CHARTERED PROFESSIONAL ACCOUNTANTS CANADA

Financial Reporting Alert: *Pension Plans*

2022 AMENDMENTS TO *PENSION PLANS*, SECTION 4600 IN PART IV OF THE *CPA CANADA HANDBOOK*

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Accounting Standards Applicable for Pension Plans

In December 2022, the Accounting Standards Board (AcSB or the Board) issued amendments to *Pension Plans*, Section 4600 in Part IV of the *CPA Canada Handbook – Accounting*.

This CPA Canada *Financial Reporting Alert* highlights the background for this project, the amendments made and the effective date of the amendments.

What Is the background for the amendments?

The AcSB developed Section 4600 in 2010 during the changeover to IFRS, for publicly accountable enterprises, recognizing the need for an independent set of standards for pension plans in Canada.

In 2018 and 2019, the AcSB consulted with pension plan stakeholders from across Canada to understand whether the standard continues to meet their needs. These consultations were performed with preparers, practitioners, users and actuaries who specialize in pension plan financial reporting. The Board learned from these consultations that while the standard generally continues to meet stakeholders' needs, several areas required clarity or new guidance to address emerging diversity in practice. The Board formed the Pension Plan Working Group (PPWG or the Working Group) to advise the Board on the current gaps in the standard and to enhance the relevance of pension plan financial statements.

Based on feedback from the Working Group, the AcSB proposed to amend Section 4600 to address some issues identified in the standard and reduce diversity in practice by providing clear guidance on areas of concern identified by stakeholders. The AcSB issued the Exposure Draft, *Pension Plans*,

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in March 2022. Following its due process, the AcSB analyzed and considered feedback received on the exposure draft through written responses, roundtable events and specific stakeholder consultations in forming the final amendments to Section 4600. The AcSB received ongoing input from the Working Group throughout this process.

What are the key changes to Section 4600?

The amendments to Section 4600 are as follows:

- clarify that a statement of changes in pension obligations is not required for defined contribution pension plans
- provide guidance on determining the split or amalgamation date for pension plans
- provide recognition, measurement and disclosure guidance on the accounting for guaranteed annuity contracts (commonly referred to as “buy-in” or “buy-out” annuity contracts)
- clarify the presentation requirements for combination plans
- enhance risk disclosure required for interests in master trusts

Statement of changes in pension obligations

The amendments clarify that a statement of changes in pension obligations is not applicable to defined contribution pension plans.

Splits and amalgamations

Section 4600 did not include guidance for determining the effective date of pension plan splits or amalgamations. This has led to diversity in practice as to when the effect of a split or amalgamation should be reflected in pension plan financial statements. For example, some pension plans accounted for the effects of an amalgamation or a split when the boards of the pension plans approved the amalgamation or the split. Other pension plans accounted for the effects after the boards of the pension plans approved the transfer of assets or waited for regulatory approval of the amalgamation or the split.

The amendments define the amalgamation date as the date on which a pension plan obtains the right to some or all of the assets and becomes liable for some or all of the obligations of the pension plan(s) with which it is amalgamating. Similarly, the split date is when a pension plan loses the right to some or all of the assets and is no longer liable for some or all of the obligations of the pension plan subject to the split.

The AcSB concluded that since the pension plan cannot transfer assets or liabilities until regulatory approval is received, a pension plan does not have the right to the assets and the obligation for the liabilities until regulatory approval is received. Therefore, a pension plan should not recognize the effects of a split or an amalgamation prior to receiving regulatory approval for the transfer.

The amendments clarify that a pension plan obtains the right to some or all of the assets and becomes liable for some or all of the obligations of one or more pension plans with which it is amalgamating, at the later of the following:

a. when the pension plan amalgamation is effective per the legal contract underlying the transaction
b. when the amalgamation is approved by the regulatory authority of the jurisdiction in which the pension plan is registered
c. when the pension plan with which it is amalgamating transfers its assets and liabilities to the plan

A pension plan loses the right to the assets and is no longer liable for the obligations of the pension plan that are subject to a split, at the later of the following:

a. when the pension plan split is effective per the legal contract underlying the transaction
b. when the split is approved by the regulatory authority of the jurisdiction in which the pension plan is registered
c. when the pension plan transfers the assets and liabilities out of the plan

The amendments additionally require that if at least one of the three criteria to recognize the effects of a split or an amalgamation are met at the date of the financial statement completion, the pension plan should disclose information about the potential split or amalgamation in its financial statements.

Accounting for guaranteed annuity contracts (Buy-in)

A pension plan may purchase an annuity contract from a third party, commonly referred to as a buy-in annuity contract, in which the timing and amount of cash flows match the timing and amount of cash flows for some or all of the benefit obligation.

A buy-in is an annuity contract under which the issuer of the annuity agrees to meet the benefit payments for a covered group of participants and beneficiaries for the duration of their lives. Before the amendments, the investment was measured at fair value at the date of the statement of financial position, while the pension obligation of a defined benefit pension plan was measured at the actuarial present value of accrued pension benefits determined by applying best estimate assumptions and the projected benefit method prorated on services. The resulting difference implied that a pension plan was either over- or underfunded.

The Working Group advised the AcSB that the substance of a buy-in contract is to offset the pension obligation dollar for dollar and that the financial statements should reflect this arrangement. Under the amendments, a pension plan shall measure the annuity contract at a value equal to the related benefit obligation, adjusted for amounts receivable under the annuity contract that are not collectible. Therefore, the revised standard requires financial statement preparers to consider the credit risk of the issuer of the annuity. This requires considering whether the investment asset should be discounted for credit risk. Any gain or loss arising from the purchase of the annuity contract shall be recognized in the statement of changes in net assets available for benefits in the year the annuity contract is purchased.

The amendments also require additional disclosures specific to buy-in contracts to provide more information to users about the nature and purpose of these investments by a pension plan.

Accounting for guaranteed annuity contracts (Buy-out)

A pension plan may purchase an annuity contract from a regulated financial institution (e.g., an insurance company), commonly referred to as a buy-out annuity contract, in which the regulated financial institution assumes some or all of the pension obligations of the pension plan.

Buy-out annuity contracts are annuity contracts that transfer the risks of a pension obligation from a pension plan to the issuer of the annuity contract. Before the amendments, the standard lacked guidance as to when the asset and pension obligation associated with the buy-out annuity contract should be derecognized from the financial statements. As a result, some pension plans retained the asset and pension obligation on their financial statements, while other pension plans did not.

Under the amendments, the following may apply:

- A pension plan shall derecognize the asset and related pension obligation when the risks of the pension obligation are transferred to the regulated financial institution. A pension plan transfers the risks of the pension obligation to a regulated financial institution in the following cases:
    a. when the pension obligation is discharged from the pension plan to the regulated financial institution by process of law; or
    b. when all of the following criteria are met:
        i. the buy-out contract is effective per the legal contract underlying the arrangement
        ii. the pension plan remits the premium to the regulated financial institution in accordance with the buy-out contract
        iii. the regulatory criteria to discharge the pension obligation from the pension plan to the regulated financial institution are met

    For the purposes of this guidance, the premium excludes any premium adjustments described below.
- After a buy-out annuity contract is effective, subsequent adjustments may be made to the premium previously remitted to the regulated financial institution in accordance with the contract. These are commonly referred to as premium adjustments. A pension plan shall recognize any premium adjustments in the statement of changes in net assets available for benefits if the premium adjustments are directly related to terms established when the annuity contract is entered into.

The amendments require specific disclosures about the amount of derecognized pension obligations in the period they are derecognized. For that period and for each subsequent period the pension plan retains the annuity, the pension plan shall disclose the following:

a. the nature of the contract

b. the period in which the pension obligations were derecognized

c. information on regulatory processes, if any, that exist to discharge pension obligations in the jurisdiction(s) applicable to the buy-out arrangement, along with the pension plan's status of obtaining a discharge in those jurisdictions

d. the circumstances, if any, that may cause the derecognized pension obligations to return to the pension plan (for example, default by the regulated financial institution or circumstances based on the terms of the annuity contract, the nature of applicable regulatory discharge processes or other protections in place)

Presentation of combination pension plans

Combination pension plans include two component types: (1) a defined benefit component and (2) a defined contribution component. The absence of guidance on the presentation of these plans resulted in the following: Some combination plans presented the defined benefit component and the defined contribution component separately, while others combined them.

The new guidance requires the defined benefit component and the defined contribution component to be presented separately on the statement of financial position, on the statement of changes in net assets available for benefits and in the notes to the financial statements. Combination plans are not required to present a statement of changes in pension obligations for the defined contribution component.

Illustrative examples are included to demonstrate alternatives for this presentation. These examples are not exhaustive, and stakeholders are encouraged to tailor their pension plan financial statements to meet their users' information needs.

Risk disclosures for interests in master trusts

Master trusts are a vehicle for multiple pension plans to pool their investments and reduce administration costs. Each plan has an interest in the assets held in the trust, and ownership is represented by the dollar interest or by units of participation.

Before the amendments, pension plans typically reported only the fair value of their investment units in a master trust, which provided limited information in the financial statements. Users needed to look elsewhere for information about the investment composition and risk profile of the master trust.

The amendments require that a pension plan with investment assets including interests in a master trust disclose the following:

a. the types of investment assets and liabilities and fair value hierarchy of the types of investment assets and liabilities held by a master trust

b. the plan's position in the master trust, such as the number of units over the total units held in the master trust or the percentage holding of the total or the plan's position in each type of investment asset and liability held by a master trust, when the plan's position is not proportionate to the plan's total position in the master trust

When are the amendments effective?

The amendments apply for annual periods beginning or after January 1, 2024, with early application permitted. A pension plan applies these amendments at the beginning of the earliest period presented.

What are the transitional provisions?

Considering the nature of each new guidance, the initial application can be different.

- The amendments related to the statement of changes in pension obligations, presentation of combination pension plans and disclosure of interests in a master trust apply as at the beginning of the earliest period presented. As such, the effects of the amendments would apply to the period in which the amendments are first applied and to the comparative period(s) presented. This approach improves comparability of financial information from period to period.
- The amendments for buy-in annuities should apply consistently in the current and comparative period(s). Similarly, buy-out annuities and the related pension obligations that existed in the comparative period(s) should be derecognized consistently across annual periods in the financial statements.
- Splits-and-amalgamations amendments apply prospectively to transactions in the period the amendments are first applied. Splits and amalgamations already accounted for in a previous period should not be restated, as the transaction has already been communicated to users of the financial statements.

What resources are available to help me?

Accounting Standards Board

- Basis for Conclusions, Amendments to Section 4600
- Accounting Standards for Pension Plans project page (FRAS Canada)

Comments

Comments on this Financial Reporting Alert, or suggestions for future Financial Reporting Alerts should be sent to:

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