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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: **September 2007, London**

Project: **IAS 19: Attribution of death in service and other non-service related benefits (Agenda Paper 6C)**

INTRODUCTION

1. In July 2004, the staff received a list of questions relating to the accounting for pensions and other post retirement benefits. One of these questions related to the attribution of death in service and other non-service related benefits to periods of service. The staff discussed the issue with the submitter and agreed that it should be brought to the IFRIC as a potential item for its agenda.

2. The issue related to the accounting for death in service benefits. For example, benefits which arise when an employer offers an employee a lump sum payment of 3 times his/her salary if the employee dies whilst in service with the employer.

3. Differing views exist as to how the Projected Unit Credit Method should be applied to such benefits. In particular, differing views exist as to how such benefits should be attributed to periods of service. The staff is aware of the following views that exist in practice:

    i. benefits *must* be attributed using a 'FAS 87' methodology. Using this approach, benefits are attributed to periods between an employee's date of hire and the assumed date of death;

    ii. benefits *may* be attributed to periods between an employee's date of hire and the expected retirement date;

    iii. all of the benefits may be attributed to the date of death; and

    iv. benefits may be accounted for on a defined contribution basis with premiums recognised in profit or loss as they become payable.

4. The question related to death in service benefits, but also stated that similar issues arose with other non-service related benefits.

5. This paper sets out the staff's considerations as to whether the issue should be taken on to the IFRIC's agenda.

Other types of non-service related benefits

6. The staff is aware of a number of different non-service related benefits that exist in practice. For example:

    - death in service benefits of the type discussed above under which an employee will receive the same multiple of their salary regardless of whether they die on the first day of employment or the last;

    - post-retirement healthcare benefits which, in some countries, become payable only when an employee is working for an employer on his/her retirement date. If the employee leaves employment before the retirement date then no benefit becomes payable; and

    - spouse's pensions payable on death. For current employees, this benefit is typically based on the period that the employee could have worked if they had lived and worked until the normal retirement age. In theory, such benefits remain a constant percentage of salary regardless of the service period.

7. The staff considers that the above schemes differ in some important respects. For example:

- If they are part of a defined benefit pension scheme, death in service benefits and spouse's pensions replace normal pensions when they become payable. Post retirement healthcare becomes payable alongside an employee's pension.
- Post-retirement healthcare may not be salary dependant. Death in service benefits and spouse's pensions increase due to increases in employee salary.
- Risks and liabilities associated with spouse's pensions and post-retirement healthcare continue beyond the termination of employment. Death in service benefits are typically lump sum amounts payable at the date that employment ceases. Risks and liabilities associated with this amount do not therefore extend beyond the employment period.

8. The staff considers that these differences are significant and may result in different accounting treatments being suitable for each of the different schemes. As the request to the IFRIC was primarily concerned with the accounting for death in service benefits, the staff has primarily considered the accounting for such items.

DIFFERING TREATMENTS

9. The staff has set out below a summary of the different treatments identified above including arguments for their use under IAS 19.

FAS 87 approach

10. The FAS 87 approach is based upon FAS 87.42(b) which states that benefits are assumed to accumulate in proportion to the ratio of completed years of service to total projected years of service for benefits not includable in vested benefits (including 'a death or disability benefit that is payable only if death or disability occurs during active service.')

11. Using this method, benefits are attributed over the period from an employee's date of hire to the assumed date of death.

12. Supporters of this approach consider that it is consistent with the guidance in IAS 19.67 which states

"*In determining the present value of its defined benefit obligations and the related current service cost and, where applicable, past service cost, an entity shall attribute benefit to periods of service under the plan's benefit formula. However, if an employee's service in later years will lead to a materially higher level of benefit than in earlier years, an entity shall attribute benefit on a straight-line basis from:*

(a) the date when service by the employee first leads to benefits under the plan (whether or not the benefits are conditional on further service); until

(b) the date when further service by the employee will lead to no material amount of further benefits under the plan, other than from further salary increases."

13. Supporters of this approach note that IAS 19 was modelled on FAS 87. They do not consider that a GAAP difference was expected to arise when IAS 19 was written.

14. Supporters of this view believe that this method is the only method for attributing benefits permitted by IAS 19.

Attribution to an expected retirement date

15. This approach attributes benefits over the period from the date of hire to an expected date of retirement.

16. Actuaries who support this view note that it consistent with the application of the Projected Unit Credit Method that exists under other national GAAPs. For example, under UK GAAP, which also uses the Projected Unit Credit Method[1], UITF 35 states that Death in service benefits should be accounted for using FRS 17 paragraphs 20 – 22.

17. FRS 17 paragraph 22 states that "*The benefits should be attributed to periods of service according to the scheme's benefit formula, except where the benefit*

[1] UK GAAP pensions accounting is described in FRS17. This requires the use of the 'Projected Unit Method'. Guidance Note GN26 issued by the Faculty and Institute of Actuaries states that "this method is also known as the Projected Unit Credit Method".

formula attributes a disproportionate share of the total benefits to later years of service. In such cases, the benefit should be attributed on a straight-line basis over the period during which it is earned."

18. The period over which death in service benefits have been earned has been interpreted by some to mean the period from the date of employment to the expected date of retirement.

19. The staff is aware that there are different variations on the way in which this method may be applied. In particular, the staff is aware that some actuaries accrue benefits using a one year insurance premium or 'burning cost' approach under which the cost for a year is computed as the likelihood of death in that year multiplied by the amount that the employee would be paid if they died in that year.

20. The staff is also aware that, in some cases, this may result in benefits being attributed after the date of death (although the staff understands that this treatment is rare and is unlikely to apply to lump-sum death in service benefits).

Accrual on date of death

21. Supporters of the view that the benefit should be accrued in full on the date of death consider that there is no liability until death occurs. The definition of a liability requires an entity to have a present obligation as a result of a past event. An employer does not have a present obligation to pay a death in service benefit until death has occurred.

22. Furthermore, supporters of this view note IAS19.130 which deals with long-term disability benefits. This states that: "*If the level of benefit is the same for any disabled employee regardless of years of service, the expected cost of those benefits is recognised when an event occurs that causes a long-term disability*."

23. Supporters of this view consider that death in service benefits are benefits that are the same for any employee regardless of the length of service. They become payable in the event that an employee is no longer able to work. In this sense, they are similar to long-term disability benefits that are also the same for any employee regardless of the length of service and also become payable when an employee is no longer able to work. Supporters of this view therefore consider that death in service benefits are analogous to disability benefits.

24. Based on paragraph 130, such benefits should therefore be accrued only when death occurs.

25. Supporters of this view also note the example included in paragraph 70 of IAS 19. Example 2 shows a situation in which a lump sum is payable to employees who are still employed by an employer at age 55, after 20 years service. The example notes that service after age 55 leads to no material additional benefits. Similarly, an employee can leave and return before age 35 with no effect on benefit. The example therefore states that benefit should be attributed between ages 35 and 55.

26. Supporters of this view consider that this example shows that attribution does not start until the point at which leaving the scheme and rejoining would affect the benefit.

27. In the case of death in service benefits, they argue that employees can leave the scheme and rejoin at any time and still be entitled to the same benefits. Therefore no accrual should be made before the date of death.

Recognition of an expense as premiums are paid

28. IAS 19.39 states:

‘*An entity may pay insurance premiums to fund a post-employment benefit plan. The entity shall treat such a plan as a defined contribution plan unless the entity will have (either directly, or indirectly through the plan) a legal or constructive obligation to either:*

(a) pay the employee benefits directly when they fall due; or

(b) pay further amounts if the insurer does not pay all future employee benefits relating to employee service in the current and prior periods.

If the entity retains such a legal or constructive obligation, the entity shall treat the plan as a defined benefit plan.’

29. Supporters of this view note that, if the conditions in IAS 19.39 are met then it would require an entity to treat an insured death in service benefit as a defined contribution scheme and the expense to be recognised as the insurance cost is incurred.

30. In other words, if the scheme is insured then entities may recognise as an expense the cost of the insurance premiums paid as they become payable and not take into account any future growth in salaries or mortality rates.

STAFF ANALYSIS

31. The attribution of benefits is considered in IAS 19 paragraphs 67 -71. IAS 19.67 is quoted in full in paragraph 12 above.

FAS 87 approach

32. The staff first considered whether the FAS 87 approach is in accordance with IAS 19. In doing so, the staff noted that IAS 19 was based on FAS 87. The staff does not consider that, in developing IAS 19, the Board intended to create a GAAP difference in this area.

33. The staff considers that death in service benefits could be seen as comprising two benefits. One is the benefit associated with a lump-sum receipt on death. The other is the benefit of receiving insurance cover through the employee's working life.

34. The staff notes that the FAS 87 method attributes benefit from the date of an employee's hire. This is the date that the employee first receives benefits under the plan (the benefit of ongoing insurance cover), and so the staff considers that this is consistent with IAS 19.67(a).

35. The staff also notes that the FAS 87 method ceases to attribute benefit at an assumed date of death. The staff considers that, after this date, the employee will receive no further benefits (either ongoing or lump-sum) under the plan and so this would be consistent with IAS 19.67(b)

36. The FAS 87 approach attributes the benefit for each year between the above dates. Mortality rates show that employees have a higher expectation of death in later years than in earlier years. It can be argued that later years therefore have a greater level of benefit than earlier years. The straight-line attribution used by the FAS 87 approach is therefore consistent with the final sentence in IAS 19.67.

37. The staff concludes that the FAS 87 method which requires the allocating of the benefit from the date of hire to an assumed date of death complies with IAS 19.67.

38. The staff considers that the question then arises as to whether the FAS 87 method is *required* under IAS 19 or whether it is merely one of a number of options that are available to entities

Attribution to the expected retirement date

39. The staff next considered whether a method that attributed benefit to an expected date of retirement could be seen as complying with IAS 19.67.

40. The staff noted that the only difference between such an approach and a FAS 87 approach would be that it would attribute benefits to a later date. In order for such an approach to be permissible under IAS 19, it would therefore be necessary to demonstrate that the retirement date met the criteria in IAS 19.67(b), ie that a retirement date is '*the date when further service by the employee will lead to no material amount of further benefits under the plan, other than from further salary increases.*'

41. An approach that attributes benefit over the period of service to the date that an employee is expected to retire will attribute the benefit over a longer period than the FAS 87 approach which only attributes benefits to an assumed date of death.

42. The staff considers that, in normal service, an employee will reach a point at which they receive no material amount of future benefits at the time at which they retire. In the case of a death in service benefit, this will normally mean that they stop receiving ongoing insurance benefits and that they lose the ability to receive a benefit on death.

43. Furthermore, in most cases, employees will live until retirement and so that is the point at which the benefit will cease to be received.

44. However, an actuarial model will assume that some employees will die before retirement. This is the basis for computing the benefit that will be paid to employees under a death in service plan. It would seem to be inconsistent to accrue an amount based on an assumption that some employees will die before retirement over a period that assumes that they will reach retirement. In that sense, the FAS 87 approach appears to apply more realistic assumptions than a method that attributes the benefit over the period to the expected date of retirement for all employees (including those who are expected to die before then).

45. The staff therefore concludes that, in the case of death in service benefits, the 'date when further service by the employee will lead to no material amount of further benefits under the plan' is the expected date of death rather than the expected date of retirement.

46. The staff therefore considers that the FAS 87 is the more appropriate method for attributing the benefit.

47. The staff notes that, in some cases, entities may attribute benefits to future periods despite the fact that the employee has died. The staff considers that any approach that attributes benefits to future periods when the employee is no longer employed by the employer clearly does not attribute benefits to periods in which services are provided and therefore does not comply with IAS 19.

Benefits attributed on the date of death

48. The staff considered whether the attribution of all of the benefits to the date of death was an acceptable method of applying the Projected Credit Unit Method.

49. In situations in which benefits are given as part of a defined benefit plan, the entity will have already made assumptions about the mortality rate in assessing its defined benefit pension liability.

50. The staff considers that it would be inconsistent for an entity to reduce its defined benefit pension obligation on the basis that certain employees are expected to die before retirement and not accrue for the death in service benefit that they will receive if they do die.

51. Furthermore, the staff notes IAS 8.13 which requires: "*An entity shall select and apply its accounting policies consistently for similar transactions, other events and conditions, unless a Standard or an Interpretation specifically requires or permits categorisation of items for which different policies may be appropriate*."

52. The staff considers that to reduce the accrual for a defined benefit pensions obligation on the assumption of a certain mortality rate and to not accrue for the resulting death in service benefit would be application of inconsistent accounting policies. In the staff's view, if an entity has reduced its accrual for defined benefit pension costs due to mortality assumptions, it should attribute

the associated death in service benefits on a consistent basis. Attribution on the date of death would not be a consistent attribution method.

53. IAS 19.130 discusses long-term disability plans. This states '*if the level of benefit is the same for any disabled employee regardless of years of service, the expected cost of those benefits is recognised when an event occurs that causes a long-term disability.*'

54. The staff considered the argument that a death in service benefit could be accounted for by analogy to long-term disability plans using paragraph 130, in which case the benefit would not accrue until death.

55. The staff noted that paragraph 130 is a specific exception to the principles in paragraphs 128-129. Using this paragraph to account for death in service benefits would be applying an exception by analogy.

56. The staff also noted that there are key differences between death in service and long-term disability benefits. In particular, an employee will either receive death in service benefits or a pension. An employee will not receive both or neither. It is therefore appropriate to accrue for one or the other. In contrast, an employee may receive both long-term disability benefits and a pension.

57. In the light of these differences, the staff does not consider that analogising in this way is appropriate.

58. The second example included in IAS 19.70 considers a situation in which an employee receives a benefit based on still being employed at age 55, having served 20 years of employment. In this example, because the employee could leave the employer and then return before age 35 with no effect on the amount or timing of benefits that they would receive, no benefit is attributed to the period before they are 35 years old. The staff considered an argument that, because there is no effect on the amount or timing of death in service benefits if an employee leaves and then returns at any age, no accrual should be made until the date of death.

59. The staff notes that, in paragraph 70 example 2, the amount receivable is a lump sum amount that is fixed and does not depend on salary. In the case of death in service benefits, the lump sum entitlement is based on a multiple of salary. This will increase throughout the employee's life as salaries increase.

60. Similarly, the value of insurance cover received will increase through the period of employment as the likelihood of death increases.

61. The staff therefore considers that, in the case of death in service benefits, further benefits do arise through the period of service. The staff therefore considers that death in service benefits are fundamentally different from example 2 in IAS 19.70 and that this paragraph does not imply that death in service benefits should not be accrued before the date of death.

62. The staff therefore concludes that not recognising a cost in respect of death-in-service benefits until the date of death is not appropriate.

Insured death in service benefits

63. IAS 19.39 (see paragraph 28 above) discusses the accounting for insured benefits. If the conditions in IAS 19.39 are met then the staff considers that the entity would be required to treat the plan as a defined contribution scheme and recognise the expense as the insurance cost is incurred.

64. If the conditions in IAS 19.39 are not met, the staff considers that the entity would be required to consider how to account for the employee benefit obligation and the insurance scheme separately. In terms of the insurance scheme, it will need to assess whether the contract is a plan asset and how it should be accounted for. In terms of the employee benefit obligation, it will be required to consider how that benefit should be accounted for.

65. The question of the separate accounting for the insurance contract is not part of the question asked to the IFRIC and so the staff has not considered this question further.

66. If the insurance contract and the obligation to the employees are separated, then the staff considers that the accounting for the obligation will be the same as if the scheme were not insured. This accounting should therefore be the same as that considered in the section above relating to the accounting for uninsured benefits.

Conclusions

67. The staff concludes that:

- The FAS 87 method is an appropriate accounting model under IAS 19.

- A method that attributes death in service benefits from the date of hire to the expected date of retirement is unlikely to comply with IAS 19.67 (b).
- It will never be appropriate to attribute benefits to future periods after the date that an employee has ceased employment.
- Not accruing a benefit until the date of death would not be an appropriate method to attribute benefits under IAS 19.
- If an entity has insured death in service benefits that meet the criteria in IAS 19.39, it will be appropriate to account for them as defined contribution benefits.

SHOULD THE ISSUE BE TAKEN ON TO THE IFRIC AGENDA?

68. The staff has considered below whether the issue meets the criteria for being added to the IFRIC agenda. In doing so, the staff has considered the criteria set out in the IFRIC due process handbook.

Is the Issue widespread and practical?

69. The staff considers that the existence of death in service benefits is widespread in some jurisdictions. Furthermore, the staff considers that, in some jurisdictions, such plans are routinely self-insured. The issue therefore has widespread relevance in some jurisdictions.

70. Furthermore, similar issues arise in the accounting for other non-service related benefits, for example, spouse’s pensions and some post-retirement healthcare schemes.

71. The staff therefore considers that the issue can be considered to be widespread and practical.

Does the Issue involve significantly divergent interpretations?

72. As discussed above, the staff considers that divergent interpretations exist in practice. In some cases, these interpretations result in accounting which the staff considers is not compliant with IAS 19.

73. For example, the staff considers that one of the fundamental principles of IAS 19 is that benefits are allocated over the period in which the employees provide services to the employer. Methods which result in benefit being allocated to periods after employment has ended do not apply this principle. Similarly, the

staff considers that using mortality assumptions in computing a pensions accrual and no mortality assumption before retirement in computing the death in service benefit would conflict with IAS 8.

74. The staff understands that in some situations with generous death in service benefits, they could comprise as much as 15% of an entity's post retirement benefit accrual. However, the staff also understands that, in most cases, this is reduced significantly. Factors that may significantly reduce the level of accrual include:

- less generous death in service benefits;
- lowered expected retirement ages (the staff understands that lowering the expected retirement age from 65 to 60, for example, reduces the death in service accrual significantly); and
- significant populations of ex-employees.

75. In addition, whilst the difference between an accrual based on the FAS 87 method and accrual based on another method may be significant, in most cases this will be reduced. For example, the difference is likely to be most significant if there is a very young workforce. Older or more balanced workforces are likely to result in reduced differences in the annual cost under the different methods.

76. Whilst the difference between a FAS 87 attribution method and other methods could be material, the staff therefore believes that, in most cases, it is unlikely to be so.

77. In addition, the staff notes that an actuarial valuation is, by its nature, an estimation. As with all estimations, there will be some degree of judgement and uncertainty involved in computing that estimation.

78. In the light of the above, whilst the staff considers that there may be significant differences in some situations, in the majority of cases the staff considers that the issue is unlikely to be sufficiently significant to warrant the development of an Interpretation.

Would financial reporting be improved by issuing an Interpretation?

79. The staff considers that, in the light of the differing interpretations that exist in practice, it could be argued that financial reporting would be improved by issuing an interpretation in this area.

80. Supporters of this view may consider that developing one consistent approach that could be used to account for all non-service related schemes would result in increased consistency and comparability of financial statements.

81. Opponents of this view may consider that developing further guidance as to how to apply the Projected Unit Credit Method is application guidance. Furthermore, the issue is not sufficiently significant to make a significant improvement to financial reporting.

Is the issue narrow enough in scope to be capable of Interpretation?

82. The staff considers that, if an Interpretation were to be issued in this area, it would not be restricted to death in service but would have to consider all similar non-service related benefits. This could be a significant exercise.

83. Furthermore, any attempt to develop such an Interpretation would have to tackle very different views as to what the benefit from a death in service scheme was and how it should be accounted for. For example, the staff is aware of differing views as to whether the only benefit of death in service benefits is a benefit that occurs on death or whether the benefit is a through life life-insurance benefit. Similarly, the staff is aware of different views as to whether the fundamental principle should be that such costs should only be accrued when an entity has a legal obligation to pay the benefit (on death) or when a constructive obligation to provide insurance exists (when the service is provided).

84. The staff considers that these questions, and differing views, may make it very hard to develop a consistent Interpretation for all non-service related benefits.

85. The staff also notes that the Board, in E54, proposed guidance in this area which was then removed prior to the publication of IAS 19. Developing an Interpretation that covers exactly the same ground as E54 may be difficult.

Does the issue relate to a current IASB Board project?

86. Whilst there is a current project on the IASB agenda discussing pensions, Phase 1 of this project is not considering the treatment of death in service benefits. The staff does not therefore consider that this issue is within the scope of the current IASB project.

CONCLUSIONS

87. Whilst the staff considers that death in service benefits may be significant in some situations, it does not consider that the differences that arise in accounting are likely to be sufficiently significant to warrant the development of an Interpretation.

88. Furthermore, the staff considers that writing detailed guidance on the application of the Projected Unit Credit Method would be in the nature of application guidance.

89. The staff therefore recommends that this issue not be taken on to the IFRIC agenda on the basis that it is not sufficiently significant and that any guidance developed in this area would be application guidance.

90. [Paragraph omitted from observer note].

Attachment 1 – Extract from E54

Death-in-service Benefits

17. An enterprise should recognise the cost of death-in-service benefits in accordance with paragraph 10 as follows:

(a) in the case of benefits insured or re-insured with third parties, in the period in respect of which the related insurance premiums are payable; and

(b) in the case of benefits not insured or re-insured with third parties, to the extent that deaths have occurred before the balance sheet date.

However, in the case of death-in-service benefits provided through a post-employment benefit plan, an enterprise should recognise the cost of those benefits by including their present value in the post-employment benefit obligation.

18. If an enterprise re-insures a commitment to provide death-in-service benefits, it acquires a right (to receive payments if an employee dies in service) in exchange for an obligation to pay the premiums.

19. Where an enterprise provides death-in-service benefits directly, rather than through a post-employment benefit plan, the enterprise has a future commitment to provide death-in-service coverage in exchange for employee service in those same future periods (in the same way that the enterprise has a future commitment to pay salaries if the employee renders service in those periods). That future commitment is not a present obligation and does not justify recognition of a liability. Therefore, an obligation arises only to the extent that a death has already occurred by the balance sheet date.

20. If death-in-service benefits are provided through a pension plan (or other post-employment plan) which also provides post-employment benefits to the same employee(s), the measurement of the obligation reflects both the probability of a reduction in future pension payments through death in service and the present value of the death-in-service benefits (see paragraph 71(b)).

21. Death-in-service benefits differ from post-employment life insurance because post-employment life insurance creates an obligation as the employee renders services in exchange for that benefit; an enterprise accounts for that obligation in accordance with paragraphs 47-114. Life insurance benefits that are payable regardless of whether the employee remains in service comprise two components: a death-in-service benefit and a post-employment benefit. An enterprise accounts for the two components separately.