
Project	Post-employment benefits
Topic	Classification

Objective

1. This paper discusses the proposals in the exposure draft *Defined Benefit Plans* (the ED) to:
 - (a) combine the categories ‘other long-term employee benefits’ and ‘post-employment benefits’ (paragraphs 3 - 6); and
 - (b) clarify the distinction between the categories ‘short-term employee benefits’ and ‘other long-term employee benefits’ (paragraphs 7 - 47).
2. The staff recommends that the Board:
 - (a) retains the existing classification of post-employment and other long-term employment benefits in IAS 19 *Employee Benefits*.
 - (b) require the classification of employee benefits as short-term employee benefits on the basis of when the whole of the amounts resulting from that type of benefit are expected to be settled.
 - (c) clarifies that the classification should be revisited if the benefit no longer meets the definition of a short-term employee benefit.

Combining ‘other long-term’ and ‘post-employment’ benefit categories

Background and proposals in the ED

3. The main difference between accounting for other long-term benefits and accounting for post-employment benefits is the option to defer recognition of

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actuarial gains and losses ('the corridor') and the requirement to recognise unvested past service cost over the vesting period. The ED proposed to eliminate the corridor and deferred recognition for post-employment benefits, and thus remove any difference in recognition requirements between post-employment benefits and other long-term employee benefits. Accordingly, the Board proposed to combine post-employment benefits and other long-term employee benefits into a single category: long-term employee benefits. This would remove the arbitrary distinction between a benefit that is payable just before completion of employment and a benefit that is payable just after completion of employment. As a consequence, the disclosure and presentation proposals in the ED for defined benefit plans would also apply to benefits previously classified as 'other long-term employee benefits'.

Overview of comments received on the ED

4. Most respondents expressed strong opposition to merging the 'post-employment' and 'other long-term employment' benefit categories. Many argued that accounting for other long-term employee benefits is not problematic, and further believe there is no benefit in disaggregating and presenting the gains and losses in the way proposed for defined benefit plans. Currently, gains and losses arising from other long-term employee benefits are recognised in the period in which they occur and presented in profit or loss. Many respondents believe that other long-term employment benefits are not subject to the same degree of uncertainty and risk as post-employment benefits, and thus do not believe that the proposed presentation and disclosure requirements for post-employment benefits are appropriate for other long-term employment benefits.
5. Although the ED identified this change in paragraph BC77, the Board did not specifically debate the amendment before publishing the ED. Some have commented that the Board should have debated a change of this significance at a public meeting and could have communicated the change better.

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Staff recommendation

6. The staff recommends that the existing classifications of post-employment and other long-term employee benefits in IAS 19 be retained for the following reasons:
- (a) In developing the ED, the Board did not specifically consider how its proposals on presentation and disclosure would apply to other long-term employee benefits.
 - (b) Accounting for other long-term employment benefits was not originally within the scope of the project. The Board has not received feedback that accounting for other long-term employment benefits is an area requiring improvement.
 - (c) The staff believe that the benefits of disaggregating the change in other long-term employment benefits into a service cost, finance cost and remeasurements component do not outweigh the costs to preparers.
 - (d) Some believe the accounting for other long-term employment benefits is more appropriate than the current or proposed accounting for post-employment benefits. More specifically, they believe that all changes in these liabilities should continue to be presented in profit or loss.
 - (e) The proposal would have a more significant effect in some jurisdictions than the Board might have realised.

Question 1

Does the Board agree to retain the existing classifications of post-employment and other long-term employment benefits in IAS 19?

Clarifying the distinction between short-term employee benefits and other long-term employee benefits

7. This section provides the following:

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- (a) background and an overview of the proposals in the ED (paragraphs 8 - 13);
- (b) an overview of the responses to the proposal in the ED (paragraph 14); and
- (c) a staff analysis and a staff recommendation (paragraphs 15 - 47).

Background and proposals in the ED

8. The Board addressed the issue of classification of a benefit as a short-term employee benefit due to diversity in practice caused by differing interpretations of the current requirements. Some interpret the current requirements as distinguishing between short-term employee benefits and other long-term employee benefits on the basis of expected settlement, and others on the basis of entitlement.
9. The classification of employee benefits as either short-term employee benefits or other long-term employee benefits determines how they are measured. IAS 19 requires short-term employee benefits to be measured at the undiscounted amount of the benefit expected to be paid and other long-term employee benefits to be measured at the present value of the defined benefit obligation (less the fair value of plans assets, if any).
10. Paragraph 7 of IAS 19 states:

The present value of a defined benefit obligation is the present value, without deducting any plan assets, of **expected future payments required to settle the obligation** resulting from employee service in the current and prior periods. [emphasis added]
11. The measurement requirement for short-term employee benefits was intended as a practical expedient to simplify the measurement for these benefits. The measurement requirement reflects that there is less uncertainty about the ultimate cost of most short-term benefits, and that the effect of discounting is not typically material over a period of less than twelve months.

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12. The ED proposed to clarify that the distinction between short-term employee benefits and long-term employee benefits (other than those payable after completion of employment) depends on the period between the date when the employee renders the service that gives rise to the benefit and the date when the entity expects the benefit to become due to be settled. For example, suppose an employee becomes entitled to holiday pay during a reporting period, but is not expected to require settlement of that benefit (ie to take that leave) within twelve months of the reporting date. The entity expects the benefit to become due to be settled more than 12 months after the end of the reporting period in which the employee renders the related service, and thus would classify the benefit as long-term.
13. The ED did not ask specific questions on the proposals for these changes, nonetheless many respondents commented on these proposals.

Overview of comments received on the ED

14. There is continuing concern that the proposed distinction between short-term employee benefits and other long-term employee benefits is unclear. These concerns relate to:
 - (a) The basis for distinguishing between short-term employee benefits and other long-term employee benefits and whether the words ‘expected to be due to be settled’ achieve that distinction;
 - (b) whether an entity should split a benefit that the entity expects to settle partly in less than 12 months and partly in more than 12 months into a short-term component and a long-term component;
 - (c) whether an entity should reclassify other long-term employee benefits as short-term employee benefits as a result of the passage of time or a change in expectation of settlement; and
 - (d) whether an entity should classify benefits as short-term employee benefits or other long-term employee benefits on an employee-by-

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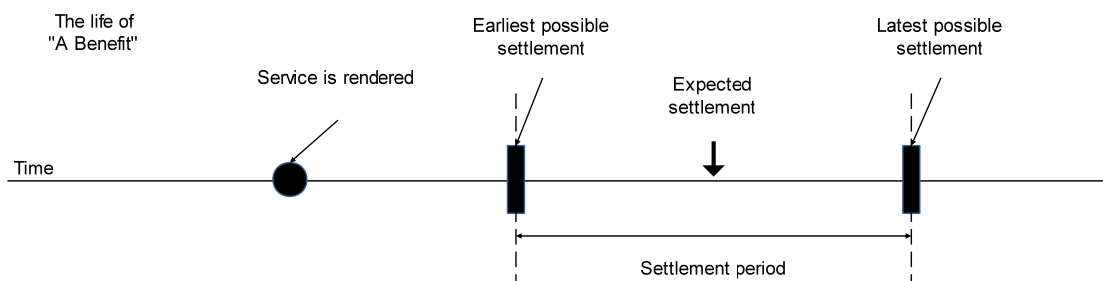
employee basis or on the basis of the plan as a whole (ie what the unit of account should be for the classification).

Staff analysis and recommendation

15. Because the measurement of short-term employee benefits is the exception to the general measurement requirements of IAS 19, the objective of the following analysis is to determine the scope of the short-term employee benefits classification that will result in an appropriate balance between:

- (a) the benefits to entities of using a simplified measurement approach for that set of employee benefits; and
- (b) the cost to users of measuring that set of employee benefits at an amount different from the general measurement requirements of IAS 19.

16. The analysis refers to the following diagram:



17. For the following analysis, the terms in the above diagram have the following meaning:

- (a) Earliest possible settlement – is the earliest possible date that an employee benefit obligation can be settled, ie when the employee is entitled to receive the benefit. This typically equates to when the benefits become vested, and therefore it can be:
 - (i) the same time as the employee renders the service (for example, wages and sick leave),
 - (ii) after a specified period of time (for example, long service leave), or

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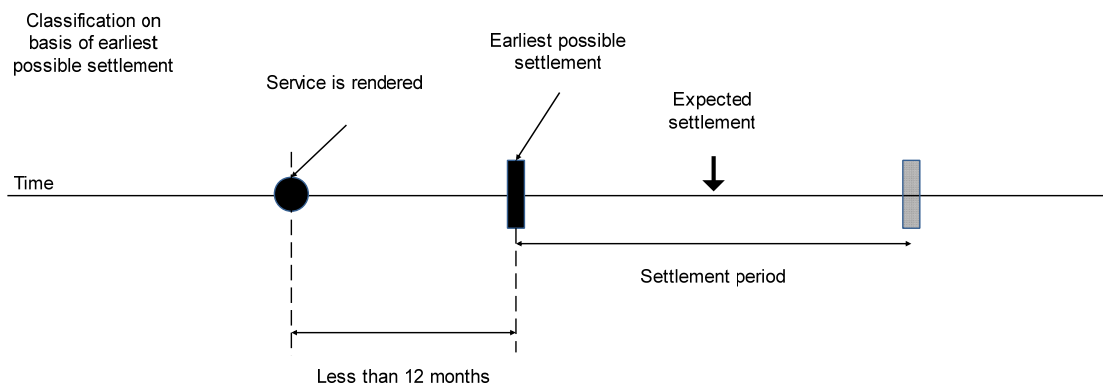
- (iii) when a specified condition is met (for example, a bonus based on performance).
 - (b) Latest possible settlement date – is the latest possible date that an employee benefit obligation can be settled, ie the date when an employee is no longer entitled to receive a benefit. This can be because of the passage of time (for example unused sick leave or annual leave that can be carried forward for a limited time), or because of an event, such as termination of employment. Some benefits do not expire, for these benefits the payment of the benefit is certain, but the timing is uncertain.
 - (c) Settlement period – is a period between the earliest possible settlement date and the latest possible settlement date. An entity expects settlement to occur at some point within this period.
18. The analysis considers the following:
- (a) Basis for the classification of short-term employee benefits (paragraphs 19 – 27)
 - (b) Other issues (paragraphs 28 – 43)
 - (c) Summary and staff recommendation (paragraphs 44 – 47)

Basis for the classification of short-term employee benefits

19. This section discusses whether the classification of a short-term employee benefit should be on the basis of:
- (a) the earliest possible settlement date,
 - (b) the latest possible settlement date, or
 - (c) the expected date of settlement.

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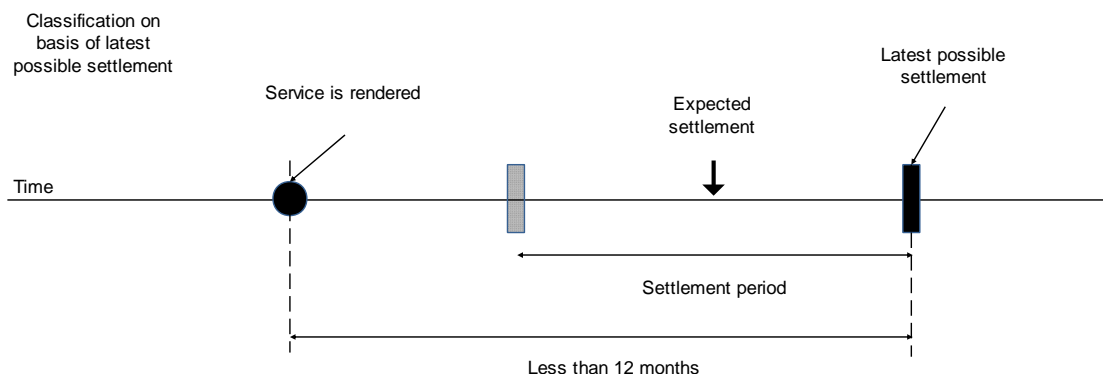
The earliest possible settlement date



20. Classifying benefits as short-term employee benefits on the basis of the earliest possible settlement will:
- (a) result in a larger set of benefits being classified as short-term than if the classification was made on the basis of the latest possible settlement date or the expected settlement date.
 - (b) increase the possibility that the benefits will be measured at an amount that differs from their present value. The earliest possible settlement will not take into consideration the length of the settlement period.
21. If the classification were made on the basis of the earliest possible settlement date, then a benefit classified as short-term could be measured at a different amount from the amount it would have been measured at using the normal measurement requirements of IAS 19. For example, if an employee is entitled to a benefit within twelve months, but the benefit is not expected to be settled until many years later, the benefit would be classified as a short-term employee benefit if the classification is on the basis of the earliest possible settlement date, and an other long-term employee benefit if the classification is on the basis of the expected date of settlement. Measuring such a benefit at its undiscounted amount would be materially different from its present value under IAS 19, therefore classifying the benefit as an other long-term employee benefit would be more appropriate than classifying it as a short-term employee benefit.

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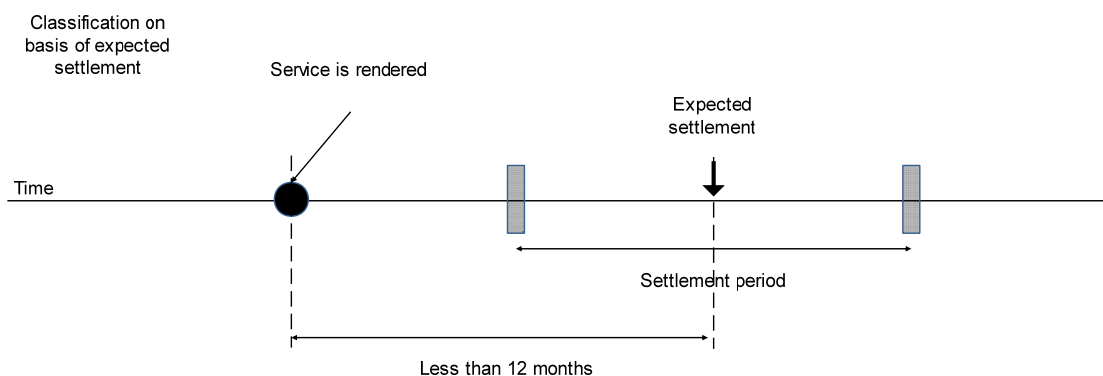
The latest possible settlement date



22. Classifying benefits as short-term employee benefits on the basis of the latest possible settlement will:

- (a) result in all benefits with a possible settlement date greater than 12 months being classified as other long-term employee benefits, thus eliminating the possibility that those benefits will be measured at an amount that differs from their present value
- (b) result in the smallest set of benefits being classified as short-term employee benefits.
- (c) raise concerns about determining what the latest possible settlement date is and whether common employment practices, such as allowing employees to carry forward leave longer than they should under the terms of the benefit, should be taken into account.

The date of expected settlement



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23. Classifying benefits as short-term employee benefits on the basis of the date of expected settlement will:
- (a) match the measurement basis the closest. All benefits with an expected settlement date greater than 12 months would be classified as other long-term employee benefits, thus eliminating the possibility that the benefits will be measured at an amount that differs from their present value.
 - (b) raise the following additional concerns:
 - (i) Change in expectation – at any point in time, the date of expected settlement can be anywhere between the earliest possible settlement date and the latest possible settlement date. If the expected settlement date of a benefit classified initially as a short-term employee benefit changes subsequently to a date more than 12 months after the end of the reporting period, then the undiscounted amount of that benefit could differ from its present value. The Board will need to consider subsequent reclassification of short-term employee benefits.
 - (ii) Unit of account – the earliest possible settlement date and the latest possible settlement date are typically determined based on the characteristics of the benefit, however the expected settlement date is determined based on a combination of the characteristics of the benefits and the characteristics of the employees. The Board will need to consider whether classification is made on an employee-by-employee basis or based on a ‘benefit type’, and if based on a ‘benefit type’, how to apply the notion of expected settlement to a ‘benefit type’.
 - (iii) Splitting benefits into components – some benefits are expected to be settled over a period of time. The Board will need to consider whether an entity will have to split a benefit that is settled over a period of time into a short-term and long-term component.

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Conclusion

24. As noted in paragraph 10, IAS 19 requires a benefit to be measured at its present value based on the expected future payments required to settle the obligation. Because the measurement of present value in IAS 19 is the present value of expected future payments required to settle the obligation, the staff believes the classification of short-term benefits should be determined on the basis of the expected date of settlement.
25. However, the concerns in paragraph 23(b) about adopting such a basis may counter-act the objective of having the short-term employee benefit classification. That is, addressing these concerns may add to costs of preparation or limit the set of benefits that meet the definition of short-term employee benefits thereby reducing the effectiveness of the short-term employee benefits classification as a practical expedient. The paper discusses the concerns raised in paragraph 23(b) further in paragraphs 28 – 42.
26. Furthermore, requiring an entity to classify the benefit based on expectations in any particular year would reflect the actuarial assumptions of that year rather than the characteristics of the benefits promised. In the staff's view, the classification of the benefits should reflect the characteristics of the benefits rather than the demographic or financial assumptions of a point in time. The approaches based on the earliest or latest possible settlement would reflect the characteristics of the benefits.
27. The Board could explore variations on the above approaches, such as setting a probability threshold around expected settlement. For example the Board could require the classification of a short-term employee benefit on the basis of whether a benefit is more likely than not to be settled within 12 months of the reporting period. However a variation such as this will also raise the concerns noted in paragraph 23(b), such as whether to reclassify if expectations change.

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Other issues

28. This section discusses the following additional issues that are relevant if the Board decides to require the classification to be made on the basis of the timing of expected settlement:
- (a) Whether the classification should be on an employee-by-employee basis or by ‘benefit type’ and if by ‘benefit type’ how to apply the notion of expected settlement to a ‘benefit type’ (paragraphs 30 – 36).
 - (b) Whether an entity should split a benefit into short-term and long-term components for the purposes of classification (paragraphs 37 – 38).
 - (c) Whether subsequent reclassification of a benefit should be required, permitted or prohibited (paragraphs 39 – 42).
29. The above issues could also be relevant, to a lesser extent, if the Board decides that classification should be on the basis of earliest or latest possible settlement, for example because a benefit’s terms set different dates for the earliest and latest possible settlement dates based on particular conditions being met that could result in these dates being different for different employees.

Employee-by-employee or benefit-by-benefit?

30. The classification of an employee benefit can either be made for each benefit provided to each employee, or for each ‘benefit type’. For this discussion a ‘benefit type’ is a benefit that is offered to many employees that has the same terms and characteristics, such as vesting conditions and settlement period.
31. IAS 19 does not specify the unit of account for employee benefits other than post-employment benefits (whose unit of account is the post-employment benefit plan) however the definitions of employee benefits, short-term employee benefits and other long-term employee benefits refer to benefits provided for service rendered by ‘employees’ (in plural).
32. The staff does not believe that the classification is intended to be on an employee-by-employee basis. If classification were required for each benefit provided to each employee, then entities would have to assess whether each

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benefit provided to each employee met the definition of a short-term employee benefit.

33. However applying the classification to each ‘benefit type’ raises the question of how such a classification will be applied to a set of benefits which may have different timing of earliest and latest possible settlement, and of expected settlement for each employee, ie will it be based on:
- (a) all benefits from that ‘benefit type’ meeting the classification criteria;
or
 - (b) an amount of benefits greater than a specified threshold from that ‘benefit type’ meeting the classification criteria (such as predominantly all benefits, a majority of benefits, typically etc).
34. The staff believe that it would be clearer and less ambiguous if the Board required that a ‘benefit type’ is classified as a short-term employee benefit only if all benefits resulting from that ‘benefit type’ meet the definition of a short-term employee benefit. Introducing a threshold, such as ‘typically’ or ‘predominantly’, would require additional guidance or discussion explaining the application of the threshold.
35. However, requiring all benefits that result from that ‘benefit type’ to meet the definition of short-term employee benefits would result in fewer ‘benefit types’ meeting the definition of short-term employee benefits than if, say, predominantly all benefits resulting from that ‘benefit type’ meet the definition. Requiring all benefits to meet the definition may also result in the same set of benefits as if the classification were based on the latest possible date of settlement.
36. Alternatively, the Board could set the classification criteria and stay silent on the unit of account. This will allow entities to use judgment in determining the appropriate unit of account to apply the classification criteria of a short-term employee benefit to. However not specifying the unit of account may result in diversity in practice.

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Split a benefit into short-term and long-term components?

37. Some interpret the definitions in IAS 19 and the proposed definitions in the ED as requiring that benefits be split into a short-term component and a long-term component if the benefit is settled over a period of time and part of the benefit meets the definition of short-term employee benefits. In the staff's view the same measurement approach should be applied to the whole of the benefit, otherwise the passage of time will require reclassification of part of the benefit and a change in measurement basis. For example, if benefits are required to be split into a short-term component and a long-term component, then amounts arising from benefits classified as long-term in the previous period would need to be split and reclassified when part of the benefits meet the definition of short-term employee benefit in the next period.
38. Applying the same measurement approach to the whole of the benefit would also be consistent with:
- (a) the measurement requirement in paragraph 66 of IAS 19 which is applicable to the measurement of other long-term employment benefits and states:
- An entity discounts the whole of a post-employment benefit obligation, even if part of the obligation falls due within twelve months after the reporting period.
- (b) the requirement in paragraph 22 of current IAS 19 to classify profit-sharing and bonus payments as long-term if they are not wholly due within twelve months:
- If profit-sharing and bonus payments are not due¹ **wholly** within twelve months after the end of the period in which the employees render the related service, those payments are other long-term employee benefits...

¹ Paragraph 22 was amended in the ED to match the wording with the definition of short-term benefits. The paragraph quoted is the current requirement in IAS 19.

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Subsequent reclassification required, permitted or prohibited?

39. IAS 19 does not specify whether an entity is required, permitted or prohibited to reclassify an employee benefit if that employee benefit no longer meets the definition of its existing classification. If, subsequent to the initial classification, an employee benefit no longer meets the definition of short-term employee benefits, measuring that benefit at the undiscounted amount could result in an amount that differs from measuring that benefit at its present value.
40. In the staff's view the Board should focus on the definition of a short-term employee benefit and whether, if an employee benefit no longer meets this definition, an entity should be required to reclassify the benefit to an other long-term employee benefit to ensure that it is being measured using the appropriate basis. Reclassification of a benefit from other long-term employee benefits when it meets the definition of short-term employee benefits is less of a concern because measuring the benefit at its undiscounted amount should not differ from measuring the benefit at its present value.
41. If the Board were to:
 - (a) require the entity to revise the classification of a short-term employee benefit because it no longer meets the definition, then gains or losses could arise because of the change in measurement method. In the staff's view, such gains or losses would be an accounting artifact that does not faithfully represent a change in the employee benefits. However any gain or loss would be not be significant if the classification is based on settlement (unless based on expected settlement and the expectation changes significantly).
 - (b) prohibit the entity from revising the classification of a short-term employee benefit after initial classification because it no longer meets the definition, then measuring the benefit at the undiscounted amount could result in an amount that differs from measuring the benefit at its present value. However this will maintain continuity of measurement throughout the life of the benefit.

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42. The staff believes that an entity should be required to revise the classification of a short-term employee benefit if it no longer meets the definition. In the staff's view this would maintain the objective that the benefits should not be measured at an amount that would differ materially from their present value.
43. Alternatively, the Board could set the classification principle and stay silent on whether a benefit that no longer meets the definition of a short-term employee benefit should be reclassified. This will allow entities to use judgment in determining whether the classification of employee benefits meets the objective that the benefits should not be measured at an amount that would differ materially from their present value.

Summary and staff recommendation

44. The staff believes that classifying benefits as short-term employee benefits on the basis of:
- (a) the earliest possible settlement would result in the largest set of benefits that would meet the definition, however this basis may not meet the objective of measuring these benefits at an amount that does not materially differ from their present value, therefore the staff does not recommend this approach.
 - (b) the latest possible settlement date would be consistent with the measurement objective, however this would result in the smallest set of benefits that would meet the definition, therefore the staff does not recommend this approach.
 - (c) the date of expected settlement would be consistent with the measurement objective, however the Board will have to consider providing additional guidance on the unit of account, to clarify whether the classification should be made for each benefit provided to each employee or for each 'benefit type', and whether the benefit should be reclassified if it no longer meets the definition of a short-term employee benefit.

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45. The staff does not believe that the classification is intended to be on an employee-by-employee basis. However classification based on the date of expected settlement may be difficult to apply for a ‘benefit type’ and the Board would have to determine whether the classification should be on the basis of all benefits resulting from that ‘benefit type’, or on the basis of a threshold such as ‘predominantly’. Alternatively, the Board may stay silent on the unit of account, allowing entities to apply their judgment based on the objective of the classification.
46. The staff believes that the classification of a short-term employee benefit should be revisited if it no longer meets that definition. Prohibiting reclassification of a short-term employee benefit would maintain continuity of measurement throughout the life of the benefit, however measuring the benefit at the undiscounted amount could result in an amount that differs from measuring the benefit at its present value if it no longer meets the definition of a short-term employee benefit. Alternatively, the Board may stay silent on whether a short-term employee benefit should be reclassified, allowing entities to apply their judgment based on the objective of the classification.
47. Finally, the staff believe that a benefit should be classified as a short-term employee benefit on the basis of when the whole of the benefit is expected to be settled.

Question 2

Does the Board agree to:

a) require the classification of employee benefits as short-term employee benefits on the basis of when the whole of the amounts resulting from that type of benefit are expected to be settled?

and

b) clarify that the classification should be revisited if the benefit no longer meets the definition of a short-term employee benefit?