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**International  
Accounting Standards  
Board**

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*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:** Thursday 22 May 2008, London

**Project:** IAS 37 Short-term convergence amendments

**Subject:** Termination Benefits – comment analysis (Agenda Paper 6)

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## **Introduction**

- 1 This paper will provide an analysis of the proposed amendments to the accounting treatment of termination benefits under IAS 19 *Employee Benefits*.

## **Background**

- 2 As part of the short-term convergence project, the Board considered the requirements of FASB Statement No. 146 *Accounting for Costs Associated with Exit or Disposal Activities* (SFAS 146). As a result the Board proposed amendments to the requirements in IAS 37 relating to the recognition of liabilities for costs associated with a restructuring to converge with SFAS 146 and to improve the Standard.
- 3 SFAS 146 also specifies the accounting for a class of termination benefits known as 'one-time termination benefits'. These are benefits provided to current employees that are involuntarily terminated under the terms of a

benefit arrangement that, in substance, is not an ongoing benefit arrangement or an individual deferred compensation contract. Because the accounting for termination benefits is specified by IAS 19, the Board also decided to amend the termination benefit recognition requirements in IAS 19 at the same time as its amendments to IAS 37.

4 The Board observed that because the accounting for termination benefits in US GAAP is specified in a number of standards, an approach that converged with all aspects of US GAAP would be difficult to integrate into IAS 19. Accordingly, the Board concluded that it should converge with the principles of SFAS 146 *Accounting for Costs Associated with Exit or Disposal Activities* and SFAS 88 *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits*, relating to one-time termination benefits and apply those principles consistently to all termination benefits. The Board acknowledged that differences with US GAAP will remain following the introduction of these amendments. Nonetheless, the Board believed that the proposed amendments will increase convergence as well as improve the accounting for termination benefits.

5 The Board therefore proposed that:

- a) the definition of termination benefits in IAS 19 be amended to clarify that benefits that are offered in exchange for an employees' decision to accept voluntary termination of employment are termination benefits only if they are offered for a *short period*.
- b) voluntary termination benefits should be recognised when employees accept the entity's offer of those benefits.
- c) involuntary termination benefits, with the exception of those provided in exchange for employees' future services, should be recognised when the entity has communicated its plan of termination to the affected employees and the plan meets specified criteria.

- d) involuntary termination benefits provided in exchange for employees' future services should be recognised over the period of the future service. It also proposed three criteria for determining whether involuntary termination benefits are provided in exchange for future services.

## **Comment Analysis**

- 6 The proposed amendments to termination benefits were set out in three questions in the ED. In total 123 comment letters were received with an average of 63 respondents commenting on each of the three questions on the proposed amendments to IAS 19. A numerical analysis is given in an Appendix.
  
- 7 Overall the majority of respondents were in favour of the proposed amendments to termination benefits. However, some concerns have been raised and will be discussed under the following headings:
  - a) Definition of termination benefits
  - b) Recognition of termination benefits
  - c) Recognition of involuntary termination benefits that relate to future services.

### **A. Definition of termination benefits**

- 8 The ED proposed amending the definition of termination benefits to clarify that benefits offered in exchange for an employee's decision to accept voluntary termination of employment are termination benefits only if they are offered for a *short period*. Other employee benefits that are offered to encourage employees to leave service before normal retirement date are post-employment benefits.
  
- 9 Whether a benefit is regarded as a termination benefit or a post-employment benefit matters because IAS 19 requires different accounting treatment for the each type of benefit. The Exposure Draft proposes that termination benefits are recognised as a liability and expense when the

## Respondent comments

- 10 Although the vast majority of respondents agreed with this proposal, many of them requested clarification on the Board's intention with '*short term*'.

Yes, we agree that benefits offered for an extended period to encourage employees to retire before normal retirement dates should be classified as post employment benefits and not as termination. We agree that benefits offered to encourage immediate termination of employment are almost always offered over for a short period of time. This is a useful characteristic to distinguish between the different types of employee benefits and account for transactions with the same substance in a similar manner. However, a short period of time could be subject to divergent interpretation and may well vary based on employment law and practices in different jurisdiction. It would be helpful for the Board to provide factors that might be considered when assessing what might be considered a 'short period of time', otherwise this may be interpreted very differently in different circumstances. [CL74]

We agree that only benefits offered for a short period should be accounted for as termination benefits and otherwise would fall within the definition of post-employment benefits. The phrase "offered for a short period" in the amended paragraph 7(b) is ambiguous in that it could refer to the period during which the employee is able to decide whether or not to accept, or the period between the offer and the actual termination of an employee. We presume it is the former and suggest that the wording is clarified. [CL51]

- 11 Respondents who disagree (mainly French and German constituents) argued that whether termination benefits are offered for a '*short term*' is not a relevant criterion in determining the nature of the employee benefit. They consider any benefit given in exchange for the early departure of an employee before the normal retirement date to be a termination benefit no matter how long the period given to employees to accept or reject it.

- 12 An example given by German constituents is that of the ‘Altersteilzeit’ (ATZ). The ATZ arrangement is an early retirement program in Germany designed to create an incentive for employees, within a certain age group, to transition from (full or part-time) employment into retirement before their legal retirement age. The program was created by legislation in 1996 and through subsequent extensions is now scheduled to expire in 2009. Employers taking advantage of this legislation must sign a contract under the legal framework outlined in the legislation with the workers’ council/unions or with the individual employees (employees not within a workers’ council/union) to qualify for subsidies from the government. The German government provides a subsidy (reimbursement) to an employer for the bonuses paid to the employee and the additional contributions paid into the German government pension scheme under an ATZ arrangement for a maximum of six years. To receive this subsidy, an employer must meet certain criteria (typically, an employer must hire replacement employees from currently registered unemployed persons or former trainees).
- 13 The ATZ arrangement typically offers two alternative arrangements for participating employees:
- a) Participants work 50% of the normal full-time schedule for each year of the entire ATZ period and receives 50% of his/her salary each year.
  - b) Participants work full-time for half of the ATZ period (the ‘active period’), and then does not work for the remaining half (the ‘inactive period’), and receives 50% of his/her salary each year during the entire ATZ period.
- 14 In its interpretation on the matter the German Institute of Chartered Accountants have stated that economically, the bonus feature is not a compensation for the service rendered by the employee but meets the criteria of termination benefits under the current IAS 19.7.

15           However, the ATZ programme requires that employees must provide service to the employer for the required portion of the ATZ period (the active period) to receive the full bonus. This ‘active period’ could be structured in different ways, but ultimately requires the employee’s services for a specified period of time before becoming eligible for the benefits under the ATZ program. Because the ATZ requires this period (normally a couple of years) of service, it does not meet the criterion of being offered only for a short period of time. Under the proposed amendments to IAS 19, it would be an ongoing benefit plan which employees would treat as part of their employment, rather than a termination benefit.

### **Staff evaluation and recommendation**

16           Paragraph 19 of the Basis for Conclusions in the ED states that if the benefits for leaving service are made available for more than a *short period*, the employer has effectively established a new ongoing benefit plan and the employees would treat the benefit as part of their employment package. In other words the benefit would be payable in exchange for the employees’ services and, therefore, should be treated like any other post-employment benefit.

17           The staff think that the use of *short term* to distinguish between termination and ongoing employee benefits is appropriate and that the Basis for Conclusions also provides an appropriate discussion. However, the staff agrees with those respondents that noted that the proposed wording could be read in such a way that it gives two alternative interpretations for the *short term* requirement:

- a) the period between the employer making the offer and the employee’s acceptance of the offer should be a short period. This was not the intention of the proposed amendment to the definition in paragraph 7.
- b) the period between the employee accepting the offer for voluntary termination and the actual termination of the employee should be a

short period. This is the intended interpretation of the proposed amendment.

- 18 The staff recommends that the wording of paragraph 7(b), be amended as follows: *(Original text struck through and new text underlined from the suggested text in the ED.)*

7(b) Voluntary termination benefits, which are benefits offered ~~for a short period~~ in exchange for an employee's decision to accept voluntary termination of employment. For such benefits to be voluntary termination benefits there can be only a short period between the acceptance of the benefits and the actual termination of the employee.

**Question to the Board**

Does the board agree with the proposed drafting?

## **B. Recognition of termination benefits**

- 19 The Exposure Draft proposed that voluntary termination benefits should be recognised when employees accept the entity's offer of those benefits. It also proposed that involuntary termination benefits, with the exception of those provided in exchange for employees' future services, should be recognised when the entity has communicated its plan of termination to the affected employees and the plan meets the specified criteria.

### **Respondent Comments**

- 20 Most of the respondents agreed with the proposal. However, some respondents have raised concerns relating to the recognition of voluntary termination benefits. The respondents commented that the proposal to recognise voluntary termination benefits only when the employee accepts the offer was inconsistent with the unconditional and constructive obligation principles set out in IAS 37.

We agree with the proposed guidance on the recognition of involuntary termination benefits. However the guidance on voluntary termination benefits that requires an offer and acceptance before recognition of a liability is difficult to reconcile with the unconditional and conditional obligations model. Using the logic set out in the proposed amendments to IAS 37 the entity has created an unconditional obligation when it makes the offer as it must stand ready to meet its obligations. There are often legal restrictions and barriers to withdrawal of offers to employees. The entity will be able to make an estimate of the numbers that will accept the offer and thus assign a value to the conditional obligation. We do not support the Board's conditional and unconditional obligations model for the recognition of liabilities. However, we believe, if the Board is introducing a new liability model, that model should be robustly tested to see that it produces appropriate outcomes for all non-financial liabilities. [CL74]

We disagree with the conclusion that a liability for voluntary termination benefits should only be recognised when employees accept the entity's offer. We think that this is inconsistent with the definition of a constructive obligation. The entity, when it offers the plan to employees, has indicated to other parties that it will accept particular responsibilities and as a result, the entity has created a valid expectation in those parties that they can reasonably rely on it to discharge those responsibilities. In BC18 it is stated that: 'until an employee accepts an entity's offer of voluntary termination of



employment, the entity would typically have the discretion to withdraw the offer and, therefore have no present obligation'. This is a matter of fact and circumstances and is not an appropriate reason for prescribing liability recognition only when the employee accepts the offer. The definition of a constructive obligation in the proposed amendment to IAS37 turns not on whether the entity has discretion but whether the other parties concerned can reasonably expect the entity to perform the responsibilities concerned. [CL54]

- 21 A few respondents requested more guidance to be provided on whether the Board intended to require specific communication to individual employees or just to the affected group of employees. In an example provided by one respondent they asked that if 10% of factory workers are to be made redundant, is it sufficient to communicate to a group of employees that 10% of them will be made redundant or must the individual employees be informed before a liability is recognised?

### **Staff evaluation and recommendation**

- 22 The Basis for Conclusions explains that until an employee accepts an entity's offer of voluntary termination of employment, the entity would typically have the discretion to withdraw the offer and, therefore, have no present obligation.
- 23 When jurisdictions stipulate that an entity cannot cancel or withdraw a voluntary termination offer it made to its employees, the entity effectively loses its discretion to withdraw such offers. In these circumstances, similar to the recognition requirements of involuntary termination benefits, a present obligation exists when the entity communicates such an offer for voluntary termination to the affected employees.
- 24 SFAS 88 requires the recognition of voluntary termination benefits only when the employee accepts the offer. It does not address the circumstances where jurisdictions regulate such offers so that entities lose their discretion to withdraw. However, the staff recommends that the proposed IAS 19 be amended to distinguish between voluntary termination benefit offers that the entity can withdraw (discretionary) and those the entity cannot withdraw (non-discretionary).

- 25 The staff suggests that the following wording be added to paragraph 137:  
(*New text underlined from the suggested text in the ED.*)

**An entity shall recognise a liability and expense for voluntary termination benefits when the employee accepts the entity's discretionary offer of those termination benefits. When the entity makes a non-discretionary offer to the employee a liability will be recognised in the same way as for involuntary termination benefits.**

- 26 The staff also recommends that paragraph 18 of the Basis for Conclusions be amended as follows: (*New text underlined from the suggested text in the ED.*)

In US GAAP, most voluntary termination benefits are within the scope of SFAS 88 (and are not within the scope of SFAS 146) and are referred to as 'special termination benefits'. SFAS 88 specifies that an employer's obligation to provide voluntary termination benefits meets the definition of a liability when the employees accept the employer's offer of termination benefits. This is different from IAS 19, because IAS 19 specifies that the benefits are recognised when the entity is demonstrably committed to provide those benefits. However, the Board concluded that in many instances the requirement of SFAS 88 would be closer to the principle underlying SFAS 146 (namely, that a liability is recognised when incurred). This is because until an employee accepts an entity's offer of voluntary termination of employment, the entity would typically have the discretion to withdraw the offer and, therefore, have no present obligation. Because of this and for the sake of convergence, the Board decided to amend IAS 19 to converge with SFAS 88. However, unlike SFAS 88, IAS 19 makes the distinction between offers of voluntary termination benefits that an entity can withdraw at its own discretion (discretionary) and those that an entity cannot withdraw (non-discretionary) to due jurisdictional restrictions. Because an entity has an obligation when it communicates such a non-discretionary voluntary termination benefits to the affected employees, such offers have the same recognition requirements as involuntary termination benefits.

#### **Question to the Board**

Does the Board agree with the proposed drafting?

27 Paragraph 138 of IAS 19 in the Exposure Draft proposes that involuntary termination benefits should be recognised when an entity has a termination plan that it has communicated to the affected employees, and actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.

28 In its Basis for Conclusions to the proposed IAS 19 the Board noted that SFAS 146 specifically required the termination plan to be communicated to the employees in sufficient detail for them to be able to determine the benefits to which they are entitled. The Board included this notion in the proposed amendment to IAS 19 as it believed that an entity does not have a present obligation to provide the benefits until communicated to the affected employees.

29 However, the proposed paragraph 138 does not indicate that the involuntary termination needs to be communicated to the affected employees *individually* before the obligation arises. This has raised some concerns with a few respondents because, in comparison, paragraph 64 of the proposed IAS 37 suggests that terminations occur only when a written notice is given to the affected employees or when the termination has been negotiated with the affected employees. The *written notice* might be thought to imply communication with the *individual* affected employees.

30 In both IAS 37 and SFAS 146 obligations exist only once:

- a) the entity has indicated to other parties that it will accept particular responsibilities
- b) the other parties can reasonably expect to the entity to perform those responsibilities
- c) the other parties will either benefit from the entity's performance or suffer harm from its non-performance.

Communication to each of the employees affected will be required in order for an obligation to exist based on the above. Otherwise, if an entity makes a general announcement to a group of employees, it can easily withdraw

such an announcement as it will not have created a specific expectation to perform a certain responsibility and none of the parties will suffer harm from the entities non-performance. The staff therefore believes that communication of the termination to *each* of the individual employees affected is required for a present obligation to exist and that this should be made clear in the proposed text.

- 31 The staff suggests that the wording of the proposed paragraph 138 be amended as follows: (*New text underlined from the suggested text in the ED.*)

**Except as specified in paragraph 139, an entity shall recognise a liability and expense for involuntary termination benefits when it has a plan of termination that it has communicated to each of the affected employees being terminated, and actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn. The plan shall:**

- (a) **identify the number of employees whose employment is to be terminated, their job classifications or functions and their locations, and the expected completion date; and**
- (b) **establish the benefits that employees will receive upon termination of employment (including but not limited to cash payments) in sufficient detail to enable employees to determine the type and amount of benefits they will receive when their employment is terminated.**

**Question to the Board**

Does the board agree?

**C. Recognition of involuntary termination benefits that relate to future services**

- 32 The Exposure Draft proposes that if involuntary termination benefits are provided in exchange for employees' future services, the liability for those benefits should be recognised over the period of the future services. The exposure draft also proposed three criteria for determining whether

involuntary termination benefits are provided in exchange for future services.

The criteria are:

- a) if those benefits are incremental to what the employees would otherwise be entitled to receive (ie benefits are not provided in accordance with the terms of an ongoing benefit plan);
- b) do not vest until the employment is terminated; and
- c) are provided to employees who will be retained beyond the minimum retention period.

### **Respondent comments**

33 Most respondents agreed with the proposed changes. However, a few respondents raised some concerns with the difference in the recognition criteria for voluntary and involuntary termination benefits paid in exchange for future services.

We believe that involuntary termination benefits should be recognised in the same way as voluntary termination benefits rather than split over the assumed future service period as the announcement signifies an obligating event. If a stay bonus is to be paid for employees remaining for 18 months, the two-thirds provision at the end of 12 months does not reflect the amount that the entity expects to pay and appears to contradict the measurement principles in both existing and proposed IAS 37. However, since the proposal would eliminate an often significant divergence between IFRS and US-GAAP, we can accept it on that basis. [CL35]

34 A few respondents commented that the standard should also provide for situations where voluntary termination benefits would be provided in exchange for future services.

### **Staff evaluation and recommendation**

35 In the proposed paragraph 132 it clearly states that the event that gives rise to an obligation is the termination of employment rather than the

- 36 In paragraph 11 of the Basis for Conclusions the Board agreed with the FASB that in some cases termination benefits, although provided as compensation for the early termination of services, also have the characteristics of being provided in exchange for employees' future services.
- 37 As proposed in paragraph 7 of the Exposure Draft and explained earlier in this paper, voluntary termination benefits are benefits offered to the employee for a *short period*. This amendment to the definition was made to create a clear distinction between employment benefits (paid to employees in exchange for services) and benefits paid for termination (paid to employees other than for services). Therefore, it would be inconsistent to recognise voluntary termination benefits in exchange for future services.
- 38 The staff suggests that Board amend the wording of the Basis for Conclusions to clarify this point as follows:

BC19 The Board noted that the definition of special termination benefits in SFAS 88 specifies that the benefits are offered for only a short period of time. The Board decided that the short-term nature of the offer was important, because it noted that if the benefits for leaving service are made available for more than a short period, the employer has effectively established a new ongoing benefit plan and the employees would treat the benefits as part of their employment package. In other words, the benefits would be payable in exchange for the employees' services and, therefore, should be treated like any other post-employment benefit. Accordingly, the Board decided to amend the definition of termination benefits to clarify that benefits paid to encourage employees to leave service should be regarded as voluntary termination benefits under IAS 19 only if those benefits are made available for a short period. As a consequence voluntary termination benefits can never be recognised in exchange for future services.

**Question to the Board**

Does the board agree?

## Appendix

### Numerical analysis of comments received

	Agreed	Disagreed	No Comment
<b>Question 1</b> – Do you agree with amending the definition of termination benefits to clarify that benefits that are offered in exchange for an employee’s decision to accept voluntary termination of employment are termination benefits only if they are offered for a short period?	49%	4%	47%
<b>Question 2</b> – Do you agree that voluntary termination benefits should be recognised when the employees accept the offer and that involuntary terminations should be recognised when the entity has communicated its plan of termination to the effected employees?	40%	15%	45%
<b>Question 3</b> – Do you agree that for involuntary termination benefits provided in exchange for employee’s future services, the liability for those benefits should be recognised over the period of the future service? Do you also agree with the three criteria for determining whether involuntary termination benefits are provided in exchange for future services?	45%	7%	50%