

Do international accounting standards  
guarantee a more secure governance  
of occupational pension schemes?

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Accounting for  
occupational  
pensions

Does it help secure  
pension schemes  
governance?

Does it provide a true  
and fair view of the  
pension scheme?

Accounting for occupational pensions

Does it help secure pension schemes governance?

Does it provide a true and fair view of the pension scheme?

What are accounting standards ?

Legal approach

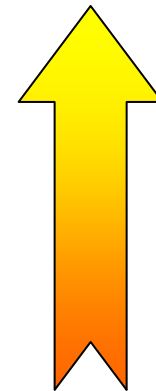
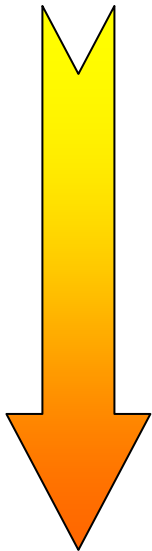
3 aspects in Accounting

Standardization

Accountability

Bookkeeping

Financial statements



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What are accounting standards ?

European accounting standardization process

### European Communities

1970's: 4th Directive (July 25th 1978)

1980's: 7th Directive (June 13th 1983)

1990's:

EC new strategy: working with the IASC

2000's:

Adoption of IAS IFRS

### IASC/B

1970's: IASC creation (June 29th 1973)

1980's: Conceptual framework (1989)

1990's:

IASC stands as the only capable international standard-setter

2000's:

IASC: actual international setter

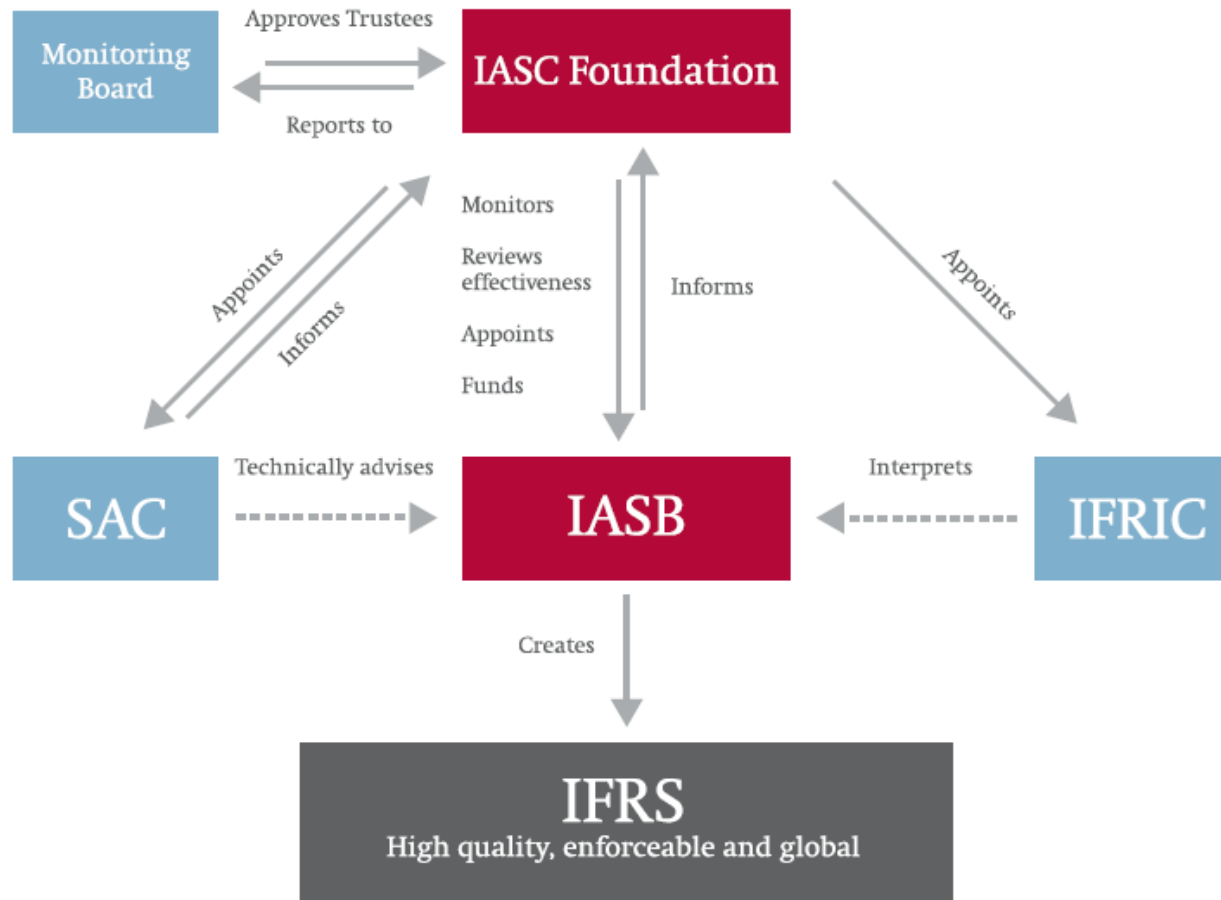
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Does it provide a true and fair view of the pension scheme?

What are accounting standards ?

European accounting standardization process — IASB's structure





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**IAS 19 — Defined benefit plans / Defined contribution plans**

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What are accounting standards ?  
European accounting standardization process

IAS 19 — Defined benefit plans / **Defined contribution plans**

Recognition as an **expense** (P&L)

Occasional recognition as a **liability** (Balance sheet)



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IAS 19 — **Defined benefit plans** / Defined contribution plans

A complex method

using actuarial techniques to make a **reliable estimate of the amount of benefit that employees have earned** in return for their service in the current and prior periods

Discounting that benefit using the Projected Unit Credit Method in order to determine the **present value of the defined benefit obligation** and the **current service cost**

Employees' careers

The obligation to pay a certain amount for retirement pensions

give rise to...

One working period

The obligation to pay:  
Total estimated amount, divided by the number of periods taken into consideration

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Determining the **fair value of any plan assets**

Fair value is defined as the amount for which an asset could be exchanged or a liability settled between knowledgeable, willing parties in an arm's length transaction.

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Determining the **fair value of any plan assets**

Determining the total amount of **actuarial gains and losses** and the amount of those actuarial gains and losses to be recognized

Increases or decreases in the present value of the defined benefit obligation  
Increases or decreases in the fair value of plan assets

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Where a plan has been introduced or changed, determining the resulting past service cost

Where a plan has been curtailed or settled, determining the resulting gain or loss

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IAS 19 — **Defined benefit plans** / Defined contribution plans

Recognition both as

**a substantial liability** (Balance sheet)

- Present value of the defined benefit obligation
- Plus any actuarial gains (less any actuarial losses) not recognized
- Minus any past service cost not yet recognized
- Minus the fair value of plan assets

**an expense** (P&L)

- Current service cost
- Interest cost
- Expected return on Plan assets
- Actuarial gains and losses
- Past service cost
- Effects of curtailments / settlements

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Limits of the accounting technique

Recognizing a provision does not mean  
funding the scheme

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— Limits of the accounting technique

— Plan assets taken into consideration

— Social pressure / technical difficulties

...Applying IAS 19 to major French publicly owned companies would have resulted in recognizing a liability of:

90 billion € for Gaz and Electricity companies

21 billion € for the public transports of Paris

111 billion € for the national railroad company

70 billion € for Postal services

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About the Postal services:

*“The explosion of pension costs was incompatible with the application of new accounting standards [...]. The 2006 reform tends to narrow the level of pension costs to the level of its competitors and to avoid recognizing a full provision for defined benefit obligations.”*

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It is not sure it helps secure defined  
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**Incentive to convert defined benefit  
plans into defined contribution plans**

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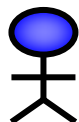
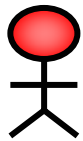
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Incentive to convert defined benefit plans into defined contribution plans

Risk transfer / Risk manageability

Under defined benefit plans

Pension requirements are measurable (liability as a provision)



Limited benefit obligation

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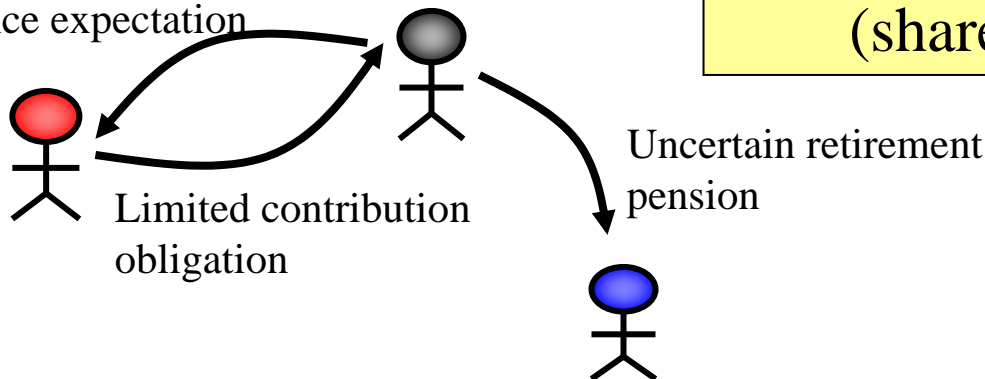
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Risk transfer / Risk manageability

**Under defined contribution plans**

Pension requirements are no longer measurable  
(shareholders expectations)

**Diffused & Unlimited**  
performance expectation



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- It is not sure it helps secure defined benefit plans
- Incentive to convert defined benefit plans into defined contribution plans
- Risk transfer / Risk manageability

What is the purpose in accounting for occupational pensions?

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Recognizing a provision for the amount of expenditure the employer expects from his pension commitments means that we fully consider these commitments as liabilities

Accounting standards define a liability as:

« a present obligation of the entreprise arising from past events, the settlement of which is expected to result in an outflow from the entreprise of resources embodying economic benefits »

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- 1) A present obligation
- 2) With no future counterpart

Accounting for occupational pensions

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1) A present obligation ?

Accounting standards require an obligation...  
But they recognize two kinds of obligation:

Legal obligation

A legal obligation is an obligation that derives from:

- a contract (through its explicit or implicit terms);
- legislation; or
- other operation of law

Constructive obligation

A constructive obligation is an obligation that derives from an entity's actions where:

- by an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; and
- as a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities

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« Obligations may be legally enforceable [...]. This is normally the case. Obligations also arise, however, from normal business practice, custom and a desire to maintain good business relations or act in an equitable manner. »

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During the employees' working life, defined benefit obligations are recognized as constructive obligations:

Employee service gives rise to an obligation under a defined benefit plan even if the benefits are conditional on future employment (in other words they are not vested). Employee service before the vesting date gives rise to a constructive obligation because, at the end of each successive reporting period, the amount of future service that an employee will have to render before becoming entitled to the benefit is reduced.

The probability that the specified event will occur affects the measurement of the obligation, but does not determine whether the obligation exists.

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« The formal terms of a defined benefit plan may permit an entity to terminate its obligation under the plan. Nevertheless, it is usually difficult for an entity to cancel a plan if employees are to be retained. Therefore, in the absence of evidence to the contrary, accounting for post-employment benefits assumes that an entity which is currently promising such benefits will continue to do so over the remaining working lives of the employees. »

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**Constructive obligation**

During the employees' working life, defined benefit obligations are recognized as constructive obligations:

**The employer does have a realistic way to avoid paying... He just has to curtail, or to cancel the pension scheme.**

**It is not that difficult to curtail, convert or cancel a pension plan**

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~~1) A present obligation ?~~

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~~1) A present obligation ?~~

2) With no future counterpart ? \_\_\_\_\_

What does future expenditure of resources correspond to?

~~the settlement of the obligation, independently from any future counterpart?~~

the assumption that the employee will pursue his career in the entreprise until retirement date?

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A contingent liability?

« A contingent liability is:

- a) a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or
- b) a present obligation that arises from past events but is not recognized because:
  - i) It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or
  - ii) The amount of the obligation cannot be measured with sufficient reliability. »

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A contingent liability?

« A entity shall not recognize a contingent liability. »

...disclosure in the notes

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## Conclusion

An inadequate exposition to market pressure

Provisionned benefit = vested benefit ?