

Reporting Employee Future Benefits by Not-for-Profit Organizations — Background Information and Basis for Conclusions

Section 3463

Foreword

In December 2013, the Accounting Standards Board (AcSB) released REPORTING EMPLOYEE FUTURE BENEFITS BY NOT-FOR-PROFIT ORGANIZATIONS, Section 3463 in Part III of the CPA Canada Handbook – Accounting. The AcSB has approved for publication the contents of this document setting out its rationale for these standards.

Background Information and Basis for Conclusions documents are sources of generally accepted accounting principles, as described in GENERALLY ACCEPTED ACCOUNTING PRINCIPLES FOR NOT-FOR-PROFIT ORGANIZATIONS, Section 1101 in Part III of the Handbook. These documents are intended to help readers understand how the AcSB reached its conclusions, but they do not include explanations of requirements or guidance on the application of the relevant Section or Accounting Guideline.

December 2013

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INTRODUCTION

- 1 This document summarizes considerations that were deemed significant by the members of the Accounting Standards Board (AcSB) in reaching their conclusions in developing REPORTING EMPLOYEE FUTURE BENEFITS BY NOT-FOR-PROFIT ORGANIZATIONS, Section 3463 in Part III of the CPA Canada Handbook – Accounting. This document sets out the reasons the AcSB undertook the project to develop this material, the process of research and deliberation, the key decisions made, and the principal reasons for adopting the positions taken and rejecting others. Individual AcSB members gave greater weight to some factors than to others.

- 2 Nothing in this document is to be taken as overriding the requirements of the Handbook. However, the discussion may help readers understand how the AcSB reached its conclusions in developing the Section and the AcSB's intent with respect to its interpretation and application.

BACKGROUND

- 3 A not-for-profit organization (NFPO) applying Part III of the Handbook also applies the standards in Part II of the Handbook, to the extent that the Part II standards address topics not addressed in Part III.
- 4 In January 2012, the AcSB issued an Exposure Draft, "Employee Future Benefits," proposing changes to the standard on employee future benefits in accounting standards for private enterprises in Part II of the Handbook. Respondents generally agreed that the Exposure Draft proposals should be applied by NFPOs following accounting standards for not-for-profit organizations in Part III of the Handbook. However, significant concerns were raised about including "remeasurements and other items 1" for defined benefit plans in an NFPO's statement of operations.
- 5 To respond to these concerns, the AcSB issued an Exposure Draft, "Reporting Employee Future Benefits by Not-for-Profit Organizations," in June 2013. The Exposure Draft proposed adding a new standard to Part III of the Handbook to provide guidance on the recognition and presentation of remeasurements and other items that differs from the guidance in EMPLOYEE FUTURE BENEFITS, Section 3462 in Part II of the Handbook. The requirements in Section 3462 in Part II would apply in all other respects.
- 6 This Background Information and Basis for Conclusions document addresses the AcSB's conclusions that it deemed significant in the guidance provided on the recognition and presentation of remeasurements and other items by NFPOs. Stakeholders are encouraged to read the Background Information and Basis for Conclusions document for Section 3462 for the AcSB's conclusions on other aspects of accounting for employee future benefits.

DEVELOPMENT OF THE STANDARD

- 7 Throughout the development of the standard, the AcSB followed its due process. This process includes:
- (a) consultation with representatives from the not-for-profit sector;
 - (b) issuance in June 2013 of the Exposure Draft, "Reporting Employee Future Benefits by Not-for-Profit Organizations"; and
 - (c) analysis and consideration of feedback received through written responses to the Exposure Draft (eight letters), follow-up with some respondents to clarify points raised and discussions with other stakeholders.
- 8 The AcSB exposed the June 2013 Exposure Draft proposals for 60 days to ensure that the effective date for Section 3463 in Part III would be the same as for Section 3462 in Part II. In making this decision, the AcSB considered whether stakeholders would be provided with sufficient time to provide their responses. The AcSB observed that these proposals are narrow in scope and respond to comments received on its January 2012 Exposure Draft, "Employee Future Benefits."
- 9 The issues considered by the AcSB in developing the June 2013 Exposure Draft and the conclusions on the more significant issues raised by respondents are discussed below. This discussion includes the anticipated effects on stakeholders that were considered by the AcSB in developing the standard.
- 10 Respondents were mainly from public accounting firms but also included preparers and an actuarial firm. They generally supported the June 2013 Exposure Draft proposals. As part of the due process related to Parts II, III and IV of the Handbook, the AcSB makes available a public file of materials relating to completed projects that includes response letters received, unless confidentiality is requested.

APPLICATION OF THE STANDARD

- 11 The AcSB's overall approach is that standards in Part II of the Handbook that will be applied by NFPOs should not be repeated in Part III of the Handbook. Consistent with this approach, Section 3463 in Part III addresses the recognition and presentation of remeasurements and other items. NFPOs refer to Section 3462 in Part II for other aspects of accounting for employee future benefits.

RECOGNITION AND PRESENTATION OF REMEASUREMENTS AND OTHER ITEMS

Background

- 12 Section 3462 in Part II requires recognition of the full amount of an entity's defined benefit liability (asset) in the statement of financial position. Changes in the defined benefit asset or liability (other than those due to contributions to the plan or payments by the plan to plan members) are recognized immediately in income when they arise. These changes include remeasurements and other items. This accounting is similar to the immediate recognition approach in former EMPLOYEE FUTURE BENEFITS, Section 3461 in Part II of the Handbook.

Recognition in net assets and presentation in statement of changes in net assets

- 13 Respondents to the January 2012 Exposure Draft expressed strong concerns about including remeasurements and other items in an NFPO's statement of operations, given the potential volatility and size of that number. The AcSB is aware that primary users of NFPO financial statements include donors and other funders, in addition to lenders. Respondents pointed out that many donors and other funders may not have the understanding of the accounting for employee future benefits that lenders can be expected to have. Remeasurement gains and losses may be significant and, if included in

- the statement of operations, may result in operating surpluses or deficits and these might also vary significantly from year to year. Respondents suggested that donors and other funders may misunderstand such surpluses and deficits. These misunderstandings could affect the willingness of donors and other funders to provide financial support to the organization. As a result of the differences in the users of the financial statements of private enterprises and NFPOs, the AcSB considered alternative ways in which remeasurements and other items might be recognized and presented.
- 14 The AcSB noted that NFPOs following International Financial Reporting Standards in Part I of the Handbook would recognize changes in the defined benefit liability (asset) in other comprehensive income. The AcSB confirmed that it does not intend to adopt an "other comprehensive income" approach for NFPOs in Part III of the Handbook. However, presenting remeasurements and other items in the statement of changes in net assets rather than in the statement of operations would be comparable to entities applying Part I that recognize a similar employee benefits amount in other comprehensive income — outside profit or loss.
 - 15 The AcSB thinks that the amount of remeasurements and other items may include important information for donors and other users of an NFPO's financial statements. Consequently, the AcSB decided to require remeasurements and other items to be presented in the statement of changes in net assets as a separately identified item. This requirement is consistent with the requirement in Section 3462 in Part II to present or disclose the amount of remeasurements and other items for the period.
 - 16 As a result, the June 2013 Exposure Draft proposed recognition of remeasurements and other items directly in net assets, and presentation of that amount as a separately identified item in the statement of changes in net assets.
Recognition in net assets
 - 17 Most respondents agreed with the June 2013 Exposure Draft proposal to recognize remeasurements and other items directly in net assets. However, some respondents suggested splitting remeasurements and other items into two components such that "remeasurements" would be recognized directly in net assets (as proposed), but "other items" (i.e., past service costs, and gains and losses arising from settlements and curtailments) would be recognized in the statement of operations (consistent with the recognition of "remeasurements and other items" in Section 3462 in Part II).
 - 18 These respondents agreed with the June 2013 Exposure Draft proposals with regard to remeasurements. However, they felt that "other items" result directly from decisions of an NFPO's board or management. These items can be significant when incurred, and can have an effect on an NFPO's resources. Accordingly, in their view, these items should be reported within the statement of operations to inform financial statement users of the effects of those decisions and provide useful stewardship information.
 - 19 In addition to the benefits noted by proponents of this alternative, the AcSB acknowledged that reporting remeasurements outside the statement of operations, but not other items, would address the significant concern expressed by NFPO respondents to the January 2012 Exposure Draft. This reporting would also be consistent with IAS 19 *Employee Benefits* (amended in 2011) in the International Financial Reporting Standards (IFRSs) in Part I of the Handbook, which recognizes the effects of remeasuring plan assets and defined benefit obligations in other comprehensive income, while the effects of plan amendments, settlements and curtailments are included in profit or loss. Some stakeholders argue that this consistency would improve the comparability between employee future benefit amounts reported in financial statements of NFPOs prepared using Part III of the Handbook versus Part I. The AcSB understands that very few NFPOs in Canada use IFRSs in preparing their financial statements.
 - 20 However, the AcSB noted that splitting remeasurements and other items into two components and reporting them differently would introduce another degree of complexity for preparers. NFPOs would compute either remeasurements or other items directly in those periods in which both components exist, instead of being able to use the simplification in Section 3462 in Part II. This simplification permits an entity to calculate remeasurements and other items as the residual after deducting current service cost and finance cost from total defined benefit cost.
 - 21 A decision to settle, curtail or amend a plan could be the result of the performance of the plan assets or of changes in the defined benefit obligation due to factors such as changes in discount rates and mortality assumptions. These gains or losses are included in remeasurements. Recording other items in the statement of operations, while excluding remeasurements, could result in a gain from a settlement or curtailment being included in the statement of operations although the remeasurement losses that led to the decision are excluded from that statement. A difference from the presentation requirements of Part II of the Handbook would also affect financial statement users who are familiar with the financial statements for private enterprises.
 - 22 For the above reasons, the AcSB decided not to include other items in income.
 - 23 The AcSB acknowledged that a decision to change this Exposure Draft proposal would create a need to consider whether the change is significant and if so, to re-expose unless it decided to forgo re-exposure for a stated reason(s). The AcSB thought that such a change would be significant because it would fundamentally alter a recognition principle. The AcSB noted that re-exposure would likely extend the timeline to finalize the standard and may lead to a delayed effective date, which would no longer be consistent with the effective date of Section 3462 in Part II.
 - 24 The AcSB noted that Section 3462 in Part II requires an entity to disclose or present the amount of remeasurements and other items in total, and considered whether an NFPO should be required to disclose or present the amount of other items for the period as a separate amount. The AcSB observed that this alternative would require an NFPO to determine

other items separately from remeasurements as outlined in paragraph 20. The AcSB also observed that an NFPO may decide to disclose the amount of other items, even if this disclosure is not required, in order to enable users of the financial statements to understand the effect of those other items (see discussion in paragraph 38 below). Therefore, the AcSB decided not to require separate disclosure of the amount of other items but to leave it to professional judgment.

- 25 As a result of considering, but rejecting, both alternatives for recognition of remeasurements and other items, the AcSB finalized the standard as exposed.

Presentation in statement of changes in net assets

- 26 Respondents agreed with the June 2013 Exposure Draft proposal that remeasurements and other items should be a separately identified item in the statement of changes in net assets. However, one respondent noted that some NFPOs following the Part III standards choose to present employee future benefits in a separate column in the statement of changes in net assets. This respondent suggested that the final standard clearly indicate that the amount of remeasurements and other items is presented as an element in the continuity of net assets from the beginning to the end of the fiscal period in the statement of changes in net assets. This proposed clarification would reduce the likelihood that NFPOs would think that remeasurements and other items should be presented in a column in the statement of changes in net assets. The AcSB agreed with clarifying the presentation requirement to avoid diversity in practice. Accordingly, the AcSB decided to require presentation of remeasurements and other items as a separately identified line item in the statement of changes in net assets to emphasize that it is an element in the continuity of net assets.

- 27 The same respondent also suggested that the final standard state that a separate column for employee future benefits in the statement of changes in net assets is not required. The AcSB does not think that columnar presentation for employee future benefits is common in practice. The AcSB concluded that accounting standards do not normally include statements of what is not required and, thus, rejected including it.

Choice of recognition in statement of operations

- 28 In developing the June 2013 Exposure Draft proposals, the AcSB considered whether to provide NFPOs with an option to present remeasurements and other items in the statement of operations rather than in the statement of changes in net assets. It noted that some NFPOs may prefer to include all pension expense that has not been capitalized in the statement of operations and also may wish to use the same presentation as private enterprises. The AcSB also understood that some NFPOs following Part III of the Handbook have chosen to adopt the immediate recognition approach permitted under former EMPLOYEE FUTURE BENEFITS, Section 3461 in Part II of the Handbook. Thus, these organizations currently recognize all changes in the defined benefit liability (asset) in the statement of operations, including remeasurements and other items.
- 29 The AcSB considered the benefits to financial statement users of comparability and decided not to include an option in the proposals. Thus, the June 2013 Exposure Draft proposed a requirement to recognize remeasurements and other items directly in net assets in the statement of financial position rather than in the statement of operations. This proposal did not allow an accounting policy choice to recognize remeasurements and other items in the statement of operations. However, this Exposure Draft sought respondents' views on this point.
- 30 Respondents generally agreed with this June 2013 Exposure Draft proposal. However, one respondent felt that there should be an accounting policy choice in this regard. The respondent noted that some NFPOs operate in sectors in which comparable entities are for-profit enterprises using accounting standards for private enterprises in Part II of the Handbook. Some other private sector NFPOs operate in sectors in which public sector NFPOs also operate and apply public sector accounting standards, which prohibit the accounting of remeasurements directly in net assets. The respondent explained that NFPOs should be permitted an accounting policy choice to allow them to apply the standard consistently with those entities that apply the Part II standards or the public sector accounting standards, potentially making their financial statement more comparable and useful to financial statement users.
- 31 Other respondents agreed with the AcSB on the importance of comparability and consistency among private sector NFPOs that would result from a single approach. The AcSB also thought that financial statement users would not generally compare financial statements of NFPOs and private enterprises, especially since private enterprise financial statements are not publicly available. The AcSB observed that if those circumstances arise, a financial statement user would have the information to adjust the financial statements to a consistent basis with respect to remeasurements and other items.
- 32 The AcSB observed that differences already exist between the accounting standards for the private and public sectors, including employee future benefits. The public sector standards for employee future benefits require deferral and amortization of actuarial gains and losses in most situations. Thus, the AcSB thinks that comparability between NFPOs applying the Part III standards and entities applying the public sector accounting standards in general, and specifically in accounting for remeasurements and other items, cannot be achieved. Accordingly, the AcSB finalized the standard as exposed.

Reclassification in a subsequent period

- 33 As a result of the AcSB's decision to propose a requirement for NFPOs to recognize the amount of remeasurements and other items directly in net assets, the AcSB considered whether reclassification or "recycling" of that amount from net assets to the statement of operations in a subsequent period should be permitted or prohibited. The proposals prohibited such reclassification, consistent with IAS 19 *Employee Benefits* (amended in 2011) in Part I of the Handbook that does

not permit reclassification of a similar amount from other comprehensive income to profit or loss in subsequent period. The AcSB agreed with the International Accounting Standards Board's (IASB) conclusion in paragraph BC99 of its Basis for Conclusions on IAS 19 that it is difficult to identify a suitable basis to determine the timing and amount of such reclassifications. Also, the AcSB had been unable to identify any method for recycling that would not be arbitrary and lacking in information content.

- 34 Respondents agreed with this June 2013 Exposure Draft proposal. Accordingly, the AcSB finalized the standard as exposed.

DISCLOSURE

- 35 The AcSB considered whether the June 2013 Exposure Draft should propose requirements for disclosures in addition to those required by Section 3462 in Part II. For all other Part II standards applied by NFPOs following the Part III standards, an NFPO is required to make the disclosures required in the Part II standard and is not required to make any additional disclosures.
- 36 The AcSB considered the needs of users of NFPO financial statements, but in the specific circumstances has been unable to identify any unique aspects of NFPOs that would support required disclosures about employee future benefits in addition to those in Section 3462 in Part II. The June 2013 Exposure Draft requested feedback from respondents on whether additional disclosures should be included in proposed Section 3463 in Part III.
- 37 All respondents agreed with the June 2013 Exposure Draft proposal not to require additional disclosures to those required by Section 3462 in Part II. Some respondents explained that the minimum level set by that Section should be adequate for the users of NFPOs.
- 38 Accordingly, the AcSB finalized the standard as exposed. In so doing, the AcSB reiterated that an NFPO may choose to provide additional disclosures to those required by the minimum level set by the standards in Part II of the Handbook. GENERAL STANDARDS OF FINANCIAL STATEMENT PRESENTATION FOR NOT FOR PROFIT ORGANIZATIONS, Section 1401 in Part III of the Handbook, states that a fair presentation in accordance with generally accepted accounting principles is achieved by financial statements providing sufficient information about transactions or events having an effect on the financial statements as is necessary to understand that effect. In considering whether to provide disclosures in addition to those required by Section 3462 in Part II, an NFPO should exercise professional judgment. The organization may consider the disclosure requirements for employee future benefits required prior to the adoption of Part III (i.e., those in EMPLOYEE FUTURE BENEFITS, Section 3461 in the pre changeover standards in Part V of the Handbook).

EFFECTIVE DATE

- 39 The June 2013 Exposure Draft proposed that the final standard would be effective for fiscal years beginning on or after January 1, 2014 — consistent with Section 3462 in Part II. This timing ensured that NFPOs would not have to recognize and present remeasurements and other items in the statement of operations as would otherwise be required by Section 3462 in Part II.
- 40 Respondents agreed with this June 2013 Exposure Draft proposal due to the importance of aligning with the effective date of Section 3462 in Part II. One respondent agreed, provided that the AcSB finalized Section 3463 in Part III on a timely basis. The final standard was issued in December 2013.

TRANSITION

- 41 ACCOUNTING CHANGES, Section 1506 in Part II of the Handbook, generally requires retrospective application of new accounting policies.
- 42 The AcSB recognized that transition to a new or amended standard can result in one-time costs to financial statement preparers and users. It noted that eliminating the option to defer and amortize actuarial gains and losses does not require preparers to obtain new or different data. It also noted that the liability in the statement of financial position will be the liability that users currently calculate and preparers currently disclose in a note to the financial statements. The AcSB concluded that eliminating this option would not create significant transition issues.
- 43 The AcSB proposed that the June 2013 Exposure Draft proposals would be applied retrospectively in a similar manner to Section 3462 in Part II and include similar transitional relief as follows:
- (a) Defined benefit plan costs may have been capitalized in previous periods as part of an asset. Restating the carrying amount of assets for the change in accounting would not meet a cost-benefit test and the transitional proposals permitted entities to avoid such restatement.
 - (b) The proposals also provided a simplified transition method for those entities that are required to change the measurement date for plan assets and plan obligations so as to avoid the need for an additional valuation. However, as a result of the different recognition and presentation requirements of remeasurements and other items compared to Section 3462 in Part II, the proposals provided additional guidance necessary for application of the simplified transition approach for a change in the measurement date.
- 44 Respondents agreed with these proposals. Accordingly, the AcSB finalized the transitional provisions as exposed, with some minor editorial changes.

CONSEQUENTIAL AMENDMENTS

- 45 The June 2013 Exposure Draft proposed consequential amendments to FIRST TIME ADOPTION BY NOT-FOR-PROFIT ORGANIZATIONS, Section 1501 in Part III of the Handbook, that are consistent with the amendments made to FIRST TIME ADOPTION, Section 1500 in Part II of the Handbook, as a consequence of issuing Section 3462 in Part II.
- 46 The consequential amendments to Section 1501 would permit a first-time adopter to apply the transitional provisions in proposed Section 3463 in Part III. For example, an NFPO that applies Part III of the Handbook for the first time may wish to avail itself of the relief from retrospective application for benefit costs capitalized as part of the cost of assets in prior years. These consequential amendments also provide specific proposals for simplifying transition for a change in the measurement date for plan assets and the defined benefit obligation. Requiring retrospective application of proposed Section 3463 in Part III by first-time adopters would entail the same difficulties that led the AcSB to include the transitional relief in that Section, as explained above under "Transition."
- 47 Furthermore, these consequential amendments would eliminate some exemptions for employee future benefits relating to deferred recognition that are no longer necessary.
- 48 Respondents to the June 2013 Exposure Draft agreed with the proposed consequential amendment to Section 1501. Accordingly, the AcSB finalized this consequential amendment as exposed except for minor editorial changes.
- 49 During its redeliberations following the exposure period, the AcSB decided to add FINANCIAL STATEMENT PRESENTATION BY NOT-FOR-PROFIT ORGANIZATIONS paragraph 4400.43A in Part III of the Handbook to provide a cross-reference to the requirement to present the amount of remeasurements and other items as a separately identified line item in the statement of changes in net assets in Section 3463 in Part III. This consequential amendment is similar to the consequential amendment made to INCOME STATEMENT, Section 1520 in Part II of the Handbook, that resulted from the issuance of Section 3462 in Part II. The AcSB also added effective date and transition paragraphs to Section 4400 as a result of this change.
- DUE PROCESS**
- 50 As part of the AcSB's due process, the AcSB considered whether the change outlined in paragraph 26 for the presentation of remeasurements and other items should be exposed for comment. The AcSB noted that this change clarifies guidance and no fundamental principles have been modified. Accordingly, the AcSB concluded that this change does not represent a significant change to the proposals and, thus, re-exposure is not required.
- 51 The AcSB also confirmed that it has adhered to its due process procedures in all aspects of developing the new Handbook material.
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Footnotes

1. Remeasurements and other items for the period comprise the aggregate of:
- (a) the difference between the actual return on plan assets and the return calculated using the discount rate used to measure the defined benefit obligation;
 - (b) actuarial gains and losses;
 - (c) the effect of any valuation allowance in the case of a net defined benefit asset;
 - (d) past service costs; and
 - (e) gains and losses arising from settlements and curtailments.
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