CHARTERED PROFESSIONAL ACCOUNTANTS CANADA

Financial Reporting Alert

ACCOUNTING STANDARDS FOR PRIVATE ENTERPRISES (ASPE)

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Amendments to Section 3462, *Employee Future Benefits*

In November 2020, the Accounting Standards Board (AcSB) issued amendments to Section 3462, *Employee Future Benefits*, in Part II of the *CPA Canada Handbook — Accounting (Handbook)*.

This CPA Canada Financial Reporting Alert (*Alert*) highlights key changes resulting from the amendments and considers some possible assurance implications.

What are the main objectives of the amendments?

There was evidence of diversity in practice in the application of Section 3462 regarding the use of an actuarial valuation for funding purposes (funding valuation) in the measurement of a defined benefit obligation (DBO). This diversity relates to how the requirements of Section 3462 interact with recent changes to pension legislation, including changes in Ontario and Quebec. For example:

- The amended Ontario regulations govern the establishment and funding of a new reserve in the going concern valuation for a pension plan called the Provision for Adverse Deviation (PfAD).
- The pension regulations in Quebec introduced a Stabilization Provision (SP) requiring this provision to be funded for private sector defined benefit pension plans on a going concern basis.

The amendments seek to eliminate the diversity in practice regarding the measurement of a DBO by clarifying the measurement of a DBO for plans in which there is a legislative, regulatory or contractual requirement to prepare a funding valuation.

The amendments also remove the accommodation to allow the use of a funding valuation for defined benefit plans without a funding valuation requirement.

Who applies the amendments?

The principal users of the amendments will be private enterprises applying Part II of the *Handbook*.

The amendments also apply to non-government-controlled not-for-profit organizations (NFPOs) applying Part III (Accounting Standards for Not-for-Profit Organizations) of the *Handbook*.[1]

In addition, the amendments also apply to pension plans applying Section 4600, *Pension Plans*, in Part IV (Accounting Standards for Pension Plans) of the *Handbook*.

When are the amendments effective?

The amendments are effective for annual financial statements relating to fiscal years beginning on or after January 1, 2022. Earlier application is permitted, but only if applied to all of an enterprise's defined benefit plans.

The AcSB encourages stakeholders to consider early adoption of the amendments. For enterprises updating or completing a funding valuation of a DBO before the effective date, it may be more efficient to adopt the amendments early to ensure the actuarial valuation is updated accordingly (see "What are the key changes?" section below for details).

REMINDER

The amendments only apply to those enterprises using a funding valuation to measure a DBO. Enterprises using an accounting valuation to measure a DBO will not apply the amendments.

What are the key changes?

Accommodation to Use a Funding Valuation

Prior to the amendments, Section 3462 permitted an accounting policy choice to measure the DBO of defined benefit plans without a funding valuation requirement using an accounting valuation or a funding valuation when certain conditions were met. For defined benefit plans with **no legislative, regulatory or contractual requirement to prepare a funding valuation**, the amendments remove the accommodation to allow for the use of a funding valuation. In other words, the accounting policy option to measure a DBO using a funding valuation can now only be used by a defined benefit plan with a legislative, regulatory or contractual requirement to prepare a funding valuation. This remains an accounting policy choice and such plans may also measure the DBO using an accounting valuation.

The AcSB was concerned about the ability to include all legislative, regulatory and contractual components in a defined benefit plan that does not require a funding valuation, the complexity associated with applying the accommodation and that it would create further diversity in practice. For this reason, the previous accommodation to use a funding valuation was removed for defined benefit plans with no legislative, regulatory or contractual requirement to prepare one.

1 A NFPO refers to Section 3463, *Reporting Employee Future Benefits by Not-for-Profit Organizations*, when accounting for employee future benefits. However, paragraph 3463.01 directs a NFPO to Section 3462 for guidance on employee future benefits, unless otherwise provided for in Section 3463. Therefore, NFPOs with defined benefit plans are required to follow these amendments.

For defined benefit plans **with a legislative, regulatory or contractual requirement to prepare a funding valuation**, the amendments clarify that an accounting policy choice to measure the DBO using a funding valuation or accounting valuation remains. However, the Background Information and Basis for Conclusions states that an accounting valuation remains the best estimate in measuring a DBO for financial statement purposes.

Appendix I of this *Alert* includes a decision tree illustrating the assessment an enterprise makes to determine when it is eligible to apply an accounting policy choice to measure its DBO.

Appendix II of this *Alert* includes additional information on accounting valuations and funding valuations.

Amount Required to be Funded by Contributions

The amendments clarify that when legislative, regulatory or contractual requirements stipulate calculations of various components of the funding requirement separately, the aggregate of those components makes up the funding valuation that would be reflected in the financial statements.

For example, the Ontario pension regulator's PfAD and the Quebec pension regulator's SP are components of an Ontario and a Quebec funding valuation, respectively, and accordingly, would be included in the measurement of the respective DBO.

KEY CONCEPT

Defined benefit plans with no legislative, regulatory or contractual requirement to prepare a funding valuation must measure the DBO using an accounting valuation. Defined benefit plans with a legislative, regulatory or contractual requirement to prepare a funding valuation can measure the DBO using either a funding valuation or accounting valuation.

What are the transitional provisions?

The amendments include transitional relief, such that an enterprise is not required to:

- Obtain a new funding valuation on transition, and can wait until one is required; or
- Retroactively restate its financial statements for the effects of the amendments. The cumulative effects of applying the amendments are recorded in opening retained earnings at the date the amendments are first applied.

KEY CONCEPT

The measurement of a DBO in the financial statements using a funding valuation reflects the aggregate of the components of the funding valuation since such components are required to be funded by contributions to the plan.

For those enterprises affected by the amendments, early consultation with their actuaries is encouraged in order to determine the impacts of the amendments on the financial statements (i.e., preparing an accounting valuation for a defined benefit plan without a funding valuation requirement or including PfAD in the measurement of a DBO for a defined benefit plan with a funding valuation requirement) and ensure compliance for fiscal years beginning on or after January 1, 2022.

The Background Information and Basis for Conclusions includes two examples which illustrate how the transitional provisions would be applied:

1. When an enterprise **has a completed** funding valuation determined in accordance with all legislative, regulatory or contractual requirements in effect at the date that the amendments would be first applied.
2. When an enterprise **does not have** a completed funding valuation determined in accordance with all legislative, regulatory or contractual requirements in effect at the date the amendments would be first applied.

Consequential Amendments

Significant consequential amendments to the *Handbook* are as follows:

- Section 1506, *Accounting Changes* – As a result of the removal of the accommodation to allow for the use of a funding valuation for defined benefit plans without a funding valuation requirement, Section 1506 is amended so that it only applies to defined benefit plans with a funding valuation requirement.
- Section 3463, *Reporting Employee Future Benefits By Not-For-Profit Organizations* – Section 3463 provides transition guidance to a NFPO that applies Section 3463 for the first time. The guidance is amended to indicate that the transitional guidance also applies on first-time adoption of Section 3463.

What are the possible assurance implications?

Application of the amendments may result in significant changes in the measurement, presentation and disclosure requirements of the DBO for some enterprises. This may require the practitioner to consider:

Risk Assessment and Audit Planning

- The need to update documentation of the practitioner's understanding of the enterprise, including an understanding of relevant internal controls related to employee future benefits and any changes resulting from the amendments.
- The need to update documentation of the enterprise's selection and application of accounting policies when the enterprise has changed from using a funding valuation to an accounting valuation for plans without a legislative, regulatory or contractual requirement to prepare a funding valuation.
- The risks of material misstatement arising from application of the amendments.

Engagement Execution and Evidence Collection

- The need to design and perform procedures to respond to the assessed risks of material misstatement, including those related to measurement, presentation and disclosure requirements of the DBO, if changes are expected as a result of the amendments.
- The need for management to provide evidence explaining how it has addressed any changes to the valuation of the DBO to reflect the amendments.
- The practitioner's requirements when using information prepared using the work of management's expert as evidence, if management employs an actuary in making the estimates required to reflect the amendments.

Auditor Reporting

- The reporting implications from the amendments, including consideration of any restatements, and additional reporting responsibilities with respect to comparative information.

What resources are available to help me?

- Employee Future Benefits – Background Information and Basis for Conclusions
- Domestic Accounting Standards Update Webinar (November 2020)

Comments

Comments on this *Alert* or suggestions for future Alerts should be sent to:

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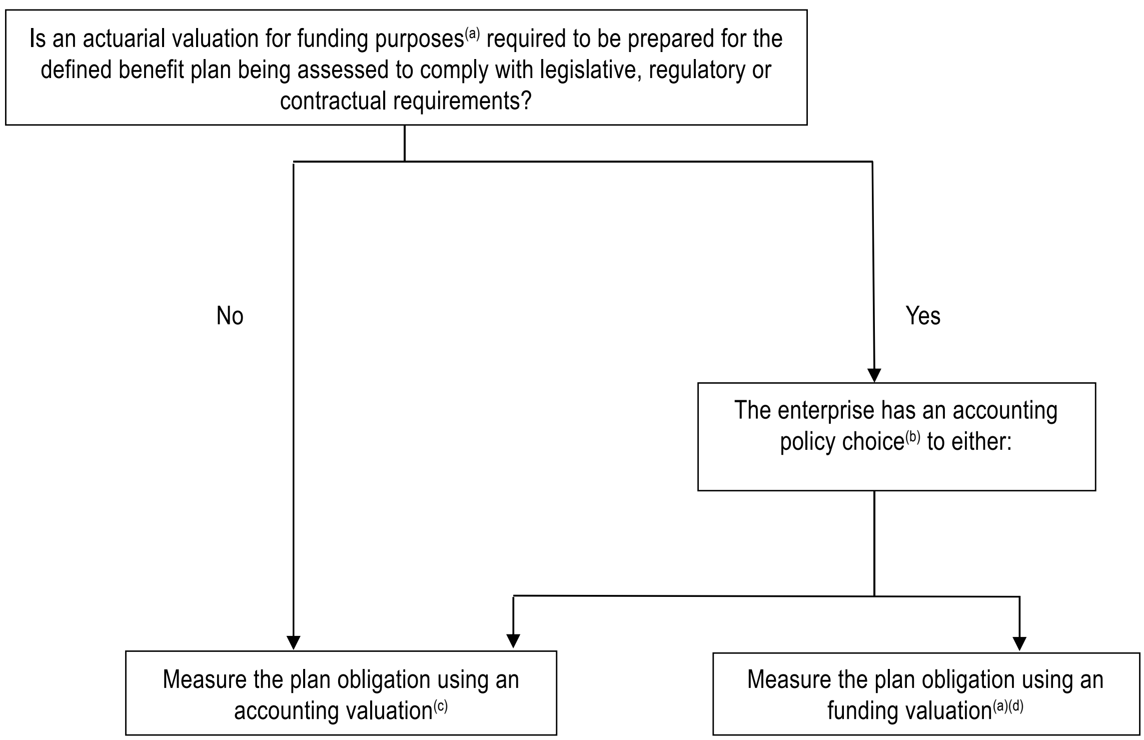
Appendix I: Decision Tree — Determining Eligibility for Using a Funding Valuation to Measure the DBO for a Defined Benefit Plan

The following decision tree illustrates the assessment an enterprise makes to determine when it is eligible to apply an accounting policy choice to measure the DBO for a defined benefit plan using a funding valuation:[2]



(a) Excludes funding valuations prepared using a solvency, wind-up or similar valuation basis.

(b) The same accounting policy choice must be applied to each defined benefit plan for which a funding valuation is required to be prepared to comply with legislative, regulatory or contractual requirements.

(c) Determined in accordance with paragraphs 3462.035-.061

(d) Determined in accordance with paragraphs 3462.029(b), 3462.029AC and 3462.029D.

2 Source: *Section 3462, Employee Future Benefits*

Appendix II: Background Information on Accounting and Funding Valuations

Accounting and funding valuations have different objectives and may use different actuarial assumptions. The following table summarizes some key points:

Accounting Valuation	Funding Valuation
Accounting valuations may use different actuarial assumptions from funding valuations. Accounting valuations are **prepared in accordance with generally accepted accounting principles** using management's best estimates and the discount rate required by Section 3462. The discount rate used to determine the DBO shall be an interest rate determined at the date of the actuarial valuation by reference to: (a) market interest rates on high-quality debt instruments with cash flows that match the timing and amount of expected benefit payments; or (b) the interest rate inherent in the amount at which the defined benefit obligation could be settled. An accounting valuation is considered the best estimate for accounting purposes.	Funding valuations are prepared in accordance with legislative, regulatory or contractual requirements, generally to determine **required contributions** to the plan. A funding valuation is permitted as a policy choice as an accommodation. Under the amendments, this policy choice is only available for those plans that have a legislative, regulatory or contractual funding valuation requirement.

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