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Considerations regarding the information about post-employment benefits disclosed by listed companies in their 2012 annual financial statements

Recommendations for the 2013 financial statements

The FSMA examined the information on defined benefit pension obligations disclosed by a number of listed companies in their consolidated financial statements for the 2012 financial year. The FSMA sought, by means of this examination, to gain a better understanding of the information disclosed about these types of employee benefits and to make recommendations for the consolidated financial statements for 2013. The study is in line with the European common enforcement priorities for 2012, as published by ESMA.

This document sets out the most important conclusions drawn from the examination and makes a number of recommendations regarding the financial statements for the 2013 financial year. Given that companies are required to implement the revised version of IAS 19 as from 2013, various aspects of the revised standard were taken into account in formulating the recommendations below.

- The FSMA asks companies to devote particular attention to the description of the characteristics of their defined benefit plans and the associated risks.
- The FSMA points out the importance of providing sufficient disaggregated data about defined benefit plans in order to enable users of the financial statements to understand the various risks associated with those plans.
- The FSMA expects companies to take into account, when determining the discount rate, the clarification provided by IFRS IC regarding high-quality corporate bonds (HQCB).
- The FSMA wishes to remind companies of the importance of devoting sufficient attention to disaggregating the information about actuarial assumptions for plans with materially different risks, in order to make possible a meaningful interpretation of these assumptions.
- The FSMA asks companies to devote more attention to describing the most significant sources of estimation uncertainty associated with defined benefit plans.
- The FSMA wishes to draw attention to the requirement under the revised IAS 19 to include in the notes a sensitivity analysis for each significant actuarial assumption.
- The FSMA asks listed companies to indicate clearly in the notes the line items under which the different income and expenses associated with defined benefit plans are recognized.
- The FSMA emphasizes that companies must devote sufficient attention to a correct classification of plans with a guaranteed return and that they also must explain their accounting and the justification for that accounting. Furthermore, it is essential that the valuation method be described, since the IASB has not laid down clear guidelines.
- The FSMA recommends making a clear distinction, in the notes to the financial statements, between post-employment benefits and other types of long-term employee benefits. As regards early retirement ('bridging') benefits, companies should make a clear distinction between early retirement benefits that fall into the category of termination benefits and those that must be recognized as post-employment benefits.

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1. DESCRIPTION OF THE RESEARCH[1]

1.1. CONTEXT

The FSMA examined the 2012 consolidated financial statements of 27 listed companies as regards their reporting on defined benefit obligations. The aim of this examination was to understand the way information is presented about this type of employee benefit and to make a number of recommendations regarding the consolidated financial statements for the 2013 financial year. This study is in line with the European common enforcement priorities for 2012[2], as published by ESMA. A number of aspects of the valuation of defined benefit obligations and the reporting on the expected impact of the first application of the revised version of IAS 19, *Employee benefits*, in 2013, are among these supervisory priorities.

This document provides an overview of the most significant findings of this research. A number of recommendations have been drawn up regarding the financial statements for the 2013 financial year. Companies must apply the revised version of IAS 19 starting in 2013, and a number of aspects of information disclosure about pension obligations also fall within the European common enforcement priorities for 2013[3]. The recommendations are based on observations made during the examination, and take into consideration the requirements of the revised version of IAS 19, although the intention was not to take account of all the changes introduced by the revised standard.

1.2. DESCRIPTION OF THE SAMPLE

Since the focus of the study was on the information disclosed about defined benefit plans, a sample was put together of companies (other than real estate UCIs [*sicafis/bevaks*]) listed on the Belgian regulated market that:

- present a long-term employee benefit liability in the statement of financial position;
- report a material present value of the defined benefit obligation (i.e. where the present value of the defined benefit obligation > 5% of the consolidated equity); and
- have not yet applied the revised IAS 19.

This selection yielded a sample of 27 companies.

[1] In annex to this document there is a glossary of terms used.
[2] http://www.esma.europa.eu/system/files/2012-725.pdf
[3] http://www.esma.europa.eu/news/Press-Release-ESMA-announces-financial-statements%E2%80%99-enforcement-priorities-2013

2. FINDINGS AND RECOMMENDATIONS

2.1. RISKS ASSOCIATED WITH VARIOUS DEFINED BENEFIT PLANS

2.1.1. Description of the characteristics of defined benefit plans

IFRS requires a general description of the type of defined benefit plan (IAS, 19.120A(b)).

Major differences were noted within the sample with regard to the scope and content of the information disclosed about the various benefit plans. In general, the FSMA takes the view that these descriptions offer insufficient insight into the materiality of the different plans and the risks associated with them. Nor will such insight be provided if the quantity of information disclosed is so large that there is a risk that important information will 'disappear' in the multitude of explanations. Disclosing relevant information and finding the right balance in the amount of detail to provide when describing the characteristics of the plans are particular challenges for companies that have many different plans in different countries.

The revised standard places particular emphasis on this topic, given that the description of the characteristics of defined benefit plans and associated risks is explicitly mentioned in the standard as an objective of the notes on defined benefit plans.

The FSMA asks companies to devote particular attention to the description of the characteristics of the defined benefit plans and the associated risks, and refers in this regard to paragraphs IAS 19R.135(a) and IAS 19R.139.

2.1.2. Degree of aggregation or disaggregation

In accordance with the current standard (i.e. the unrevised standard as applicable to the 2012 financial statements), a company that has more than one defined benefit plan can choose whether to disclose the required information in total, separately for each plan or in such groupings as are considered to be the most useful. The standard mentions only that it may be useful to distinguish groupings by criteria such as the geographical location of the plans or whether plans are subject to materially different risks (IAS 19.122).

In its examination, the FSMA looked at whether the companies in fact disaggregated the information into the various categories of plans when providing the required information about the reconciliation of (1) the present value of the defined plan obligation, (2) the fair value of the plan assets[4] and (3) the assets and liabilities recognized in the statement of financial position (as required under IAS 19.120A(c), (e) and (f) (see section 5.1)).

[4] See Annex: glossary of terms used

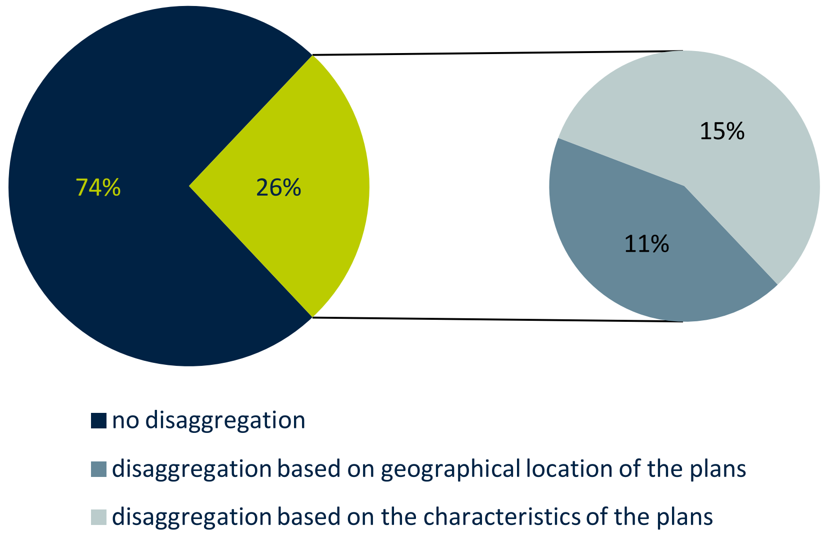

Figure 1 Disaggregation of the reconciliation required by IAS 19.120A (c), (e) and (f) into different categories

As indicated in Figure 1, 74% of the companies do not in their notes disaggregate their defined benefit plans into different categories. The notes do not always reveal whether there are in fact no materially different risks associated with the companies' plans. 26% of the companies do, however, distinguish in their notes among several categories: 15% of the companies disaggregate the data by geographical location of the plans (e.g. Europe versus the United States) and 11% disaggregate the data by the characteristics of the plans (e.g. pension plans versus other post-employment benefits).

In the revised IAS 19, more emphasis is placed on aggregation or disaggregation of information about the different plans. IAS 19R.138 explicitly states that companies must assess whether all or some disclosures should be disaggregated to distinguish plans or groups of plans with materially different risks. Thus disclosures regarding plans may be disaggregated based on different geographical locations, characteristics, regulatory environments, reporting segments or funding arrangements.

The FSMA recommends that companies pay sufficient attention to the degree of aggregation or disaggregation of the disclosures regarding defined benefit plans (as required under IAS 19R.138 and 142), in order to enable users of the financial statements to understand the different risks associated with the plans.

2.2. ACTUARIAL ASSUMPTIONS

Since the assets and liabilities of defined benefit plans recognized in the statement of financial position depend considerably on the actuarial assumptions used, the notes on these assumptions deserve particular attention. The current standard requires companies to disclose the significant actuarial assumptions in the notes. In its examination, the FSMA looked at the type of information companies publish about the discount rates used and the expected return on plan assets.

All the companies in the sample report one or more discount rates for calculating the present value of the defined benefit obligation.

All the companies with funded defined benefit plans report in their notes the expected return on plan assets.

Given the material effect of such assumptions on the assets and liabilities presented, the FSMA deems it extremely important to devote sufficient attention to the actuarial assumptions (see section 2.2.1), the degree of aggregation or disaggregation of the information disclosed in the notes (see section 2.2.2) and the description of the sensitivity of the carrying amount to the principal assumptions and estimates (see section 2.2.3).

2.2.1. Determining the actuarial assumptions

IAS 19 specifies that the discount rate used must be determined by reference to the market yields on high-quality corporate bonds with a maturity that matches the estimated maturity of the benefit payments. In countries where there is no deep market in such bonds, the market yields on government bonds are to be used.

As a result of the financial crisis, the number of corporate bonds with an 'AAA' or 'AA' rating has decreased. The FSMA draws the attention of companies to the position taken by the IFRS Interpretations Committee at its meeting of November 2013[5]: "*The Interpretations Committee further noted that 'high quality' as used in paragraph 83 of IAS 19 reflects an absolute concept of credit quality and not a concept of credit quality that is relative to a given population of corporate bonds, which would be the case, for example, if the paragraph used the term 'the highest quality'. Consequently, the Interpretations Committee observed that the concept of high quality should not change over time. Accordingly, a reduction in the number of HQCB should not result in a change to the concept of high quality. The Interpretations Committee does not expect that an entity's methods and techniques used for determining the discount rate so as to reflect the yields on HQCB will change significantly from period to period. Paragraphs 83 and 86 of IAS 19, respectively, contain requirements if the market in HQCB is no longer deep or if the market remains deep overall, but there is an insufficient number of HQCB beyond a certain maturity.*"

The IFRS IC and the IASB also discussed whether it would be useful to look at the market yields on high-quality corporate bonds in other countries where these are issued in the same currency. The IASB tentatively decided to amend paragraph 83 of IAS 19 through Annual Improvements to clarify that "*in determining the discount rate, an entity should include high quality corporate bonds issued by entities operating in other countries, provided that those bonds are issued in the currency in which the*

[5] IFRIC Update, November 2013.

benefits are to be paid. Consequently, the depth of the market for high quality corporate bonds should be assessed at the currency level and not at the country level."[6]

The FSMA expects companies to take into account, when determining the discount rate, the clarification provided by the IFRS IC, and to assess whether there is a deep market in high-quality corporate bonds in euros at Eurozone level.

Pursuant to IAS 1.125, companies must disclose information in their financial statements about assumptions made about the future, and other major sources of estimation uncertainty that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year. One actuarial assumption that is generally expected to have a material effect is the discount rate.

In the European common enforcement priorities published in November 2012, ESMA stressed the need for transparency with regard to the manner in which the discount rate is determined: "*entities are expected to disclose: if they used yields coming from high-quality corporate bonds or other means, a description of how they determined yields from high-quality corporate bonds (including any significant judgment used, or any reference to a regional market to which the issuer has access).*"

The results of this study indicate that approximately half of the companies in the sample determine the discount rate by reference to high-quality corporate bonds. In almost all cases, the notes are limited to simply paraphrasing the provisions of IAS 19.78. Neither is there much information provided about how the expected return on plan assets is determined.

The FSMA asks companies to devote more attention in their annual financial statements for 2013 to describing the most significant sources of estimation uncertainty associated with defined benefit plans, as required by IAS 1.122 and 125ff. (see also the European common enforcement priorities for the 2013 financial statements).

[6] IASB Update, October 2013.

2.2.2. Degree of aggregation or disaggregation

Where a company has several plans with different risks, using only one discount rate or one expected return on plan assets generally does not provide sufficient meaningful information. The actuarial assumptions can differ considerably depending on the geographical location, characteristics or funding arrangements.

Figure 2 and Figure 3 provide an overview of the disaggregation of the discount rate in the notes, on the basis of the geographical location and of the characteristics of the plans.

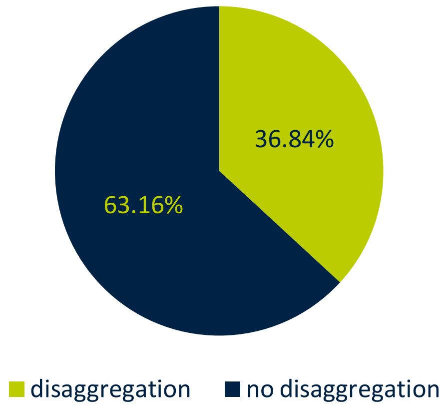

Figure 2 Disaggregation of the discount rate based on geographical location of the plans

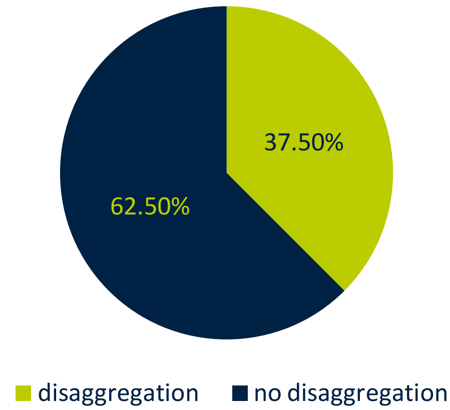

Figure 3 Disaggregation of the discount rate based on the characteristics of the plans

An analysis of the notes shows that 63.16% of the companies in the sample with defined benefit plans in different geographical locations report only one discount rate in the notes, and do not disaggregate the discount rate based on the location of the plans.

The same tendency was noted among companies with different types of plans (e.g. post-employment medical benefits versus pension plans). Only 37.5% of these companies provide a disaggregation, in their notes, of the discount rate on the basis of plan characteristics. This means that the users of the financial statements have more difficulty interpreting the discount rate used.

With regard to the expected return on plan assets, there is even less tendency to disaggregate the information in the notes based on the location of the plan (17.5% of the companies) or the type of plan assets (12.5% of the companies).

The FSMA wishes to remind companies of the importance of devoting sufficient attention to the disaggregation of the information on actuarial assumptions for plans with materially different associated risks, in order to make possible a meaningful interpretation of these assumptions; in this regard it also draws attention to the requirements of IAS 19R.135 & 138.

2.2.3. Sensitivity analysis

In the current standard, a sensitivity analysis is explicitly imposed only for the actuarial assumptions regarding the changes in the cost of medical services. In accordance with IAS 1.129, companies must, however, also disclose sufficient information on the sensitivity of the carrying amounts to the methods, assumptions and estimates underlying their calculation.

For 79% of the companies with post-employment medical plans, the notes contained a sensitivity analysis of the change in the cost of medical services. It was not always clear from the notes whether these involved material medical plans. Only 18.5% of the companies in the sample included information about the expected impact of changes in the discount rate used. None of the notes contained a sensitivity analysis for the expected return on plan assets.

The FSMA wishes to draw attention to the requirement under the revised IAS 19 to include in the notes a sensitivity analysis for each significant actuarial assumption as of the end of the reporting period. This sensitivity analysis must show how the defined benefit obligation would have been affected by changes in the relevant actuarial assumption that were reasonably possible at that date (IAS 19R.145). The FSMA thus expects a significant increase in the number of sensitivity analyses of defined benefit plans in the financial statements for the 2013 financial year.

2.3. Accounting policies

2.3.1. Presentation of expenses

The notes must disclose information about the total expenses in relation to post-employment employee benefits included in the statement of profit or loss and other comprehensive income, mentioning the line item(s) under which these expenses are recognized.

The study shows that in general, the companies clearly disclose the amounts of the various expenses in the notes, but that it is not always clear under which line item(s) these expenses are recognized.

The current IAS 19 requires companies to present the current service cost, the interest cost and the expected return on plan assets in the statement of profit or loss. The standard does not impose any other obligation as regards the line item on the statement of profit or loss under which these expenses must be entered. Figure 4 provides an overview of the presentation of these costs in the statement of profit or loss.

Approximately 20% of the companies in the sample do not state clearly under which item(s) the various costs are recognized. This study also shows that most of the companies present the current service cost as a component of the operating result. The presentation of interest costs and expected return on plan assets is much less consistent. The category 'other' in the figure below refers to companies that make no clear distinction in their statement of profit or loss between operating and financial income or that present the expenses across financial and operating results.

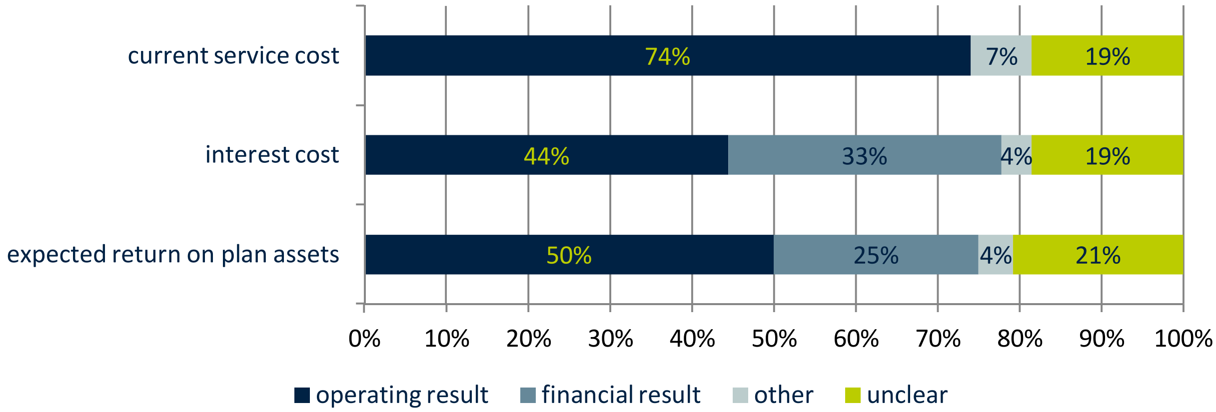

Figure 4: Presentation of the current service cost, interest cost and expected return on plan assets in the statement of profit or loss

As regards actuarial gains and losses, the current standard offers an option of either recognizing the gains and losses immediately in 'other comprehensive income' or using the corridor approach. 46% of the companies opted to recognize the actuarial gains and losses immediately in other comprehensive income. The remaining 54% opted for the corridor approach, and recognized the actuarial gains and losses that exceeded the corridor in the statement of profit or loss. Three of these companies did not exceed the corridor.

Figure 5 provides an overview of the presentation of the actuarial gains and losses in the statement of profit or loss. The category 'other' in the figure refers to companies that make no clear distinction in their statement of profit or loss between operating and financial result or that spread the actuarial gains and losses across financial and operating results.

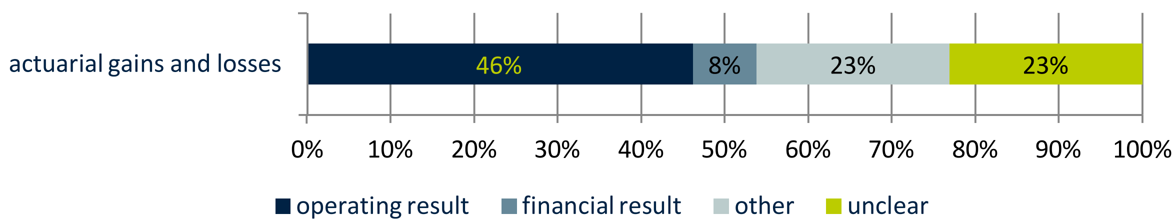

Figure 5: Presentation of the actuarial gains and losses in the statement of profit or loss

The FSMA asks listed companies to indicate clearly in the notes the line items where the income and expenses associated with defined benefit plans are recognized.

2.3.2. Guaranteed return

In certain jurisdictions legal provisions ensure that employees have the right to a guaranteed minimum return on the employer's or the employee's portion of the pension contributions.

IAS 19.39 provides that: "*An entity may pay insurance premiums to fund a post-employment benefit plan. The entity shall treat such a plan as a defined contribution plan unless the entity will have (either directly, or indirectly through the plan) a legal or constructive obligation to either:*

(a) pay the employee benefits directly when they fall due;

(b) pay further amounts if the insurer does not pay all future employee benefits relating to employee service in the current and prior periods.

If the entity retains such a legal or constructive obligation, the entity shall treat the plan as a defined benefit plan."

Only 30% of the companies reported that they have plans that provide employees with the right to a minimum return on the pension contributions paid by the employer or the employee. The notes on these plans are for the most part very general and discuss only the classification of these plans as defined benefit or defined contribution plans. No information is provided on the measurement of the obligation. The following figure provides an overview of the information about the classification of these plans:

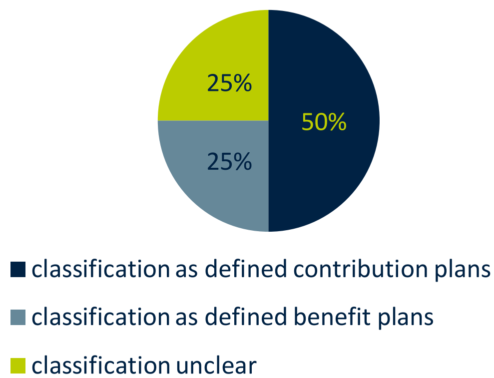

Figure 6: Classification of plans that provide employees with a right to a guaranteed minimum return on the contributions paid.

In order to justify classifying a plan as a defined contribution plan, companies indicate that the risk is not material or that the minimum return is sufficiently covered. Classification as a defined contribution plan is, however, in principle correct only if the company retains no risks regarding the guarantee should the pension fund or the insurance company have insufficient assets to provide for the guaranteed return.

It should further be noted that there is for the moment discussion regarding how such plans should be measured. "*IAS 19 Employee Benefits—Employee benefit plans with a guaranteed return on contributions or notional contributions*" is currently under consideration by the IFRS IC[7]. As there is still a lack of clarity regarding the measurement of such obligations, clear disclosures and consistent application of the valuation method used is essential, particularly for plans that are significant.

The FSMA emphasizes that companies must pay the necessary attention to a correct classification of plans with a guaranteed return and that they must also clearly disclose their accounting policy and the justification for that accounting policy. Furthermore, it is essential that the valuation method be described, since the IASB has not yet laid down clear guidelines.

[7] IFRIC Update, November 2013.

2.4. MISCELLANEOUS

2.4.1. Terminology

During the selection of this sample, it became clear that companies do not always and clearly distinguish between post-employment benefits (for which there are specific regulations regarding actuarial gains and losses) and other long-term employee benefits (for which the actuarial gains and losses are immediately recognized in the statement of profit or loss). Such a distinction remains unchanged in the revised version of IAS 19.

The FSMA also noted that the companies' accounting for early retirement (‘bridging’) benefits is not always clear. Since the term ‘pensions’ is used, companies sometimes too readily conclude that this refers to post-employment benefits. Where a company has created a reasonable expectation at the time of hiring or during the time of service that an employee is entitled to an early retirement benefit prior to the legal retirement age, this is indeed a post-employment benefit. In other cases, it is in fact a termination benefit (which can be a short- or long-term benefit) that should be accounted for in a different way.

The FSMA recommends making a clear distinction, in the notes accompanying the financial statements, between post-employment benefits and other types of long-term employee benefits. With regard to early retirement benefits, a clear distinction must also be made between those early retirement benefits that fall into the category of termination benefits and those that must be recognized as post-employment benefits.

2.4.2. Disclosure of the reconciliation of various items

With regard to defined benefit plans, information must be disclosed regarding the reconciliation of various items. The information to be given shall include:

- a reconciliation of opening and closing balances of the present value of the defined benefit obligation;
- a reconciliation of the opening and closing balances of the fair value of the plan assets; and
- a reconciliation of the present value of the defined benefit obligation and the fair value of the plan assets to the assets and liabilities presented in the statement of financial position.

This information is necessary to enable the users of financial statements to understand the changes underlying the various movements.

This study shows that approximately 81% of the companies under study provide a reconciliation of opening and the closing balances of the present value of the defined benefit obligation.

A reconciliation, in accordance with IAS 19, of the opening and closing balances of plan assets is provided by 71% of the companies with funded plans, while 12% provide a reconciliation that does not entirely fulfil the requirements of IAS 19 (see Figure 7)[8].

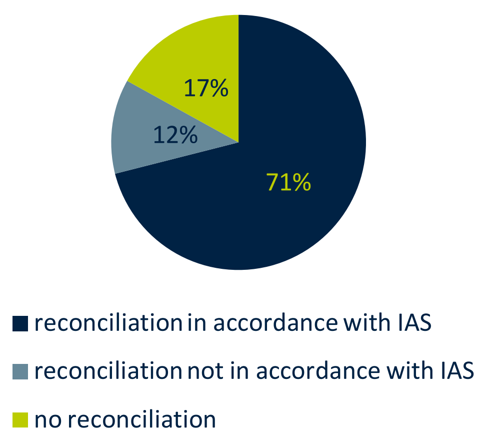

Figure 7: disclosure of the reconciliation of the plan assets (only for companies with funded plans)

A reconciliation of the pension liability included in the overview of the financial position is provided by nearly all the companies.

The revised IAS 19 similarly requires disclosure of the reconciliation of various items. The FSMA therefore expects these reconciliations to be included, as required by the revised standard.

[8] For the most part the effective yield on plan assets is reported instead of the expected yield on plan assets on the one hand and the actuarial gains and losses on the other.

2.4.3. Disclosure of the impact of the revised standard

IAS 8.30 requires that companies disclose whether there are any revised IFRSs, issued but not yet effective, that they have not applied. If so, they must also disclose any known or reasonably estimable information relevant to assessing the possible impact the application of the new IFRS will have on the company's financial statements in the period of initial application. The European common enforcement priorities issued by ESMA emphasize in this regard that quantitative information about the impact of the application of the revised IAS 19 was expected in the 2012 financial statements.

41% of the companies provided quantitative information and 29% indicated that the impact would not be material. In certain cases, this information was vague and quite general. 4% of the companies indicated that there would be a material impact, but did not quantify that impact. 26% of the companies gave no information about the impact (22%) or indicated that the impact had not yet been estimated (4%).

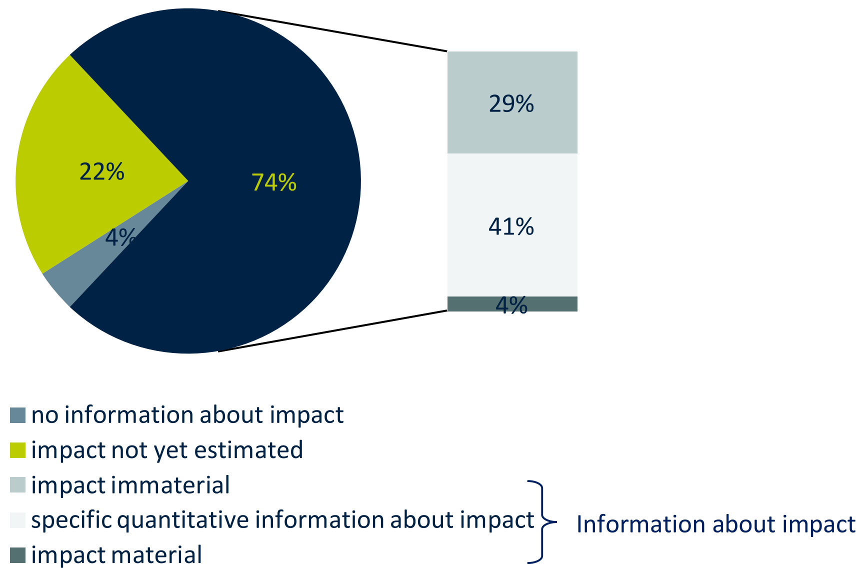

Figure 8: information about the impact of IAS 19R

The FSMA recommends that the impact of standards that have not yet been applied be described in concrete terms and that as far as possible an estimate of the quantitative impact be provided for standards that will have a material impact on future reporting. For the 2013 financial year, this can be the case in particular for IFRS 10, IFRS 11 and IFRS 12.

3. CONCLUSION

This study indicates that for the most part the companies have applied the disclosure provisions of IAS 19 quite well. However, in a considerable number of cases there was insufficient disaggregated information to allow users of the financial statements to form a clear understanding of the characteristics of the pension plans, the associated risks and the context of actuarial assumptions. As well, very little information was provided about the sensitivity to certain assumptions of the figures reported. The FSMA has therefore made recommendations made in this regard in this study.

Nearly all the companies under study report the items of income and expense associated with defined benefit plans recognized in the statement of profit or loss and in the presentation of other comprehensive income. IAS 19 also requires the disclosure of the line item(s) in which the expense is recognized. This information is not always provided. Since even under the revised IAS 19 differences in presentation within the statement of profit or loss remain possible, the FSMA wishes to emphasize the importance of disclosing this information. The disclosures regarding the reconciliation of various items associated with defined benefit obligations are generally good.

With regard to the accounting for pension plans with a guaranteed return, the FSMA emphasizes that companies should pay sufficient attention to classifying them correctly. Furthermore, it is essential that the measurement method be described, since the IASB has not yet laid down clear guidelines.

The study shows that the specific terminology used in IAS 19 to indicate various types of employee benefits is not used consistently throughout the financial statements, giving rise to some doubt as to the correct accounting for certain employee benefits.

ANNEX: GLOSSARY[9]

- Other long-term employee benefits: employee benefits (other than post-employment benefits and termination benefits) that are not due to be settled within twelve months after the end of the period in which the employees render the related service.
- Defined benefit obligation: obligation resulting from a defined benefit plan using the projected unit credit method
- Plan assets: the assets held by a long-term employee benefit fund and qualifying insurance policies
- Other comprehensive income: Income and expenses that are not recognized in profit or loss
- Termination benefits: employee benefits payable as a result of (a) a company's decision to terminate an employee's employment before the normal retirement date; or (b) an employee's decision to accept redundancy in exchange for those benefits.
- Statement of financial position: balance sheet
- Projected unit credit method: the method according to which benefits are attributed pro-rated on the service rendered, also known as the accrued benefit method pro-rated on service or as the benefit/years of service method.
- Defined contribution plans: post-employment benefit plans under which a company pays fixed contributions into a separate entity (a fund) and will have no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods.
- Defined benefit plans: all post-employment benefit plans other than defined contribution plans.
- Post-employment benefits: employee benefits (other than termination benefits) payable after the completion of employment

[9] The terminology used comes from the official European version of IAS 19 in English.