

## Accounting Change Fatigue? Revised International Pension Accounting Standards Have Implications for Canadian Companies

Although it was expected, the release by the International Accounting Standards Board (IASB) of “improvements” to International Accounting Standard (IAS) 19, *Employee Benefits*, which codifies pension accounting requirements,<sup>1</sup> is not welcomed by many employers. That is because pension accounting was often an uncomfortable aspect of the transition to International Financial Reporting Standards (IFRS) in Canada.<sup>2</sup> The amended standard introduces some significant changes that all plan sponsors reporting under IFRS will have to comply with for accounting years commencing on or after January 1, 2013. (The changes are briefly summarized in [the box on page 2.](#)) This *Spotlight* highlights some of the likely consequences of the changes and suggests approaches to make the transition less disruptive.

### WHAT ARE THE MOST IMPORTANT CONSEQUENCES OF THE CHANGES?

The most important consequences of the changes are summarized below:

- **Reported profits for most companies will be lower.** The removal of the expected return on assets concept will reduce profits where the expected return on assets assumption would have been higher than the discount rate. Profits for the sponsor of a typical plan with assets of \$100 million could be \$1.5 million lower as a result of this change alone (based on typical 2011 assumptions). Further, being forced to move away from the corridor method may also hurt some employers’ reported profits because existing unrecognized gains will bypass the profit and loss statement (P&L). Lastly, even if future investment returns are higher than the discount rate, those ‘gains’ will never flow through annual P&L.
- **Some balance sheets will be more volatile.** A key reason for retaining the corridor method through the initial transition to IAS 19 was that it often smoothes changes in the balance sheet from year to year. Under the revised IAS 19, the balance sheet will reflect the funded status of the plan and, consequently, will be fully exposed to volatility in assets and liabilities. This could be particularly problematic for companies with cash-flow restrictions or solvency requirements.
- **Canadian companies may look worse compared to their U.S. competitors.** U.S. companies will not suffer from the potential hit to profits described above because they are not typically subject to IFRS. On the face of it, otherwise identical firms reporting under U.S. Generally Accepted Accounting Principles (GAAP) may appear to do better than those reporting under Canadian GAAP.
- **A brighter light will shine on pension risks.** Investor awareness of pension costs and risks has been slowly increasing in recent years, a trend that is expected to continue. It will be interesting to see how markets react to the increased pension disclosure in company accounts.

<sup>1</sup> The amended version of IAS 19 can be accessed from the IAS website by eIFRS subscribers: [www.ifrs.org](http://www.ifrs.org) The project summary is available to non-subscribers: <http://www.ifrs.org/NR/ronlyres/D06B86E4-8907-4209-A6DB-671948046C44/0/EmpBenFSIAS190611.pdf>

<sup>2</sup> Compliance with IFRS became mandatory for publicly accountable entities in the first fiscal year beginning on or after January 1, 2011. The pension aspects of the transition were discussed in Sibson Consulting’s October 2010 *Spotlight*, “Last Chance for Canadian DB Plan Sponsors to Manage the Impact of Adopting IAS 19”: <http://www.sibson.com/publications/spotlight/oct10Canada.pdf>

**WHAT CAN COMPANIES REPORTING UNDER IFRS DO NOW TO MITIGATE THE EVENTUAL IMPACT OF THE LATEST PENSION ACCOUNTING CHANGES?**

- **Pension fund investment strategies may become more conservative.** Under the amended IAS 19, investment strategy will no longer directly affect reported profits. This makes a high risk/reward investment strategy less attractive from an accounting perspective. The increased risk disclosures in the accounts may also lead to a preference for a reduction in investment risk even though this might be expected to increase the real cost of the plan.

Companies reporting under IFRS can start to take the following actions now:

- **Analyze the effect on P&L and the balance sheet.** Both the relative change and the impact on volatility should be considered, together with the implications for other key financial metrics and debt covenants.
- **Assess communication needs.** Key stakeholders, such as investment analysts and rating agencies, need to understand the effect of the accounting changes.
- **Review investment strategy.** The risk/reward profile of the investment portfolio will need to be re-examined. With no P&L credit for taking investment risk, and greater disclosure around investment risks, risky investment strategies may seem less attractive. These factors, combined with increased balance sheet volatility, may make new investment options that transfer risk to another entity appear more attractive.
- **Review risk management strategy.** The strategy should look beyond investment risk and consider such factors as longevity, inflation, regulatory and administration risks.
- **Begin collecting any additional information needed.** Examples include preparing a template for the additional disclosure requirements.



*Employers should rely on their accountants for authoritative advice on changes to Canadian GAAP. Sibson can be retained to work with employers to mitigate the impact of the accounting changes on pension plan. For assistance with this and other de-risking strategies, contact either Rob Kay (416.969.3993, [rkay@sibson.com](mailto:rkay@sibson.com)) or Ron Olsen (416.969.3972, [rolsen@sibson.com](mailto:rolsen@sibson.com)) in Sibson's Toronto office.*

### SUMMARY OF THE CHANGES TO IAS 19

The amended version of IAS 19 was issued on June 16, 2011. It was adopted into Canadian GAAP by the Accounting Standards Board on July 13, 2011. The changes are effective for reporting periods beginning on or after January 1, 2013, but early adoption is possible. A summary of the most significant changes follows:

- The "corridor" method is abolished. This method allowed the impact on the balance sheet of market movements and other experience to be smoothed. All companies will now use the "Other Comprehensive Income (OCI)" method and the balance sheet will reflect the funded status of each plan.
- The expected return on assets is abolished. The return a company expects will no longer be relevant to determining profit and loss.
- Certain technical issues are clarified. These include the treatment of plans with risk sharing features, and the treatment of administration costs.
- Expanded, "principles-based" disclosures (as opposed to "rules-based") will be required.