



Project **Post-employment benefits**

Topic **Termination benefits**

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### **Purpose of this paper**

1. In October 2009 the Board tentatively decided to publish the amendments to IAS 19 relating to termination benefits, and originally exposed in the project to amend IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, without waiting for the completion of the revised IAS 37.
2. While drafting the amendments we realised we could simplify the requirements by making two changes that we think better reflect the Board's reasoning.
3. This paper:
  - (a) Sets out the background of the Board's deliberations on the termination benefits amendments.
  - (b) Reconsiders the Board's decision regarding termination benefits provided for future service and recognition of termination benefits.

### **Summary of staff recommendations**

4. We recommend that:
    - (a) the Board amend the definition of termination benefits to include only benefits provided in exchange for termination of employment and not include benefits provided in exchange for employee service.
    - (b) the Board require an entity to recognise termination benefits when it no longer has the ability to withdraw an offer of those benefits.
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This paper has been prepared by the technical staff of the IASCF for discussion at a public meeting of the IASB.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the IASB.

Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRIC or the IASB can make such a determination.

The tentative decisions made by the IASB at its public meetings are reported in IASB *Update*. Official pronouncements of the IASB, including Discussion Papers, Exposure Drafts, IFRSs and Interpretations are published only after it has completed its full due process, including appropriate public consultation and formal voting procedures.

## Background

5. In June 2005, the Board published an Exposure Draft of Amendments to IAS 19, dealing with the accounting for termination benefits, together with proposed amendments to IAS 37.
6. As part of the short-term convergence project, the Board proposed amendments to the requirements in IAS 37 relating to the recognition of liabilities for costs associated with a restructuring. Those amendments were intended to converge with then SFAS 146 *Accounting for Costs Associated with Exit or Disposal Activities* (now US Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) topic 420 *Exit or Disposal Cost Obligations* (FASB ASC Topic 420)) and to improve the Standard.
7. FASB ASC Topic 420 also specifies the accounting for a class of termination benefits known as ‘one-time termination benefits’. These are benefits provided to current employees whose employment is 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 IAS 19 specifies the accounting for termination benefits, the Board also decided to amend the termination benefit recognition requirements in IAS 19 at the same time as its amendment to IAS 37.
8. The Board at the time 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 and SFAS 88 *Employers’ Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits* (now FASB ASC topic 712 *Compensation-Nonretirement Postemployment Benefits*) relating to special 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.

9. The amendments proposed that:
  - (a) the definition should be amended to clarify that benefits that are payable in exchange for an employee's decision to accept voluntary redundancy 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 should be recognised when the entity has communicated its plan of termination to the affected employees and the plan meets specified criteria, unless the involuntary termination benefits are provided in exchange for employees' future services (ie in substance they are a 'stay bonus'). In such cases, the liability for those benefits should be recognised over the future service period.
  
10. The Board exposed its proposals for public comment in June 2005. The comment letters were supportive of the proposed amendments. In May 2008 the Board considered the comments received on the exposure draft's proposals for termination benefits and made the following tentative decisions:
  - (a) In the proposed definition of voluntary termination benefits, the term 'short period' refers to a period between the offer for voluntary termination and the actual termination of the employment.
  - (b) Because the definition of voluntary termination benefits refers to a short period, voluntary termination benefits do not relate to future services.
  - (c) If an entity offers voluntary termination benefits and cannot withdraw that offer, the entity should recognise a liability in the same way as for involuntary termination benefits.

- (d) Before an obligation exists for involuntary termination benefits, employees need to know whether they are in the class of employees whose employment will be terminated.
11. We wish to re-consider the decisions regarding:
- (a) whether termination benefits include benefits provided in exchange for future service and
  - (b) the timing of recognition of termination benefits.

### **Benefits provided in exchange for future service**

12. Under IAS 19, termination benefits are distinguished from other employee benefits because the event that gives rise to a termination benefit is the termination of employment rather than employee service. However in developing the ED of the proposed amendments, the Board agreed with the FASB conclusion that sometimes an entity provides termination benefits in exchange for employees' future services, such as when an entity provides higher benefits if employees stay for a period before termination (a stay bonus). The Board further reasoned that this would be applicable to only involuntary termination benefits and not to voluntary termination benefits. An entity provides voluntary termination benefits to persuade people to go, not to stay.
13. To reflect this view of voluntary termination benefits, the Board proposed amending the definition of voluntary termination benefits to include only those benefits with a short time between acceptance of the offer and termination of employment. If there is a long time between acceptance of the offer and termination of employment, the entity is providing the benefits in exchange for service during that period and the benefits are post-employment benefits.
14. The staff now thinks that the same principle that applies currently in IAS 19 and to voluntary termination benefits, ie that termination benefits are benefits for termination, not future service, should apply to involuntary termination benefits. In other words benefits that an entity provides in exchange for employees' future

services, such as when an entity provides higher benefits if employees stay for a period before termination (a stay bonus), should be regarded as post-employment benefits not termination benefits. We believe that labelling such benefits as termination benefits, while consistent with US GAAP, is confusing.

15. We note that treating such benefits as post-employment benefits results in the same recognition as is required under SFAS 146. It is just the label that is different. But calling such benefits post-employment benefits makes the section in IAS 19 on termination benefits much easier to understand.

**Question 1**

Does the Board agree that termination benefits should not include benefits provided in exchange for employee service?

**Timing of recognition of termination benefits**

16. The proposals in the ED also made 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) due to jurisdictional or other restrictions. The Board decided that for discretionary voluntary termination benefits, the timing of recognition would depend on when the employee accepts the offer because until that point the entity can withdraw the offer. The Board also decided that for non-discretionary voluntary termination benefits, the timing of recognition would depend on when it communicates the offer to the affected employees because until that point the entity can withdraw the offer.
17. We believe the reasoning in paragraph 16 implies that the relevant factor determining the timing of recognition for voluntary termination benefits is an entity's ability to withdraw the offer.
18. However, the ED proposed that an entity should recognise voluntary termination benefits as follows:

- (a) discretionary termination benefits when an employee accepts the offer and
  - (b) non-discretionary termination benefits using the same recognition requirements as involuntary termination benefits.
19. While the recognition of involuntary benefits includes the requirement to recognise when an entity communicates the offer to the affected employees, it also includes the ability to recognise termination benefits over a future period if those benefits are in exchange for future service. As discussed above, we think that this latter requirement is inconsistent with the Board's reasoning that an entity does not give voluntary termination benefits in exchange for future services.
20. We agree with the Board's reasoning that voluntary termination benefits are not given in exchange for future service. We think this implies that an entity should recognise voluntary termination benefits when it no longer has the ability to withdraw an offer of those benefits, not over a future period of service. We think this would also result in a simpler set of requirements than those proposed in the ED, and, in this case, would be more closely converged with US GAAP.
21. In summary, we believe that the Board's general timing of recognition for termination benefits is when an entity no longer has the ability to withdraw the offer, and that this could be:
- (a) when an employee accepts an offer of voluntary termination benefits which the entity can withdraw prior to the employees acceptance.
  - (b) when an entity has communicated an offer of:
    - (i) involuntary benefits, or
    - (ii) voluntary benefits which the entity cannot withdraw.

**Question 2**

Does the Board agree that an entity should recognise voluntary termination benefits when that entity can no longer withdraw an offer of those benefits?

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Current recognition requirements	Recognition requirements proposed in 2005 ED (with the May 2008 decisions <u>underlined</u> )	Proposed recognition requirements
<p><b>133</b> An entity shall recognise termination benefits as a liability and an expense when, and only when, the entity is demonstrably committed to either:</p> <p>(a) terminate the employment of an employee or group of employees before the normal retirement date; or</p> <p>(b) provide termination benefits as a result of an offer made in order to encourage voluntary redundancy.</p> <p><b>134</b> An entity is demonstrably committed to a termination when, and only when, the entity has a detailed formal plan for the termination and is without realistic possibility of withdrawal. The detailed plan shall include, as a minimum:</p> <p>(a) the location, function, and approximate number of employees whose services are to be terminated;</p> <p>(b) the termination benefits for each job classification or function; and</p> <p>(c) the time at which the plan will be implemented. Implementation shall begin as soon as possible and</p>	<p><b>133A</b> An entity shall recognise a liability and expense for voluntary termination benefits when the employee accepts the entity's <u>discretionary offer</u> of those termination benefits. <u>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.</u></p> <p><b>133B</b> 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 <u>each of</u> the affected employees <u>whose employment is terminated</u>, 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:</p> <p>(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</p> <p>(b) establish the benefits that employees will receive upon termination of</p>	<p><b>133A</b> An entity shall recognise termination benefits when the entity can no longer withdraw its offer of those benefits. This includes:</p> <p>(a) when an employee accepts an offer of voluntary termination benefits which the entity can withdraw prior to the employees acceptance,</p> <p>(b) when an entity has a plan of termination as described in paragraph 133B for an offer of:</p> <p>(i) involuntary benefits</p> <p>(ii) voluntary benefits which the entity cannot withdraw.</p> <p><b>133B</b> An entity has a plan of termination when</p> <p>(a) it has communicated that plan to each of the affected employees whose employment is terminated;</p> <p>(b) 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.</p> <p>(c) it has identified the number of</p>



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<p style="text-align: center;"><b>the period of time to complete implementation shall be such that material changes to the plan are not likely.</b></p> <p>135 An entity may be committed, by legislation, by contractual or other agreements with employees or their representatives or by a constructive obligation based on business practice, custom or a desire to act equitably, to make payments (or provide other benefits) to employees when it terminates their employment. Such payments are termination benefits. Termination benefits are typically lump-sum payments, but sometimes also include:</p> <p>(a) enhancement of retirement benefits or of other post-employment benefits, either indirectly through an employee benefit plan or directly; and</p> <p>(b) salary until the end of a specified notice period if the employee renders no further service that provides economic benefits to the entity.</p> <p>136 Some employee benefits are payable regardless of the reason for the employee's departure. The payment of such benefits is certain (subject to any vesting or minimum service requirements) but the timing of their payment is uncertain. Although such benefits</p>	<p>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.</p> <p>133C If involuntary termination benefits are provided in exchange for employees' future services, an entity shall recognise the termination benefits as a liability and an expense over the period of the employees' future services (ie from the date specified in paragraph 133B to the date that employment is terminated).</p> <p>133D In some cases, involuntary termination benefits are provided in exchange for employees' future services. For the purpose of this Standard, this is the case if those benefits:</p> <p>(a) are incremental to what the employees would otherwise be entitled to receive (ie the benefits are not provided in accordance with the terms of an ongoing benefit plan);</p> <p>(b) do not vest until the employment is terminated; and</p> <p>(c) are provided to employees who will be retained beyond the minimum</p>	<p>employees whose employment is to be terminated, their job classifications or functions and their locations, and the expected completion date; and</p> <p>(d) it has established the termination benefits that employees will receive in sufficient detail that employees can determine the type and amount of benefits they will receive when their employment is terminated.</p> <p>133C When termination benefits are provided through a post-employment benefit plan, the liability and expense recognised initially include only the value of the additional benefits that arise from providing those termination benefits. Other changes in any defined benefit obligation for the post-employment benefit plan resulting from employees leaving employment at a date earlier than originally assumed should be recognised either as actuarial gains or losses or as a curtailment.</p> <p><b>Notes:</b> 2005 ED paragraph 133A now sets out overall recognition principle followed by sub-criteria for voluntary and involuntary benefits.</p>
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<p>are described in some countries as termination indemnities, or termination gratuities, they are post-employment benefits, rather than termination benefits and an entity accounts for them as post-employment benefits. Some entities provide a lower level of benefit for voluntary termination at the request of the employee (in substance, a post-employment benefit) than for involuntary termination at the request of the entity. The additional benefit payable on involuntary termination is a termination benefit.</p>	<p style="text-align: center;">retention period.</p> <p>133E In some cases, employers provide involuntary termination benefits that are expressed as an enhancement of the existing terms of an ongoing benefit plan. Examples are a doubling of benefits specified by employment legislation and an increase in retirement benefits to be provided through a post-employment benefit plan. If the termination benefits that are attributable to the enhancement of the ongoing benefit plan do not represent a change to the terms of the ongoing plan (and therefore would not apply to employees leaving service in the future) and satisfy the criteria in paragraph 133D(b) and (c), they shall be recognised in accordance with paragraph 133C.</p> <p>133F When termination benefits are provided through a post-employment benefit plan, the liability and expense recognised initially include only the value of the additional benefits that arise from providing those termination benefits. Other changes in any defined benefit obligation for the post-employment benefit plan resulting from employees leaving employment at a date earlier than originally assumed should be recognised either as actuarial gains or losses or as a curtailment.</p>	<p>2005 ED paragraphs 133C, 133D and 133E are no longer applicable because benefits in exchange for future service are now post-employment benefits.</p>
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