The Institute of Chartered Accountants of Pakistan

CA PAKISTAN

Topic wise Selected Opinions

IAS 26 - Accounting and Reporting by Retirement Benefit Plans

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1. Treatment of employer's unpaid contribution to defined benefit fund under IAS 26 Accounting & Reporting by Retirement Benefit Plans

Enquiry:

It has been practiced of the companies and firms to show "Receivable from Employer" in the financial statements of the defined benefit plans. But as per the "Topic Wise Selected Opinions" on IAS 26 Accounting & Reporting by Retirement Benefit Plans, issued by the Institute of Chartered Accountants of Pakistan, unpaid contributions cannot form part of the "Net assets available for benefits" in the separate financial statements of a defined benefit plan and may be disclosed in the notes.

As per the definition of the Net assets available for benefits given in IAS 26, assets of plan less liabilities are the Net assets available for benefits. Definition from IAS 26 paragraph 8 is reproduced below:

> *'Net assets available for benefits are the assets of a plan less liabilities other than the actuarial present value of promised retirement benefits.'*

Please note that as per the definition of an asset, the amount "Receivable from Employer" is also an asset. Our query is that why the Institute has not considered the "Receivable from Employer" as an asset of defined benefit plan, when the company shows it as an obligation to pay in its financial statements and confirms it as its liability and the fund also says that it is an asset in form of receivable from employer. Please note further that IAS 26 also has not restrained from recognizing it as an asset then why we cannot recognize it as an asset in financial statements of fund. Copy of the Topic Wise Selected Opinions on IAS 26 issued by the Institute of Chartered Accountants of Pakistan is enclosed for your ready reference.

We would appreciate ICAP's views and necessary clarification on the above mentioned query.

Opinion:

The Board considers it pertinent to highlight that as per the enquirer's submissions, the enquirer is of the opinion that as per the definition of an asset, the amount receivable from employer or unpaid contributions is also a plan asset (of defined benefit fund). Therefore, in the light of principles outlined in the Conceptual Framework for Financial Reporting (the Framework) and IFRS Standards in general, the Board noted that determination of whether unpaid contributions from an employer towards a defined benefit fund, fulfill the definition of an asset needs careful assessment.

The Board noted that previously, the Technical Advisory Committee (TAC) of the Institute, in its opinion (dated January 11, 2016) concluded that unpaid contributions cannot form part of the 'Net assets available for benefits' in the separate financial statements of a defined benefit plan and may only be disclosed in the notes. TAC in its analysis also highlighted that paragraphs 17 and 28 of IAS 26 explain different formats of presentation of net assets and actuarial obligation. Further, these paragraphs do not prescribe that the amount not yet contributed by the company is part of the Net assets available for benefits.

While reconsidering the matter, the Board considered that paragraph 4.3 of the Framework defines an asset as:

> "An asset is a present economic resource controlled by the entity as a result of past events."

Further, paragraph 4.4 states that an economic resource is a right that has the potential to produce economic benefits. Paragraphs 4.6 - 4.7 explain that rights that have the potential to produce economic benefits take many forms, including:

(a) rights that correspond to an obligation of another party, for example:

(i) rights to receive cash.

(ii) rights to receive goods or services.

(iii) rights to exchange economic resources with another party on favourable terms. Such rights include, for example, a forward contract to buy an economic resource on terms that are currently favourable or an option to buy an economic resource.

(iv) rights to benefit from an obligation of another party to transfer an economic resource if a specified uncertain future event occurs.

(b) rights that do not correspond to an obligation of another party, for example:

(i) rights over physical objects, such as property, plant and equipment or inventories. Examples of such rights are right to use a physical object or a right to benefit from the residual value of a leased object.

(ii) rights to use intellectual property.

The Board understands that it can be inferred from the above paragraphs that, for unpaid contribution to a defined benefit fund to meet the definition of an asset, it must correspond to an obligation of the other party, i.e. the company making the contributions.

The Board would like to highlight that guidance on obligation of employer under various types of post-employment benefit plans, is outlined in *IAS 19 Employee Benefits.*

Defined contribution plans and defined benefit plans are defined in IAS 19 as under:

> **"Defined contribution plans** are post-employment benefit plans under which an entity pays fixed contributions into a separate entity (a fund) and will have no legal or constructive obligation to pay further."
>
> **"Defined benefit plans** are post-employment benefit plans other than defined contribution plans."

Further, the Board noted paragraph 114 of IAS 19 outlines that (emphasis added):

> *"<u>Plan assets exclude unpaid contributions due from the reporting entity to the fund,</u> as well as any non-transferable financial instruments issued by the entity and held by the fund. Plan assets are reduced by any liabilities of the fund that do not relate to employee benefits, for example, trade and other payables and liabilities resulting from derivative financial instruments."*

The Board understands that, in context of employer's financial statements, the employer's interest is a net liability or asset that reflects a long-term measure of the cash inflows and outflows of the defined benefit plan. Cash inflows include cash generated from the assets of the defined benefit plan and contributions from employees; cash outflows include the payment of benefits. Under such an approach, the employer would recognise a liability when there is a shortfall in expected cash flows of the defined benefit plan that has to be met by the employer, i.e. when the cash flows from the assets of the defined benefit plan are not expected to be sufficient to meet its liabilities. Measurement of the liability would then reflect the employer's obligation to pay contributions to the defined benefit plan in order that the plan can meet its liabilities when they fall due. Similarly, the employer would recognise an asset when there is a surplus in expected cash flows of the defined benefit plan and the employer had the right to benefit from that surplus.

In relation to the entity's funding obligations, IAS 19 requires an entity to disclose the employer's best estimate, as soon as it can be reasonably determined, of contributions expected to be paid to the plan during the annual period beginning after the balance sheet date.

Paragraph 30 of IAS 19 states that under defined benefit plans, the entity's obligation is to provide the agreed benefits to current and former employees and actuarial risk (that benefits will cost more than expected) and investment risk will fall, in substance, on the entity. If actuarial or investment experience are worse than expected, the entity's obligation may be increased.

The Board noted that the financial statement content of a defined benefit plan is explained in IAS 26 Accounting and Reporting by Retirement Benefit Plan.

Paragraph 28(a) of IAS 26 states that "a statement is included in the financial statements that shows the net assets available for benefits, the actuarial present value of promised retirement benefits, and the resulting excess or deficit".

IAS 26 defines net assets as follows:

> *"Net assets available for benefits are the assets of a plan less liabilities other than the actuarial present value of promised retirement benefits*."

The Board would like to highlight that the deficit in a defined benefit plan would only arise, if contribution receivable from entity, as discussed in query, is not recognized in the books of account of defined benefit plan.

Other formats of presentation of financial statements of defined benefit plan under IAS 26 do not explicitly differ in terms of such non-recognition.

In context of the submitted fact pattern, the Board noted that USGAAP [ASC 960] can also be referred for explanation purposes. ASC 960-310-25(4) outlines that the unfunded prior service costs are not receivables of the plan because at the reporting date those amounts are not due from the employer(s). The employer(s) may or may not intend to eventually contribute amounts sufficient to eliminate the unfunded prior service costs. Until such payments are formally committed to the plan, unfunded prior service costs do not constitute a recordable resource of the plan. For similar reasons, any existing excess of the actuarial present value of accumulated plan benefits over the net assets available for benefits (excluding contributions receivable) is not a plan asset unless at the reporting date that amount is legally, contractually, or pursuant to a formal commitment due the plan.

The Board understands that plan assets include all those assets over which plan has beneficial ownership interest, generally, the employer contributions become an asset of the plan only when the contribution has been made, rather than when the contribution become due under the plan.

Accordingly, it is to be noted that until paid, the employer contributions specifically included in the plan's statutory arrangement i.e. the unpaid contributions are not plan assets, and are not creditor protected.

(August 27, 2019)

2. Technical Opinion on IAS 26

Enquiry:

Our Company is maintaining separate funded Gratuity and Pension Funds (defined benefit plans) for the provision of retirement benefits to its eligible employees. Annual actuarial valuations are carried out for the determination of the liability to be recorded in the Company's financial statements as of year-end as per IAS 19. The defined benefit liability recognized in the financial statements of the Company for the above defined benefit plans, as per the requirement of IAS 19, is the net total of the present value of defined benefit obligation at the end of the reporting period and current service cost minus the fair value of plan assets at the end of the said reporting period.

The following example would be helpful to explain the above fact and for discussions hereinafter:

	(Rupees)
Present value of defined benefit obligation as of the year end	300
Fair value of plan assets as of the year-end	(100)
Net liability at end of the year (as recognized in the financial statements of the company) / unpaid contributions (representing deficit in the Fund)	200

Enquiry:

The query is in respect of the preparation of the separate financial statements of defined benefit plans and not from the perspective of the Company.

The query is in respect of assets that can be recognized in the separate financial statements of the defined benefit plans under IAS 26 (Accounting and Reporting for Retirement Benefit Plans), under which these financial statements are being prepared.

To be specific, can a defined benefit retirement plan record the above deficit of Rs. 200 in the Fund as an amount receivable from the Company in its separate financial statements under IAS 26 (as an asset)? In other words, can it form part of the 'Net assets available for benefits' to be reported in the separate financial assets of a defined benefit plan?

Company's Viewpoint / Treatment

We have been preparing our funds' financial statements on the convention that amount not yet contributed by the Company (amounting to Rs.200 in the above example) is booked as receivable from company in the 'Statement of Net Assets Available for Benefits' of the funds. This view is based on the fact that liability for the said amount has also been recognized by the Company in its own financial statements.

Furthermore, previously our funds were being audited by one of the top audit firms for a period of six years and they maintained the same treatment. However, our audit firm has been rotated for FY2015 and the incoming auditors are of the view that such amount should not be made part of 'Statement of Net Assets Available for Benefits' instead it should only be disclosed in the notes to financial statements. The detailed viewpoint of our existing auditors is given in following paragraphs

In view of the above, we are in disagreement with our existing auditors and request you for the advice in this regard at the earliest.

Auditors' Viewpoint / Treatment

Existing auditor recommends that this amount of Rs.200, representing deficit in the fund, is not part of the 'Net Assets Available for Benefits' and as such cannot be so recorded as an amount receivable from the Company in the separate financial statements of the defined benefit plan for inclusion in the said net assets (although its separate disclosure is required as a deficit in the Fund).

As per the definition of 'Net assets available for benefits' given in IAS 26, the amount of deficit mentioned above do not form part of the 'Net assets available for benefits'. This fact can be corroborated from the definition itself wherein it indicates that net assets are the assets of the plan (net of liabilities mentioned therein). Plan assets have been explained in more detail in paragraph 114 of IAS 19, under which it states that the 'Plan Assets.' exclude unpaid contributions due from the reporting entity to the fund, and as such for this reason the view is that since no 'funding' has been made to the Fund by the Company, un-contributed amount cannot be considered part of the assets or 'Net Assets' of the Fund.

Paragraphs 17 and 28 of IAS 26 gives different formats for the presentation of actuarial information. In each of these formats, essentially the essence is the quantification/ presentation of deficit/ surplus and is determined by deducting the 'net assets available for benefits' with the actuarial present value of promised retirement benefits. In case the amount yet due from the Company (amounting to Rs.200 in the above mentioned example) is included in the net assets available for benefits' in the separate financial statements of the defined benefit plan, essentially there would no deficit or excess to quantify and report. These paragraphs essentially contain different modes of the presentation of net assets and actuarial obligation and at no point does it mention that the amount not yet contributed by the Company is part of the net assets available for benefits.

Essentially the view is that in case of both the Company and the separate financial statements of the defined benefit plan, fair value of the plan assets should be the same (i.e. Rs. l00 in the above mentioned example) on the assumption that the Fund carries all of its assets at fair values.

Furthermore, since these are defined benefit plans, the obligation vests with the reporting entity (i.e. the Company) and as such an obligation cannot be created in the separate financial statements of the Fund for the present value of promised retirement benefits. Recognition of a balance receivable from the Company in the said separate financial statements (in respect of the deficit / unpaid contributions) would amount to the recognition of the liability as explained above. Fund's responsibility is only the maintenance of the assets in accordance with its mandate.

We would appreciate ICAP's views and necessary clarification on the above-mentioned query.

Opinion:

The Committee would like to draw your attention to the following paragraphs of IAS 26 'Accounting and Reporting for Retirement Benefit Plans': (underline is ours)

Net assets available for benefits are the <u>assets of a plan less liabilities other than the actuarial present value of promised retirement benefits</u>.

Actuarial present value of promised retirement benefits is the present value of the expected payments by a retirement benefit plan to existing and past employees, attributable to the service already rendered.

17 The financial statements of a defined benefit plan shall contain either:

(a) a statement that shows:

(i) the net assets available for benefits;
(ii) the actuarial present value of promised retirement benefits, distinguishing between vested benefits and non-vested benefits; and
(iii) the resulting excess or deficit; or

(b) a statement of net assets available for benefits including either:

(i) a note disclosing the actuarial present value of promised retirement benefits, distinguishing between vested benefits and non-vested benefits; or

(ii) a reference to this information in an accompanying actuarial report.

If an actuarial valuation has not been prepared at the date of the financial statements, the most recent valuation shall be used as a base and the date of the valuation disclosed.

Financial statement content

28 For defined benefit plans, information is presented in one of the following formats which reflect different practices in the disclosure and presentation of actuarial information:

(a) a statement is included in the financial statements that show the net assets available for benefits, the actuarial present value of promised retirement benefits, and the resulting excess or deficit. The financial statements of the plan also contain statements of changes in net assets available for benefits and changes in the actuarial present value of promised retirement benefits. The financial statements may be accompanied by a separate actuary's report supporting the actuarial present value of promised retirement benefits;

(b) financial statements that include a statement of net assets available for benefits and a statement of changes in net assets available for benefits.

The actuarial present value of promised retirement benefits is disclosed in a note to the statements. The financial statements may also be accompanied by a report from an actuary supporting the actuarial present value of promised retirement benefits; and

(c) financial statements that include a statement of net assets available for benefits and a statement of changes in net assets available for benefits with the actuarial present value of promised retirement benefits contained in a separate actuarial report.

In each format a trustees' report in the nature of a management or directors' report and an investment report may also accompany the financial statements.

Your attention is also drawn to following paragraph of IAS 26 'Accounting and Reporting for Retirement Benefit Plans':

31 This Standard accepts the views in favor of permitting disclosure of the information concerning promised retirement benefits in a separate actuarial report. It rejects arguments against the quantification of the actuarial present value of promised retirement benefits. Accordingly, the formats described in paragraph 28(a) and (b) are considered acceptable under this Standard, as is the format described in paragraph 28(c) so long as the financial statements contain a reference to, and are accompanied by, an actuarial report that includes the actuarial present value of promised retirement benefits.

From the above referred definitions and paragraphs, it implies that unpaid contributions due from the reporting entity to the fund are excluded from plan assets. Paragraph 17 and 28 explains different formats of presentation of net assets and actuarial obligation and does not anywhere mention that the amount not yet contributed by the Company is part of the net assets available for benefits.

Based on the above, the Committee is of the view that unpaid contributions cannot form part of the 'Net assets available for benefits' in the separate financial statements of a defined benefit plan and may be disclosed in the notes.

(January 11, 2016)

3. Accounting for Investments of Provident Fund Trust

Enquiry:

Trust Deed and the Trust Rules made there-under are the constitutive documents of a Provident Fund Trust. These constitutive documents also spell out the accounting/ financial reporting and book keeping requirements of the Provident Fund Trust.

Financial statements of Provident Fund Trust are prepared in accordance with IAS 26 'Accounting and Reporting by Retirement Benefit Plans'. IAS 26 mandate valuation of investments of the Provident Fund Trust at fair value.

In case of some Provident Fund Trusts, the financial reporting provisions contained in the Trust Deed or the Trust Rules made there-under require that: a percentage of surplus arising on re-measurement of investments to fair value should not be appropriated among Provident Fund Trust Members; or a particular type of investment should be measured at cost; or a particular type of investment be measured at lower of fair value and cost etc.

Trustees of the Provident Fund Trust include such requirements in the Trust Deed the Trust Rules made there-under in view of prudence concept and to counter the demerits of fair value accounting of investments and in some cases to maximize the returns to Provident Fund Trust members

As the Trust Deed and the Trust Rules made there-under are the constitutive documents of a Provident Fund Trust, hence have an overriding effect on requirements of IAS 26. Please confirm this understanding.

Strength is also derived from the financial statements of open end mutual funds. In case of open end mutual funds, Trust Deed is the constitutive document and it is mentioned therein to amortize the preliminary expenses and flotation costs over a period of five years. Hence, requirements of constitutive document have an overriding effect on approved accounting standards. Accounting policy of "Preliminary expenses and flotation costs" and "Statement of compliance" of an open end mutual fund is reproduced below for ready reference:

"Preliminary expenses and floatation costs:

Preliminary expenses and floatation costs represent expenditure incurred prior to the commencement of operations of the Fund. These costs are being amortized over a period of five years commencing from _____, as per the requirement of the Trust Deed of the Fund."

Statement of compliance

These financial statements have been prepared in accordance with approved accounting standards as applicable in Pakistan. Approved accounting standards comprise of such International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board as are notified under the Companies Ordinance, 1984, the requirements of the Trust Deed, the Non-Banking Finance Companies (Establishment and Regulation) Rules, 2003 (the NBFC Rules), the requirements of the Non-Banking Finance Companies and Notified Entities Regulations, 2008 (the NBFC Regulations) and the directives issued by the Securities and Exchange Commission of Pakistan (SECP). Wherever the requirements of the Trust Deed, the NBFC Rules, the NBFC Regulations or the directives issued by SECP differ with the requirements of IFRSs, the requirements of the Trust Deed, the NBFC Rules, the NBFC Regulations or the directives issued by SECP prevail."

Opinion:

The retirement benefit funds are established under the Trust Act, 1882 as separate entities in Pakistan and the trust deed is the incorporation document under which trust rules are formulated. The Trust Act, 1882 and the trust deed of the retirement benefit fund both require the preparation of financial statements for the funds but do not specify the applicable financial reporting framework under which the financial statements of the funds are required to be prepared. The generally accepted accounting framework in Pakistan is IAS/IFRS and for companies the requirement is emanating from section 234 of the Companies Ordinance 1984.

The accounts in Pakistan are required to be prepared in accordance with generally applicable framework so that they are comparable and understandable by the users. If the accounts are prepared in accordance with trust deed of each fund, then they would not remain comparable. Trust deed can guide as to what is to be or not to be distributed but cannot override accounting policies which are required to be followed in accordance with IAS/IFRS. Hence, in view of the Committee IAS 26 will be the accounting framework of provident funds.

(*November 12, 2015*)