

## Accounting Standard Board Forum

### 2004-04-14 – Employee Future Benefits — Additional Disclosures

#### Employee Future Benefits — Additional Disclosures

##### SLIDE 1 (title slide)

This presentation summarizes and highlights the disclosure requirements of *Employee Future Benefits*, Section 3461 of the *CICA Handbook – Accounting*. Specifically, paragraphs 150 to 163 of Section 3461 have been revised and replaced. In March 2004, the Canadian Accounting Standards Board [AcSB, for short] released revisions to these disclosure requirements after its re-deliberations following input received on its October 2003 Exposure Draft, *Employee Future Benefits – Additional Disclosures*.

Section 3461 is the official version of the AcSB's requirements. Nothing in this presentation overrides the requirements of Section 3461, which contains details not covered in this presentation.

NEXT SLIDE: Drivers of Change

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#### Drivers of Change

##### SLIDE 2

To help you understand why the AcSB amended the disclosure requirements for employee future benefits, staff explains the drivers behind these amendments.

Declines in the fair value of pension plan assets as well as lower market interest rates and a strong Canadian currency have led to:

- an increased benefit obligation as an inverse relationship exists between the obligation and interest rates (i.e., a low interest rate leads to an increase in the obligation),
- a funded status in a deficit position, i.e., the accrued benefit obligation exceeds the fair value of plan assets in most situations,
- a drain on cash flow with many employers making substantial contributions to their pension plans, and
- increased pension costs.

NEXT SLIDE: Drivers of change (cont'd)

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#### Drivers of Change (cont'd)

##### SLIDE 3

In this post-Enron era, attention has been drawn to these results including the off-balance sheet debt associated with employee future benefits that results from various “smoothing mechanisms” that are part of the accounting, i.e., the recognition of certain events is deferred rather than recognized immediately.

Poor plan performance has increased this off-balance sheet debt leading some financial statement users as well as numerous articles, reports and discussions in accounting and actuarial circles, to argue that this information is not as complete or as transparent as it could, and probably should, be and may even be misleading.

These concerns as well as developments at the US Financial Accounting Standards Board [FASB, for short] and the International Accounting Standards Board [IASB, for short] led the AcSB to undertake an employee future benefits disclosure project in the summer of 2003. As a result of its disclosures project, in late 2003 the FASB released a revised standard, Statement of Financial Accounting Standards No. 132 (revised 2003), *Employers' Disclosures about Pensions and Other Postretirement Benefits* [referred to as SFAS 132 (revised 2003)].

In addition to the FASB and IASB developments, the AcSB obtained valuable input from a roundtable discussion with analysts and others, and from participation in a think-tank at the University of Calgary. The Accounting Standards Oversight Council discussed this topic in July 2003 and supported the AcSB's addition of such a disclosure project.

The AcSB considered whether any quick fixes should be made to the measurement and/or recognition aspects of Section 3461. While agreeing that a re-evaluation of changes affecting the measurement and recognition of costs and obligations associated with employee future benefits would be beneficial, it concluded such a re-evaluation was beyond the scope of the current project and would best be done in conjunction with other accounting standard setters internationally. (At the time of writing, the FASB planned to discuss the possibility of addressing pensions jointly with the IASB.)

NEXT SLIDE: Project Objectives

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#### Project Objectives

##### SLIDE 4

These “drivers of change” led the AcSB to conclude that additional disclosures would enable increased understanding by users of the effects of defined benefit plans on the financial statements — to shed light on a complex area. At the beginning of October 2003, the AcSB issued an Exposure Draft, *Employee Future Benefits – Additional Disclosures*, in which all interested parties were invited to comment. The AcSB considered the responses received to this Exposure Draft as well as additional input from roundtables with both preparers and users held at the end of October. Most respondents acknowledged the need for improved disclosures and increased transparency relating to accounting for employee future benefits, and supported the AcSB’s efforts to enhance the usefulness of the information presented through a disclosures only project. However, concerns were raised that additional disclosures might contribute to “disclosure overload”, that the costs of compiling some of the proposed disclosures would be significant, particularly for those entities with multiple plans, and that some of the proposed disclosures would be of limited value to shareholders and analysts, and could even be confusing in some situations. In redeliberating the proposals, AcSB members were concerned that increasing the quantity and complexity of the disclosures as a whole might reduce their usefulness and value. It noted that many companies have multiple plans and would provide the disclosures on a consolidated basis, which would limit the meaningfulness of some potential disclosures. The AcSB was also cognizant of the cost implications for entities, particularly those with multiple plans. Overall, AcSB members wanted to ensure that any additional or revised disclosure requirements would provide significant benefits to users. It expressed a desire to refrain from adding tangential information to clutter or detract from an already long note and asked themselves “What do users really need?”.

The AcSB issued revisions to the disclosure requirements of *Employee Future Benefits*, Section 3461, with the March 2004 release of the Accounting Handbook.

NEXT SLIDE: Existing Requirements Retained

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#### **Existing Requirements Retained**

##### SLIDE 5

The AcSB reviewed and decided to retain the existing disclosure requirements about defined benefit plans (but restructured them to make it easier to understand how the disclosures fit together) and defined contribution plans, special termination benefits and multiemployer benefit plans as the AcSB considered all of these requirements valuable. It also added new requirements, which are highlighted in this presentation.

The enhancements apply to pension benefits as well as post-retirement and post-employment benefits just as Section 3461 applies to them all.

NEXT SLIDE: Disclosure Objectives

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#### Disclosure Objectives

##### SLIDE 6

Overall, the AcSB identified key disclosure objectives as it felt that these objectives, together with the guidance in *Handbook* Section 1400, *General Standards of Financial Statement Presentation*, would be useful in determining an entity's specific employee future benefits disclosures and in understanding why specific disclosures are required.

The AcSB agreed to incorporate an overall principle in paragraph 150 of Section 3461 that states:

*“The objective of the disclosure requirements is to provide users of financial statements with information about:*

*(a) the effect of employee future benefits on the entity's financial statements, and*

*(b) plan obligations and assets for defined benefit plans;*

*that is useful in understanding the entity's obligation to provide employee future benefits, and the costs, risks and uncertainties associated with those obligations,*

NEXT SLIDE: Disclosure Objectives (cont'd)

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#### Disclosure Objectives (cont'd)

##### SLIDE 7

*for purposes of making resource allocation decisions as well as assessing management stewardship. To meet this objective, an entity should provide, at a minimum, the disclosures in paragraphs 3461.151-.163.”*

The AcSB decided not to require all the disclosures in SFAS 132 (revised 2003), and to include certain disclosures that the FASB did not. Canadian entities that wish to comply with US GAAP, in addition to Canadian GAAP, can do so by including certain additional disclosures in their Canadian GAAP financial statements. For example, those entities that wish to comply with US GAAP can do so by including certain additional disclosures in their Canadian GAAP financial statements such as a narrative description of investment policies and strategies. The AcSB decided not to require this description as it felt that these types of disclosures are forward-looking or provide explanatory information and commentary. The AcSB recognized the value in disclosing these items but considered them more appropriate for MD&A than for financial statements.

NEXT SLIDE: Significant Accounting Policies

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#### Significant Accounting Policies

##### SLIDE 8

The AcSB also strengthened and clarified the **accounting policy note** disclosure requirements in response to input from financial analysts and others about the opaqueness of many entities' accounting policy note disclosures for employee future benefits. The AcSB identified relevant choices available in selecting accounting policies in this area as well as the disclosures that preparers should make to convey a relevant and useful message to readers of the financial statement notes. Non-technical language was used to the extent possible and the AcSB encourages entities to use this language when it will make the disclosures easier to understand.

NEXT SLIDE: Significant Accounting Policies (cont'd)

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#### Significant Accounting Policies (cont'd)

##### SLIDE 9

Paragraph 152 requires an entity to disclose **significant accounting policies** it has adopted in applying Section 3461, including where applicable:

- The method used to determine the accrued benefit obligation;
- The method used for calculating the expected long-term rate of return on plan assets;
- The method used to amortize past service costs and the amortization period;

NEXT SLIDE: Significant Accounting Policies (cont'd)

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#### Significant Accounting Policies (cont'd)

##### SLIDE 10

- The amortization of actuarial gains and losses, including whether all actuarial gains and losses are amortized or only those in excess of 10 percent of the greater of the accrued benefit obligation and the fair value (or market-related value) of plan assets at the beginning of the year;
- The method used to amortize a transitional asset or obligation; and
- Other inclusions carried forward from existing requirements, such as the sequence in which a settlement and a curtailment are accounted for when a transaction or event gives rise to both.

NEXT SLIDE: Defined Contribution Plans

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#### Defined Contribution Plans

##### SLIDE 11

The AcSB added a requirement to disclose the **total cash amount** initially recognized in the period as paid or payable for that period for employee future benefits to provide users with the total cash outflow from the entity in respect of those benefits – this requirement replaced the proposal to disclose the total actual contributions.

At a minimum, total cash outflow required adding two amounts that are shown in separate parts of the employee future benefits note disclosure, that is, employer contributions to funded plans (disclosed as part of the plan asset reconciliation) and benefits paid for unfunded plans (disclosed in the plan obligation reconciliation). If a company had either funded and unfunded pension plans, or funded and unfunded plans other than pension plans, the payments with respect to the unfunded plans could not be identified by the reader. In addition, readers could inappropriately view the “employer contributions” (included in public enterprise reconciliations) to include the company’s total cash outflows for employee future benefits. As a result, the AcSB added separate disclosure of the total cash amount recognized by the entity under the headings in Section 3461 labelled “Defined Contribution Plans” and “Defined Benefit Plans” as it covers all employee future benefits.

The total cash amount includes:

- contributions to funded defined benefit plans and to defined contribution plans;
- payments directly to employees, their beneficiaries or estates; and
- payments to a third-party service provider on behalf of the employees.

NEXT SLIDE: Disclosures related to the Reporting Entity’s Financial Statements for Defined Benefit Plans

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#### Disclosures related to the Reporting Entity's Financial Statements for Defined Benefit Plans

##### SLIDE 12

An asterisk appears beside disclosures not addressed in US SFAS 132 (revised 2003). A complete chart comparing employee future benefit disclosures between Canada and the US can be found in the Background Information and Basis for Conclusions document, *Employee Future Benefits — Additional Disclosures*.

The AcSB added the **balance sheet classification** of the amount recognized as an asset or liability to enable users to determine which balance sheet line item would change if the asset or liability changed;

Another new requirement is to provide **a reconciliation of the off-balance sheet accrued benefit obligation to the amount reported on the balance sheet as an asset or liability**, rather than providing the reconciling elements in isolation;

NEXT SLIDE: Disclosures related to the Reporting Entity's Financial Statements for Defined Benefit Plans (cont'd)

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#### Disclosures related to the Reporting Entity’s Financial Statements for Defined Benefit Plans (cont’d)

##### SLIDE 13

In addition, the enhancements include the **costs recognized in the period showing separately the costs incurred** in the period (such as current service costs, actual gains and losses on plan assets, and actuarial gains and losses for the period) and the accounting adjustments to allocate costs to different periods so as to recognize the long-term nature of employee future benefits, which will make the effects of “smoothing” more clearly visible. The FASB has a requirement to disclose the components and the total, but not in a manner showing the effects of smoothing.

NEXT SLIDE: Disclosures related to the Reporting Entity’s Financial Statements for Defined Benefit Plans (cont’d)

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#### **Disclosures related to the Reporting Entity’s Financial Statements for Defined Benefit Plans (cont’d)**

##### SLIDE 14

Slide 14 provides a simplified example of the required disclosure of the components of costs recognized. This example assumes no plan amendments or transitional amounts. The “defined benefit costs recognized” of \$160 in 2003 ties to the amount recognized in the financial statements for defined benefit plans. The example shows the elements of employee future benefit costs before adjustments totalling \$235 in 2003 and then the adjustments to recognize the long-term nature of employee future benefit costs – adjustments, in this example, for the difference between the expected rate of return on plan assets that flowed through to the income statement and the actual return on plan assets (\$(25) in 2003) as well as for the difference between the actuarial (gain) loss recognized for the year and the actual actuarial (gain) loss on the accrued benefit obligation for the year (\$(50) in 2003). The difference related to the actuarial gain or loss on plan assets has already been captured in the line above, that is, in the \$(25) for 2003.

NEXT SLIDE: Disclosures related to the Reporting Entity’s Financial Statements for Defined Benefit Plans (cont’d)

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#### Disclosures related to the Reporting Entity's Financial Statements for Defined Benefit Plans (cont'd)

##### SLIDE 15

The AcSB modified the original disclosure requirements that encouraged broad disclosure of sensitivity analysis to require the **effects of a one-percentage-point increase/decrease in the health care cost trend rates** on total service and interest costs as well as on the accrued benefit obligation as a result of the significance of health care costs and their degree of uncertainty.

NEXT SLIDE: Disclosures related to the Reporting Entity's Financial Statements for Defined Benefit Plans (cont'd)

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#### Disclosures related to the Reporting Entity's Financial Statements for Defined Benefit Plans (cont'd)

##### SLIDE 16

The AcSB considered but rejected requiring **other sensitivity information** such as the effects of changes in actuarial assumptions on obligations or costs as a result of concerns that changes in one assumption would often occur in concert with changes in one or more other assumptions, for example, a change in discount rate will often be caused by factors that will affect the long-term rate of return on plan assets. Furthermore, the effect on financial statements of different changes may not be proportionate, for example, the effect of a half-percentage-point change may not be half of the effect of a one-percentage-point change. The AcSB was concerned with the additional cost and effort required to generate sensitivity data on defined benefit plans, given the concerns over the usefulness of such data. In discussing the discount rate, AcSB members also noted that sensitivity information is not required for other assets and liabilities that are measured using a market interest rate, such as certain financial instruments.

NEXT SLIDE: Disclosures related to the Defined Benefit Plan

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#### Disclosures related to the Defined Benefit Plan

##### SLIDE 17

With respect to disclosures related to the defined benefit plan, the amendments to the disclosure requirements include:

- a **description of the type of plans** as the AcSB agreed that users would benefit in understanding multiple plans and plans in multiple countries, and it was a natural starting point for the employee benefits note. Even though SFAS 132 (revised 2003) does not require this disclosure, the AcSB understands that many US employers currently disclose a brief description of the plan.
- in response to a need for information on plan assets to forecast future plan performance, the **actual allocation of plan assets** for each major category of plan assets (major categories include but are not limited to equity securities, debt securities and real estate);
- the **date used to measure the plan assets and the benefit obligations** as users had noted the importance of disclosing such a date given that the measurement date can be measured up to three months prior to the balance sheet date. For example, the measurement date could be October 31<sup>st</sup> for an entity with a December 31<sup>st</sup> year end;

NEXT SLIDE: Disclosures related to the Defined Benefit Plan (cont'd)

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#### Disclosures related to the Defined Benefit Plan (cont'd)

##### SLIDE 18

- the **effective date of the last (as well as the next required) actuarial valuation for funding purposes** to allow users to compare the timing of the valuation to the timing of market upswings or downturns — useful information in Canada since we require actuarial valuations only every three years unlike every year in the US;
- separate disclosure of the **discount rate used to determine the benefit cost** (the discount rate for the prior year) and the **discount rate used to determine the accrued benefit obligation** (the discount rate at the end of the period) in order to clarify the discount rate used to calculate these key amounts. Also to present these rates in **tabular form, along with other significant assumptions** such as the expected long-term rate of return on plan assets; and
- a carry over of the original Section 3461 requirement to provide **reconciliations of the plan obligation and plan assets**. Analysts find the reconciliation format useful because it ties together the various elements that have an impact on pension plans, including market returns on assets, benefit payments and employer/employee contributions. Without the reconciliation it is difficult to reconstruct all the different elements that could contribute to changes in assets or liabilities. The Canadian requirements retained the reconciliation as the AcSB acknowledged the benefit to users. The FASB proposals eliminated this requirement but on pushback from respondents, the FASB reinstated this requirement. This reversal points to the importance in voicing concerns with proposals – standard setters encourage all interested parties to provide their support or concerns on their proposals – to find out about documents currently open for comment in Canada – visit our web site at [www.acsbcanada.org](http://www.acsbcanada.org) and view the “Documents for Comment” page.

NEXT SLIDE: Relief Provided for Non-Public Entities

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#### **Relief Provided for Non-Public Entities**

##### SLIDE 19

As in the original disclosure requirements of Section 3461, the Canadian enhancements also distinguish between public and non-public entity requirements, with public entities requiring the full suite of disclosures and non-public entities a subset. The AcSB provides relief to non-public entities in the following areas:

- Components of the benefit cost;
- Separate unamortized amounts, otherwise disclosed in accordance with the reconciliation of the off-balance-sheet accrued benefit obligation to the on-balance-sheet accrued benefit asset or liability — non-public entities need only provide the total of the unamortized amounts;
- Reconciliation of the beginning and ending balances of the fair value of plan assets and a similar reconciliation for the accrued benefit obligation for the period; and
- The effects of a one-percentage-point increase or decrease in the assumed health care cost trend rates.

NEXT SLIDE: Amendments to Other Parts of Section 3461

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#### Amendments to Other Parts of Section 3461

##### SLIDE 20

The AcSB also made amendments to other parts of Section 3461. It noted that this Section uses the term “expense”, whereas the FASB employee benefit standards use “cost” in the same context. The AcSB was informed that, in practice, “expense” has been interpreted in Canada to mean “cost”. For consistency with the FASB terminology, the AcSB agreed to use “cost”, and accordingly, reviewed and made the necessary consequential amendments to the balance of Section 3461, with the exception of “expense” in connection with the accounting for termination benefits, as the AcSB does not support the deferral of such items. These consequential amendments included adding a footnote to clarify that costs recognized for the period include amounts expensed and costs that may have been capitalized as part of an asset such as inventory.

To conform terminology as well as to conform with *Generally Accepted Accounting Principles*, Section 1100, amendments were made to other parts of Section 3461. Accounting Handbook Revisions Release No. 28, dated March 2004, provides these amendments, including related explanations.

NEXT SLIDE: Interim Financial Statements

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#### Interim Financial Statements

##### SLIDE 21

The enhancements go beyond annual requirements and require interim disclosure to address users' concerns about annual information being sufficient or up-to-date – they want to know how cost has changed during the quarter. *Interim Financial Statements*, paragraph 14(k) of Section 1751, was added to require that interim financial statements disclose the total benefit cost determined by Section 3461 for both the current interim period and the current fiscal year to date. This requirement is effective for interim financial statements of interim periods ending on or after June 30, 2004.

NEXT SLIDE: Transitional Provisions

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#### **Transitional Provisions**

##### SLIDE 22

The amended annual disclosure requirements are effective for fiscal years ending on or after June 30, 2004. Earlier application is encouraged. The AcSB backed off on an earlier effective date given respondents' concerns that the project was proceeding at too fast a pace. Furthermore, the AcSB acknowledged that additional staff time would lead to a better-quality standard. Members also took into account the FASB's relaxed timeframe for foreign plans and non-public entities.

The amendments do not change any recognition or measurement aspects currently in the Section and as a result, all other paragraphs of Section 3461 apply to fiscal years beginning on or after January 1, 2000.

NEXT SLIDE: Illustrative Material

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#### **Illustrative Material**

##### SLIDE 23

In addition to revising and replacing the disclosure paragraphs in Section 3461, the AcSB revised and replaced the disclosure example. Situation I illustrates disclosures for a public company with a number of defined benefit and defined contribution plans of different types and Situation II illustrates the reduced disclosures for a non-public entity by comparing to those disclosures provided in Situation I.

NEXT SLIDE: Background Information and Basis for Conclusions document

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#### **Background Information and Basis for Conclusions document**

##### SLIDE 24

The AcSB also issued a Background Information and Basis for Conclusions document, *Employee Future Benefits — Additional Disclosures*, in April 2004 that explains the rationale for its revisions to the disclosure paragraphs in Section 3461 and related amendments to other parts of this Section. As mentioned earlier, the Basis document includes a chart comparing employee future benefit disclosures between Canada and the US to highlight differences in the disclosures for the benefit of preparers and financial statement analysts.

NEXT SLIDE: Feedback

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**Feedback**

SLIDE 25

Thank you for taking the time to view this presentation. We hope it is helpful to you in understanding the revisions to the disclosure requirements of *Employee Future Benefits*, Section 3461.

Comments on this presentation can be sent to [ed.accounting@cica.ca](mailto:ed.accounting@cica.ca).

END