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International Accounting Standards Board

INFORMATION FOR OBSERVERS

Board Meeting: **19 July 2007, London**

Project: **Post-employment benefits**

Subject: **Measurement of the contribution requirement (Agenda paper 7F)**

Introduction

1. Agenda Paper 7E notes that two approaches for measuring the contribution component of a defined return promise based on specified contributions and the IAS 19 discount rate were raised at the June meeting. This paper discusses those approaches.

Staff recommendation

2. The staff recommends the contribution requirement should be measured at the specified contributions discounted at the IAS 19 discount rate.

The two approaches

3. The two approaches are:

   (a) discount the contributions at the IAS 19 discount rate and

   (b) an approach suggested by a Board member.

4. The approach suggested by the Board member measures the contribution component at the undiscounted amount of the contributions plus the specified

return earned to date. The return component would then be the incremental promised future return compared to the IAS 19 discount rate.

5. The following example illustrates the two methods, using a present value for the return component instead of a fair value for simplicity. The effect of using fair value for the return component is discussed in paragraph 10 below.

6. A benefit promise is to pay in five years' time a lump sum of a contribution of 1000 plus a return of 6% per year. The discount rate specified by IAS 19 at the balance sheet date is 5%.

7. When the contribution is first earned, before any returns have accumulated:

   (a) Under approach (a), both the contribution component and the return component are measured at a present value, ie discounted for 5 years at a rate of 5%.

   (b) Under approach (b), the contribution component is the undiscounted amount of the contributions and the return component is the present value of the incremental return compared to the IAS 19 discount rate.

	Approach (a)	Approach (b)
Contribution	784[1]	1000
Return	265[2]	49[3]
Total	1049	1049

8. After one year, a return of 60 has accumulated:

   (a) Under approach (a), both the contribution component and the return component are measured at a present value, ie discounted for 4 years at a rate of 5%.

   (b) Under approach (b), the contribution component is the undiscounted amount of the contributions plus the accumulated return and the return component is

[1] 1000/(1.05^5)
[2] ((1000x1.06^5)-1000)/(1.05^5)
[3] ((1000x1.06^5)-(1000x1.05^5))/(1.05^5)

the present value of the incremental future return compared to the IAS 19 discount rate.

	Approach (a)	Approach (b)
Contribution	823	1060
Return	278	41
Total	1101	1101

9. Approach b effectively moves the time value of money on the contribution from the liability for the contribution requirement to the liability for the return component. It also moves the accumulated return from the return component to the contribution requirement. If both components were measured using the same measurement attribute, as in the above example, both approaches would give the same answer.

10. However, a problem then arises because we want to measure the liability for the return component at fair value, as adjusted in Agenda Paper 7E. So in the above example, the liability for the return component would not be the present value of the future incremental returns discounted at the IAS 19 discount rate. It would be the fair value of that incremental future return.

11. On balance, the staff argues that the most straight-forward way to include the time value of money on the contribution component is to require the contributions to be discounted at the IAS 19 discount rate. The Board's concern with this approach was that it weakens the comparison with defined contribution promises. However, the staff notes that, in fact, IAS 19 currently requires discounting of contributions to a defined contribution plan that do not fall due within twelve months of the period in which the employee renders service. So discounting the contribution requirement by the IAS 19 discount rate would be exactly consistent with the existing treatment of defined contribution promises.