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**International
Accounting Standards
Board**

This document is provided as a convenience to observers at IASB meetings, to assist them in following the Board's discussion. It does not represent an official position of the IASB. Board positions are set out in Standards.

These notes are based on the staff papers prepared for the IASB. Paragraph numbers correspond to paragraph numbers used in the IASB papers. However, because these notes are less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

Board Meeting: 25 May 2006, London

Project: Business Combinations II

Subject: Accounting for Employee Benefits in a Business Combination (Agenda Paper 2C)

PURPOSE OF THIS MEMO

1. The purpose of this memo is to discuss whether, as proposed in the Exposure Draft on business combinations (BC ED), an exception should be made to the fair value measurement principle for assets and liabilities related to employee benefits in the scope of the following standards:

- a. IAS 19, Employee Benefits
 - b. FASB Statements No. 87, Employers' Accounting for Pensions, and No. 106, Employers' Accounting for Postretirement Benefits Other Than Pensions.
2. [Paragraph 2 relates to material being discussed by the FASB only and is omitted from observer notes]

EMPLOYEE BENEFITS: A PROPOSED EXCEPTION TO THE MEASUREMENT PRINCIPLE

3. Paragraph 48 of the BC ED proposes that an acquirer measure employee benefit obligations using the measurement guidance in the following standards rather than fair value:

- a. IAS 19, Employee Benefits
- b. FASB Statements No. 87, Employers' Accounting for Pensions, and No. 106, Employers' Accounting for Postretirement Benefits Other Than Pensions.

4. If affirmed, that proposal would be an exception to the following fair value measurement principle that the Boards agreed to in March 2006:

In a business combination, the acquirer **measures** each recognized asset acquired and each liability assumed at its acquisition-date fair value.

5. The Boards' reason for making an exception to the fair value measurement principle for particular employee benefit obligations is described in the basis for conclusions to the FASB's BC ED (the wording of the IASB's basis for conclusions is similar and the rationale is the same):

The Board concluded that if, at this time, it were to consider requiring that employee benefit obligations assumed in a business combination be measured at their acquisition-date fair values, the Board also would need to either (a) comprehensively reconsider the relevant standards for those employee benefits, or (b) at minimum, determine whether accommodations would be required, for their subsequent measurement following the acquisition date, or (c) both. At this time, the Board does not have an active project to comprehensively reconsider the relevant standards for employee benefits. Thus, due to the complexities in accounting for employee benefit obligations in accordance with [IAS 19 / Statements 87 and 106], the Board decided that at this time those benefits should continue to be measured in accordance with their applicable standards. (FASB BC ED paragraph B153/IASB BC ED paragraph BC133).

6. In October 2005, after issuance of the BC ED, the FASB added to its agenda a multi-phased project to comprehensively reconsider the guidance related to employee benefits included in Statements 87 and 106. The phase of that project that will reconsider the measurement of employee benefit

obligations is expected to begin in late 2006. The IASB expects to consider in upcoming months whether to undertake a project to reconsider some or all of the employee benefit guidance in IAS 19. Following any agenda decision made by the IASB, the staff will consider ways that the Boards might coordinate their activities, consistent with their shared objective to both improve and converge their standards in this area.

Comment Letter Responses

7. Few comment letters to the BC ED specifically addressed employee benefits. Most respondents that did address them simply stated that they agreed the measurement of employee benefits is an appropriate exception to the fair value measurement principle and that those assets and liabilities should be measured using IAS 19 or Statements 87 and 106.

8. A few respondents disagreed that employee benefits should be an exception to the measurement principle. For example, Mind the GAAP LLC stated:

. . .we remain unconvinced that employee benefit plans should be excluded from fair value measurement principles. . . . Under Statement No. 87, for example, pension accounts are often recorded on a net basis. Moreover, the “true” obligation under a pension plan can be obfuscated by unrecognized transition obligations, past service costs, and other “smoothing” mechanisms. Therefore, we believe that it would be beneficial to users of the financial statements to remeasure the fair value of assumed employee benefit obligations (as well as related acquired employee benefit plan assets) at the time of a business combination to provide users with relevant and reliable information about assumed employee benefit obligations. [CL #57, page 10]

Staff Analysis

9. The staff believes the Boards should affirm the fair value measurement exception for employee benefit obligations¹ in the scope of IAS 19 or Statements 87 and 106.² While the staff believes that measuring the benefit

¹Statements 87 and 106 and IAS 19 require plan assets to be measured at fair value at the acquisition date and, thus, only plan obligations are an exception to the measurement principle.

² IAS 19 applies broadly to all employee benefits. The IASB staff is examining IAS 19 in the context of business combinations and notes that it might bring additional matters to its Board at a future meeting.

liabilities at fair value would likely provide more decision-useful and transparent financial information, the staff believes the Boards would need to provide guidance for measuring those liabilities at fair value. The staff believes that comprehensive reconsideration or modification of the guidance related to employee benefits in IAS 19 or Statements 87 and 106, as would be required to implement the fair value measurement principle, is outside the scope of the business combinations project. A project on accounting for benefit obligations, which the FASB has on its active agenda and the IASB might add to its agenda in the near term, is the better place to consider such fundamental changes.

[Paragraphs 10 to 30 relate to material being discussed by the FASB only and are omitted from observer notes]

QUESTIONS FOR THE BOARDS AND STAFF RECOMMENDATIONS

31. The staff recommends the Boards affirm that assets acquired and liabilities assumed related to employee benefits within the scope of IAS 19 / Statements 87 and 106 be an exception to the fair value measurement principle. Therefore, an acquirer would measure those assets or liabilities in accordance with those standards rather than at fair value.

Do the Boards agree?

[Paragraphs 32 to 38 relate to material being discussed by the FASB only and are omitted from observer notes]