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International Accounting Standards Board

This observer note is provided as a convenience to observers at IFRIC meetings, to assist them in following the IFRIC's discussion. Views expressed in this document are identified by the staff as a basis for the discussion at the IFRIC meeting. This document does not represent an official position of the IFRIC. Decisions of the IFRIC are determined only after extensive deliberation and due process. IFRIC positions are set out in Interpretations.

Note: The observer note is based on the staff paper prepared for the IFRIC. Paragraph numbers correspond to paragraph numbers used in the IFRIC paper. However, because the observer note is less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

IFRIC meeting: **July 2007, London**

Project: **IAS 19 – Benefit allocation for defined benefit plans – expected salary increases (Agenda Paper 6B)**

Introduction

1. IAS 19 requires that the benefit in defined benefit plans is attributed to periods of service in accordance with the benefit formula, unless the benefit formula would result in a materially higher level of benefit allocated to future years. In that case the benefit is allocated on a straight line basis (paragraph 67 of IAS 19).

2. In the deliberations leading to D9 *Employee Benefits with a Promised Return on Contributions or Notional Contributions*, the IFRIC considered whether expected increases in salary should be taken into account in determining whether a benefit formula expressed in terms of current salary allocates a materially higher level of benefit in later years.

3. The IFRIC concluded that future salaries should be included in the assessment of whether the benefits are higher in later years of service. It reflected its conclusion in paragraph IE4 of the illustrative examples to D9 (reproduced in the appendix). However, there was considerable opposition to this conclusion in

the comment letters to D9. Respondents stated that the IFRIC's implicit conclusion that expected future salary increases lead to non-level benefits is a significant change in practice and one with implication beyond the cash balance plans discussed in D9.

4. The IFRIC did not reconsider its decision in D9 that expected increases in salary should be taken into account in determining whether a benefit formula expressed in terms of current salary allocates a materially higher level of benefit in later years. The Board's project on post-employment benefits had begun and the IFRIC decided to wait to see what implications might be drawn from the Board's deliberations about cash balance plans.

5. The Board has now considered the allocation of benefits in phase one of its project on post-employment benefits. This paper discusses what the IFRIC might do in the light of the Board's decisions.

Staff recommendation

6. The staff recommends that the IFRIC remove this issue from its agenda in the light of the Board's on-going project on post-employment benefits. Draft rejection wording is suggested in paragraph 13 [omitted from observer notes].

Staff analysis

7. The Board's phase 1 project on post-employment benefits considers the allocation of benefits in relation to a new category of promises called defined return promises. Defined return promises are promises in which the benefit comprises contributions that can be expressed in terms of current salary and a specified return on those contributions based on assets or indices.

8. The Board tentatively decided that an entity should always allocate the contribution component of a defined return promise to periods of service in line with the benefit formula. This would be the case even when the benefit formula specifies a materially higher level of contributions in later years. Therefore, there is no longer any need to assess whether a benefit formula allocates a materially higher level of benefit in later years. Consequently, the question of whether expected increases in salary should be taken into account in such an assessment also falls away.

9. Defined return promises include the type of promises that were considered by the IFRIC in D9 and to which the IFRIC conclusion about expected salary increases applied. So it could be argued that there is nothing left for the IFRIC to consider.

10. However, the respondents to D9 argued that the issue applies more broadly. It applies also to promises that would continue to be classified as defined benefit promises under the Board's proposals. Because the Board's Phase 1 of the post-employment benefits project does not envisage changes to the accounting for typical defined benefit arrangements, the IFRIC could address this issue as it applies to defined benefit promises through an Interpretation of IAS 19.

11. At its June 2007 meeting, the Board discussed whether its decisions on the allocation of benefit to periods of service for defined return plans have implications for defined benefit plans that should be addressed by the Board in Phase 1 of its post employment benefits project or by the IFRIC. The Board decided that, for defined benefit promises, it was outside the scope of Phase 1 to address whether expected increases in salary are included in assessing whether a benefit formula allocates a materially higher level of benefit in later years. The Board noted that the IFRIC had identified this issue for possible future consideration but also noted that the IFRIC was constrained by IAS 19's existing definition of defined benefit plans. This definition includes the cash balance plans that were the subject of the Board's project. The Board expressed reservations on whether, because of the Board's active phase one of the project on post-employment benefits, it would be appropriate for the IFRIC to address this issue for defined benefit plans *including plans that under the Board's proposals would be classified as defined return*.

12. Accordingly, the staff recommends that the IFRIC reject this issue in the light of the Board's project on post-employment benefits.

13. [Paragraph omitted from observer note].

Appendix

Extract from the illustrative examples to D9 Employee Benefits with a Promised Return on Contributions or Notional Contributions. *The IFRIC reflected its conclusion that salary increases should be taken to account in determining whether a benefit formula attributes materially higher benefits to later periods of service in paragraph IE4.*

Numerical example

IE3 Consider a plan under which a contribution of 10 per cent of current salary is paid and the employees receive the higher of the actual return on plan assets and an annual return on the contribution of 4 per cent per year over the period to when the benefits are paid. Assume also that expected salary increases are 7 per cent per year and the contributions are due and are made at the beginning of the year.

IE4 The fixed component of the plan is the contributions plus the guaranteed 4 per cent return. The variable component is the contributions plus the actual return on plan assets. The fixed component benefits projected over an expected service life of five years are as follows.

	Year 1	Year 2	Year 3	Year 4	Year 5	Total per the benefit formula	Benefit allocated on a straight-line basis*
Year 1 benefit	100.0 (contribution) 4.0 (return)	4.2† (return)	4.3 (return)	4.5 (return)	4.7 (return)	121.7	128.9
Year 2 benefit		107.0§ 4.3	4.5	4.6	4.8	125.2	128.9
Year 3 benefit			114.5 4.6	4.8	5.0	128.9	128.9
Year 4 benefit				122.5 4.9	5.1	132.5	128.9
Year 5 benefit					131.1 5.2	136.3	129.0
Total benefit						644.6	644.6

* Paragraph 67 of IAS 19 requires benefits to be allocated on a straight-line basis if the benefit formula attributes materially higher benefits to later periods of service. For the purposes of this example, it is assumed that the benefits attributed to later years of service are materially higher.

† 4.2 is the return of 4% on the asset balance of 104 (100 plus 4) at the end of year 1.

§ The contribution has increased by 7% since year 1 because of salary increases.