirements on the qualitative aspects of the plan.</td><td>Additional requirements for qualitative disclosures on the amount, timing and uncertainty of future cash flows. It includes:
Sensitivity analysis for each significant actuarial assumptions;
Methods used in preparing sensitivity analysis and its limitations;
Changes in the methods and assumptions and the reasons for such change.
A description of any asset-liability matching strategies or plan risk management.
Funding arrangements and expected contributions for the next reporting period
Information on the maturity profile of the defined benefit obligation.</td></tr>
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QAU Opinion

- *The enhanced disclosure on defined benefit plans will increase the credibility of an entity's financial statements. Compliance from such extensive requirements is expected to result to additional cost, time and significant judgment.*

New Recognition Criteria on Termination Benefits

The revised standard introduced new recognition criteria for termination benefit. It requires the recognition of such benefits when the entity cannot withdraw the offer for termination. The following are some example in applying the new recognition criteria:

> Entity A decided to discontinue one of its segment with 100 employees offering ₱100,000 per employee if they leave on September 14, 2013. Should the employees stay and continue to render their services until the scheduled closure in December, they will receive an additional compensation equivalent to their current rates. Out of 100 employees 10 of which remain until December. The Management paid ₱9,000,000 for those who leave on the 14th of September while ₱1,250,000 for those who stayed until December. In this example, the termination benefits should be recorded at ₱10,000,000 because the Company cannot withdraw the offer to each employee while the ₱250,000 should be recorded under short-term benefits. The recognition of termination benefits is in accordance with the recognition criteria for a provision in PAS 37.

QAU Opinion

- *The revised standard provides a clearer guidance on the recognition of termination benefits. Moreover it clarifies that termination benefits are the result of termination of employment to differentiate with benefits in exchange for conditional services.*

Current Issues in Accounting for Employee Benefits in the Philippines

The accounting profession has raised issues in accounting for employee benefits. The current PAS 19 requires accounting post-employment benefits as defined contribution (DC) or defined benefits (DB). Considering the provisions of RA 7641 "Minimum Benefit Guarantee" for private sector, the following question arises:

- How should an entity classify its DC plan?

  The DC plan should be referred as *"defined contribution plan with a defined benefit under pin"* which should be accounted as DB plan in accordance with PAS 19.29(R).

- How should the obligation and pension cost under the DC plan be accounted for and measured?

  An entity should recognize pension expense as the higher between DB and DC. If DB is higher than DC, there is not much contention as all accounts should be computed under DB in accordance with PAS 19(R). However, in cases wherein the DC is higher than DB a different perspective would arise in accounting for the excess. Accordingly, the Interpretations Committee is currently looking for two approaches

Approach 1

Pension cost, contributions, and service cost should be recognized at same amount. Since assets and the liabilities have also same amounts and cancel each other, no interest cost is recognized and there should be no surplus or deficit movement.

Approach 2

Show a tabular disclosure or make a narrative disclosure explaining that additional expense is booked on top of the computed DB given that the benefits provided under the DC plan is higher than that of the DB.

QAU Opinion

In our opinion approach 1 is simpler and consistent with the revised PAS19(R). The narrative disclosure under approach 2 is already a requirement in par 139 of the revised standard which requires disclosing the plan specific risks. In this case, an entity should disclose the risk wherein the plan assets could not provide the benefits previously agreed and exposes the Company to provide the minimum benefit under the law.

- What are the required disclosures relating to the DC plan?

  Disclosure requirements pertaining to DB plan should be complied with while the accounting policy for such DC plan should be disclosed in the financial statements.

The Interpretations Committee is currently finalizing their consensus on this matter. For the meantime, let us wait for them to come out with the final interpretation.

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