

STAFF PAPER

3 November – 4 November 2011

IFRS Interpretations Committee Meeting

Project	IAS 19 <i>Employee Benefits</i>		
Paper topic	Definition of termination benefits		
CONTACT(S)	Manuel Kapsis	mkapsis@ifrs.org	+442072466410

This paper has been prepared by the staff of the IFRS Foundation for discussion at a public meeting of the IFRS Interpretations Committee. Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretations Committee or the IASB can make such a determination. Decisions made by the IFRS Interpretations Committee are reported in *IFRIC Update*. The approval of a final Interpretation by the Board is reported in *IASB Update*.

Introduction

1. The IFRS Interpretations Committee (the Committee) received a request to clarify the application of IAS 19 *Employee Benefits* to ‘Altersteilzeit’ or ‘Old-age-part-time-work’ arrangements in Germany (ATZ plans).
2. This agenda paper includes:
 - (a) Background information on the issue (paragraphs 3 – 6).
 - (b) Staff analysis (paragraphs 7 – 14).
 - (c) Assessment against the Committee’s Agenda criteria (paragraphs 15 – 22).
 - (d) Staff recommendation (paragraph 23).
 - (e) Proposed wording for tentative agenda decision (Appendix A).
 - (f) Relevant requirements of IAS 19 (2011) (Appendix B).
 - (g) The submission (Appendix C).

Background

3. In October 2011, the Committee received a submission seeking clarification on the classification of the bonus payment benefits in ATZ plans under the new IAS 19 issued in June 2011. The submission asks whether the bonus payments paid under the ATZ plan meet the definition of termination benefits or not.

4. Typically ATZ plans have the following features:

- (a) *Eligibility* - An employee is eligible to begin working under the ATZ plan only when they would meet the normal retirement age after the ATZ period. Thus, eligibility is primarily on the basis of age however other eligibility requirements might also be present. In some cases, an employee is required to work for a minimum period of time with that employer prior to being eligible to sign-up for the ATZ plan (for example, 5 years). The employer may have entered into a collective or company-wide arrangement offering employees these benefits (ie it may be part of an employers ongoing benefit plan).
- (b) *Arrangement* – Typically two alternative types of arrangements for participating employees. During the period covered by the plan (the ATZ period), the employee receives 50% of salary in each year throughout the period under both arrangements and either:
 - (i) the employee works 50% of time in each year throughout the ATZ period and (Type I plan); or
 - (ii) the employee works 100% of time for the first half of the ATZ period and then 0% of time for the second half of the period (Type II plan).
- (c) *Bonus payment* - Under both alternatives, the participant also receives an annual bonus, which varies by employer, but will generally equal 20-35% of their full-year salary. Employees must provide service to an employer for the required portion of the ATZ period in order to receive the full bonus payment. If a participant dies, voluntarily leaves the company, or is otherwise terminated prior to fulfilling the service period requirement, the ATZ arrangement will be unwound and the total benefit received by the employee will be adjusted to the amount that would have received if they had never signed up for the ATZ plan.
- (d) *ATZ period* – typically runs over a period of one to six years, depending on the age at which a participant signs up for the plan.

5. The submitter provides three possible views:

- (a) Bonus payments are termination benefits - This view is based on what many set out as the economic substance of the ATZ plan. According to the proponents of this view the annual bonuses are provided to the employees if they accept the early termination of their employment and therefore are termination benefits.
 - (b) Bonus payments are not termination benefits - According to this view the annual bonus payments do not meet the definition *termination benefits*, because they are conditional on future service to be provided by the employee during the ATZ period. Further, in many instances the benefits also are provided in accordance with the terms of an existing employee benefit plan and are therefore available to all employees meeting the eligibility criteria.
 - (c) Bonus payments may be termination benefits depending on the individual facts and circumstances.
6. The amendments to IAS 19 issued in June 2011 did not significantly amend the definition of termination benefits. The Board decided to retain the existing distinction between benefits provided in exchange for employee service and benefits provided in exchange for the termination of employment. However the Board decided to clarify the distinction and provide some additional discussion, including indicators, to help entities distinguish between benefits provided in exchange for the termination of employment from benefits provided in exchange for employee service. Thus these changes were made to improve IAS 19 by providing additional guidance to help entities identify termination benefits.

Staff analysis and recommendation

7. Difficulties can arise when classifying a benefit that might have features of both a benefit in exchange for employee service and the termination of service. The definitions of other employee benefits in IAS 19 exclude benefits that meet the definition of termination benefits. For example “*Short-term employee benefits* are employee benefits (other than termination benefits)...” Thus the following

analysis focuses on whether the benefits offered under ATZ plans meet the definition of termination benefits:

Termination benefits are employee benefits provided in exchange for the termination of an employee's employment as a result of either:

- (a) an entity's decision to terminate an employee's employment before the normal retirement date;**
or
- (b) an employee's decision to accept an offer of benefits in exchange for the termination of employment.**

8. Paragraph 162 of IAS 19 (refer Appendix A) was introduced by the amendments made in 2011 and provides a non-exhaustive list of two indicators that an employee benefit is provided in exchange for services and not in exchange for the termination of employment. The first indicator is that the benefit is conditional on future service (eg if the benefit vests based on future service) and if the level of the benefit increases if further service is provided (eg the benefit formula is based on service). The second indicator is whether the benefit is provided in accordance with the terms of an employee benefit plan (eg the employee is entitled to the benefit as part of their overall employment package).
9. However, an entity's determination of the classification should be based on the definition of termination benefits and thus may consider features of the benefit in addition to the indicators in paragraph 162, such as when eligibility is based on service (eg eligibility based on 5 years of prior service may indicate that benefit was in exchange for the previous 5 years service) or when termination of employment is one of the conditions of the benefit.
10. In the staff's view a benefit cannot be provided in exchange for both employee service and the termination of employee service. This would be equivalent to offering a benefit that is payable if the employee works for an additional year and leaves employment immediately (it would be impossible to meet both conditions). Therefore, in circumstances where both features are present, an entity should consider what condition takes primacy. Would the benefit be paid if the

employee works for an additional year, or would it be paid if the employee leaves employment immediately?

11. In the case of ATZ plans, although termination of service earlier than would otherwise be the case is part of the overall arrangement, the bonus payments are only paid if the employee provides the required service during the specified period. Therefore, if the employee’s service is terminated before the end of the specified period, the employee does not receive the termination benefits. Hence, the defining characteristic of the benefit is the requirement to provide service and the benefit is not a termination benefit. How and when employment is terminated does not change the amount of the benefit, rather the length of service changes the amount of the benefit.
12. One of the views in the submission argues that the bonus payments are not termination benefits because the bonus payment is conditional on future service to be provided by the employee during the active service period. Thus if employment is terminated before this required period of service, the employee does not receive the bonus payment. The staff agrees with this view for the reasons set out in the above paragraph. Furthermore, the staff thinks that this view is strengthened if
 - (a) the ATZ plan is an existing benefit plan that employees can opt-in once they meet the eligibility requirements; and
 - (b) the eligibility requirements are based on a number of years of prior service.
13. Proponents of the view that the bonus payments are termination benefits argue that:
 - (a) Based on the ‘economic substance’ or ‘objective’ of the bonus payments, that “the additional compensation is provided to the employees if they accept the (early) termination of their employment and therefore additional compensation is termination benefit”. The staff does not agree with this view because the bonus payments are not paid if employment is terminated before the required service is provided.

- (b) The definition in IAS 19 has not changed substantively in the amendments to IAS 19, therefore the application of the definition should not change. The staff does not agree with this view. The Board considered it important to clarify the distinction between termination benefits and other employee benefits to improve the application of the definition and, in part, to converge with the accounting requirements under US GAAP for ‘stay bonuses’ (as discussed in paragraph BC277 of the Basis for Conclusions). Stay bonuses are benefits paid to employees to encourage them to stay for a limited period following a restructuring. The staff’s understanding is that the clarifications will result in accounting changes, particularly when it comes to boundary effects to do with definitions and classification.
- (c) The example illustrating paragraphs 159-170 (refer Appendix B) illustrates the difference between a ‘stay bonus’ and the additional bonus payments under ATZ plans and thus why the bonus payment is a termination benefits and the ‘stay bonus’ is not. The submission states that:

“The incremental benefits [stay bonus] that employees ... will receive – if they provide services for the full ten-months period – are in exchange for additional future services provided over that period when compared to the other employees terminated immediately.”

“In contrast, in line with an [ATZ plan] the employee receives higher payments ... although the service provided is less than the employee would need to provide if the [ATZ plan] had not been agreed. This supports again the view, that the additional compensation is not for future (additional) services but for the fact that the employee accepts to leave the company earlier than without an [ATZ plan], thus it represents a termination benefit.”

In other words, proponents of this view argue that:

- (i) ‘stay bonuses’ are additional benefits in exchange for employees remaining in employment longer than employees terminated immediately and thus are an employee benefit; while
- (ii) bonus payments under an ATZ plan are additional benefits in exchange for employees terminating employment earlier than employees remaining in normal employment and thus are a termination benefit.

The staff do not agree with this analysis because:

- (i) the bonus payments are conditional on future employment, similar to stay bonuses.
- (ii) the bonus payments are not payable if the employee leaves before providing the required service, similar to stay bonuses.

Therefore, the staff considers the bonus payments to be economically similar to stay bonuses in that an employee is offered a higher rate to convert from permanent employment to temporary employment in both cases. Termination benefits do not include benefits provided in exchange for a reduction in employment (ie a higher hourly rate in exchange for an employee changing from full-time to part-time). Furthermore, the staff do not think that the classification of benefits under IAS 19 is a comparative or relative analysis based on the whole package of benefits (ie comparing varying levels of service and benefit to determine).

14. The staff can envisage modifications to the fact patterns above that could lead to the benefits meeting the definition of termination benefits. For example if it is standard business practice to pay the bonus payments regardless of whether the employee provides the required service or not, in addition to the offer of those benefits as part of a restructuring.

Agenda criteria

15. The staff has assessed the submission against the Committee’s criteria as follows:

- (a) The issue is widespread and has practical relevance.
 - (b) The issue indicates that there are significant divergent interpretations (either emerging or existing in practice).
 - (c) Financial reporting would be improved through the elimination of the diverse reporting methods.
 - (d) The issue can be resolved efficiently within the confines of existing IFRSs and the Framework, and the demands of the interpretation process.
 - (e) It is probable that the Committee will be able to reach a consensus on the issue on a timely basis.
 - (f) If the issue relates to a current or planned IASB project, is there a pressing need for guidance sooner than would be expected from the IASB project?
16. Although the submission makes reference to the ATZ plans in Germany specifically, anecdotal evidence suggests that similar arrangements exist in other jurisdictions. Similar arrangements could include supplementary early-retirement schemes, employees switching from full-time to part-time employment or from permanent to temporary employment and stay bonuses.
- (a) In Belgium employers offer prepension benefits to employees that that retire before the normal retirement age. Under the Belgian pre pensions scheme, employees are entitled to additional benefits once they reach a specified age, however other eligibility requirements and conditions vary and the classification depends on the individual facts and circumstances.
 - (b) In Mexico employers offer severance payments to employees on the termination of employment. However if the offer of these benefits is expected by employees through established business practice there may be a constructive obligation for these benefits.
17. The submission highlights divergent interpretations that are emerging in Germany. However the staff has not had the opportunity to determine whether there is diversity in practice for the arrangements referred to above in other jurisdictions. The staff notes that classification of benefits requires judgment and

slight differences in the fact pattern can result in differing classifications that could be valid. Anecdotal evidence would suggest that there is no diversity in practice for the accounting for supplemental early retirement schemes and increases in pay in exchange for reducing working hours. The staff will undertake outreach to confirm the extent of diversity in practice.

18. The improvements to IAS 19 made in 2011 for termination benefits were intended to clarify the existing requirements and therefore improve the consistency of application of the definition of termination benefits. However the amendment to IAS 19 (2011) has not yet become effective and therefore further evidence of diversity in practice may emerge once it becomes effective.
19. In the staff's view, eliminating diversity in practice would be appropriate where there is diversity in accounting for the same fact pattern. Accounting for the same arrangement as termination benefits or other employee benefits will result in different recognition and measurement of the same liability.
20. In the staff's view the requirements in IAS 19 as further reinforced by the additional discussion included in the amendments made in June 2011 are sufficiently clear. Judgment is required in determining the classification of benefits therefore further clarification could only be provided on a case by case basis by examining the individual facts and circumstances. Any interpretation or amendment would only be applicable to ATZ plans.
21. In the staff's view a consensus on the issue could be reached on a timely basis.
22. The IASB recently completed a limited scope project on IAS 19, including amendments to the termination benefits paragraphs of concern. This limited scope project did not fundamentally reconsider the classification of benefits, however a fundamental review of IAS 19 is a suggested project for the Board's future agenda. Any such fundamental project will take some years to complete.

Staff recommendation

23. Based on the above the staff recommends that the Committee should not take the issue onto its agenda. We propose a draft for the tentative agenda decision in Appendix A.

Questions for the Committee

Does the Committee agree with the recommendation?

Appendix A — Proposed wording for tentative agenda decision

We propose the following wording for the tentative agenda decision:

IAS 19 *Employee Benefits*—Applying the definition of termination benefits to ‘Altersteilzeit’ plans

The Interpretations Committee received a request for regarding the application of IAS 19 to ‘Altersteilzeit’ plans (ATZ plans) in Germany. ATZ plans are early retirement programs designed to create an incentive for employees within a certain age group to smooth the transition from (full or part time) employment into retirement before the employees’ legal retirement age. ATZ plans offer bonus payments to employees in exchange for a 50% reduction in employment with the employment terminated at the end of the required service period. The bonus payments are conditional on the completion of the required service period.

The Committee observed that the classification of a benefit that has both a required service condition and a termination of employment condition requires the application of judgement. The Committee noted that similar fact patterns (including supplementary early retirement schemes, benefits in exchange for employees switching from full-time to part-time employment or from permanent to temporary employment and stay bonuses) are widespread in many jurisdictions and anecdotal evidence suggests that there is no diversity in practice in accounting for these benefits.

Consequently, the Interpretations Committee [decided] not to add the issue to its agenda.

Appendix B— Requirements under IAS 19

Requirements under IAS 19 as issued in June 2011 (showing changes from the previous version of IAS 19):

8 ...

Termination benefits are employee benefits provided in exchange for the termination of an employee’s employment payable as a result of either:

- (a) **an entity’s decision to terminate an employee’s employment before the normal retirement date; or**
- (b) **an employee’s decision to accept ~~voluntary redundancy~~ an offer of benefits in exchange for those benefits the termination of employment.**

~~132~~159 This Standard deals with termination benefits separately from other employee benefits because the event ~~which~~that gives rise to an obligation is the termination of employment rather than employee service. Termination benefits result from either an entity’s decision to terminate the employment or an employee’s decision to accept an entity’s offer of benefits in exchange for termination of employment.

160 Termination benefits do not include employee benefits resulting from termination of employment at the request of the employee without an entity’s offer, or as a result of mandatory retirement requirements, because those benefits are post-employment benefits. Some entities provide a lower level of benefit for termination of employment at the request of the employee (in substance, a post-employment benefit) than for termination of employment at the request of the entity. The difference between the benefit provided for termination of employment at the request of the employee and a higher benefit provided at the request of the entity is a termination benefit.

~~135~~161 ~~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. The form of the employee benefit does not determine whether it is provided in exchange for service or in exchange for termination of the employee’s employment. Termination benefits are typically lump sum payments, but sometimes also include:~~

- (a) ~~enhancement of retirement benefits or of other post-employment benefits, either indirectly through an employee benefit plan or directly; and~~
- (b) salary until the end of a specified notice period if the employee renders no further service that provides economic benefits to the entity.

162 Indicators that an employee benefit is provided in exchange for services include the following:

- (a) the benefit is conditional on future service being provided (including benefits that increase if further service is provided).

(b) the benefit is provided in accordance with the terms of an employee benefit plan.

163 Some termination benefits are provided in accordance with the terms of an existing employee benefit plan. For example, they may be specified by statute, employment contract or union agreement, or may be implied as a result of the employer's past practice of providing similar benefits. As another example, if an entity makes an offer of benefits available for more than a short period, or there is more than a short period between the offer and the expected date of actual termination, the entity considers whether it has established a new employee benefit plan and hence whether the benefits offered under that plan are termination benefits or post-employment benefits. Employee benefits provided in accordance with the terms of an employee benefit plan are termination benefits if they both result from an entity's decision to terminate an employee's employment and are not conditional on future service being provided.

~~136~~164 ~~Some employee benefits are payable~~provided 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 are described in some ~~countries~~jurisdictions 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.~~

Example illustrating paragraphs 159–170

Background

As a result of a recent acquisition, an entity plans to close a factory in ten months and, at that time, terminate the employment of all of the remaining employees at the factory. Because the entity needs the expertise of the employees at the factory to complete some contracts, it announces a plan of termination as follows.

Each employee who stays and renders service until the closure of the factory will receive on the termination date a cash payment of CU30,000. Employees leaving before closure of the factory will receive CU10,000.

There are 120 employees at the factory. At the time of announcing the plan, the entity expects 20 of them to leave before closure. Therefore, the total expected cash outflows under the plan are CU3,200,000 (ie $20 \times \text{CU}10,000 + 100 \times \text{CU}30,000$). As required by paragraph 160, the entity accounts for benefits provided in exchange for termination of employment as termination benefits and accounts for benefits provided in exchange for services as short-term employee benefits.

Termination benefits

The benefit provided in exchange for termination of employment is CU10,000. This is the amount that an entity would have to pay for terminating the employment regardless of whether the employees stay and render service until closure of the factory or they leave before closure. Even though the employees can leave before closure, the termination of all employees' employment is a result of the entity's decision to close the factory and terminate their employment (ie all employees will leave employment when the factory closes). Therefore the entity recognises a liability of CU1,200,000 (ie $120 \times \text{CU}10,000$) for the termination benefits provided in accordance with the employee benefit plan at the earlier of when the plan of termination is announced and when the entity recognises the restructuring costs associated with the closure of the factory.

Benefits provided in exchange for service

The incremental benefits that employees will receive if they provide services for the full ten-month period are in exchange for services provided over that period. The entity accounts for them as short-term employee benefits because the entity expects to settle them before twelve months after the end of the annual reporting period. In this example, discounting is not required, so an expense of CU200,000 (ie $\text{CU}2,000,000 \div 10$) is recognised in each month during the service period of ten months, with a corresponding increase in the carrying amount of the liability.

Basis for Conclusions on IAS 19 as issued in June 2011:

- BC256 IAS 19 requires an entity to account for termination benefits separately from other employee benefits, because the event that gives rise to a present obligation is the termination of employment rather than employee service. In contrast, FASB ASC Topic 420 regards some involuntary termination benefits as being provided in exchange for employees' future services (or, expressed another way, a 'stay bonus'). In such cases under US GAAP, an entity recognises the cost of those benefits over the period of the employees' service, consistently with the accounting for other employee benefits.
- BC257 In the 2005 ED, the Board proposed that IAS 19 should specify recognition requirements for an entity providing termination benefits in exchange for future service, consistent with Topic 420. However, when finalising the amendments made in 2011, the Board noted the potential for confusion caused by accounting for some benefits provided in exchange for future service as termination benefits. The Board concluded that treating benefits provided in exchange for future service as short-term or other long-term employee benefits or post-employment benefits would result in the same recognition as is required under Topic 420 (ie the cost of those benefits would be recognised over the period of service), and would maintain the existing distinction between benefits provided in exchange for termination of employment and benefits provided in exchange for services.

Appendix C—Interpretations Committee potential agenda item request

The staff received the following request. All information has been copied without modification, except for details that would identify the submitter of the request and details that are subject to confidentiality.

I. The issue

Accounting for Early Retirement Programs in the form of Old-age-part-time-work

On 16 June 2011 the IASB published the amended version of IAS 19 *Employee Benefits* (IAS 19 (2011)) to be applied for annual periods beginning on or after 1 January 2013. Earlier application of the Standard is permitted. Under the requirements of the amended standard significantly divergent interpretations are expected to emerge in accounting for Early Retirement Programs in the form of Old-age-part-time-work arrangements.

The specific issue in question is described as follows: To account for the feature ‘additional compensation’ in the context of Old-age-part-time-work arrangements (for further technical explanations please refer to the below description of such arrangements), i.e. whether one of the following three views is required to be applied or whether there is any other more appropriate accounting in order to account for such arrangements in line with the requirements of IAS 19 (2011):

View 1 – additional compensation is to be categorised as *termination benefits*,

View 2 – additional compensation does not fall into the category of *termination benefits*,
or

View 3 – considering individual facts and circumstances either View 1 or View 2 needs to be followed.

In order to further detail the issue, this *Potential Agenda Item Request* (PAIR) is structured as follows:

- A. Description of Old-age-part-time-work arrangements
- B. Possible views of the accounting for Old-age-part-time-work arrangements in accordance with IAS 19 (2011)

A. Description of Old-age-part-time-work arrangements

Old-age-part-time-work arrangements are early retirement programs designed to create an incentive for employees within a certain age group to smooth the transition from (full or part time) employment into retirement before the employees' legal retirement age. Old-age-part-time-work arrangements are provided for certain age groups in connection with voluntary workforce reduction programs, as part of a variety of measures intended to address the needs and preferences of different age groups. These arrangements are also provided in connection with larger restructuring measures.

Old-Age-part-time-work programs or similar programs are applied in a few European countries and in countries outside Europe. The following description is referring to typical arrangements as agreed in Germany, since in this country Old-age-part-time work is much more widely used as compared with other jurisdictions.

Employees taking advantage of an Old-age-part-time-work arrangement must sign a contract with the employer. The employer may offer such contracts

- since they are committed by collective labor agreement,
- in the course of a company-agreement, or
- individually for selected employees.

The employer typically offers two alternative arrangements for participating employees:

- Type I: participant works 50 percent of the regular time during each year of the entire Old-age-part-time-work period, and receives 50 percent of his / her salary each year.
- Type II: participant works full-time for half (the "service period") of the Old-age-part-time-work period, and then does not work for the remaining half (the "inactive period"), and receives 50 percent of his / her salary each year during the entire Old-age-part-time-work period.

Under both alternatives, participants also receive an 'additional compensation' comprised of so called 'uplift' payments and additional contributions are made by the employer into the national government pension scheme.

The uplift payments vary by employer, but will often equal 10–20 percent of the participants' most recent regular pay prior to the start of the Old-age-part-time-work period; thus, the regular combined paid compensation will normally equal about 60–70 percent of the participants' most recent regular pay prior to the start of the Old-age-part-time-work period.

The employer further has to make additional contributions into the national government pension scheme for participants (to compensate for the fact that the employee has not been working at his / her previous level during the Old-age-part-time-work period) during the entire Old-age-part-time-work period. Contributions into the national government pension scheme (as well as length of service) determine the amount of pension benefits the employee will receive from the national government pension scheme upon retirement. Therefore, by making additional contributions into the national government pension scheme during the entire Old-age-part-time-work period, the pension benefits paid to the

employees will be higher than they would have been had the contributions been based solely on the employees' active service during the Old-age-part-time-work period.

The majority of participants in Old-age-part-time-work arrangements select the Type II arrangement.

The following illustrates the relationship between the work performed and the uplift-payment received by a participant under a Type II arrangement, during the Old-age-part-time-work period, assuming an Old-age-part-time-work period of four years:

<i>Year</i>	<i>% worked</i>	<i>% salary paid</i>	<i>uplift paid (as % of full-time salary)</i>	<i>Total</i>
1	100%	50%	10%	60%
2	100%	50%	10%	60%
3	0%	50%	10%	60%
4	0%	50%	10%	60%

Employees must fulfill their obligation to provide service to an employer for the required portion of the Old-age-part-time-work period in order to receive the full additional compensation. If a participant dies, voluntarily leaves the company, or is otherwise terminated prior to fulfilling the service period requirement, the Old-age-part-time-work arrangement will be unwound and the total compensation received by the participant will be adjusted to the amount that the participant would have received if he / she had not participated in the Old-age-part-time-work arrangement (salary is contractually set at the amount the employee earned just prior to signing the contract with the employer). For example, if an employee signs up for a 4-year Type II Old-age-part-time-work arrangement and leaves the company after 1 year, the employee will receive (for the 1 year worked) 100 percent of his / her most recent pre - Old-age-part-time-work agreement annual salary and will not receive any Old-age-part-time-work additional compensation.

During the inactive period under the Type II - Old-age-part-time-work arrangement, participants are legally under a work contract with the employer (thus, they are considered employees); however, an employee is not permitted to return to any active work.

The detailed terms of Old-age-part-time-work arrangements in various industries may differ because of negotiations and / or agreements between employers and the respective workers' council / union, or employees. Typical additional features of the framework within an Old-age-part-time-work arrangement include the following:

- The individual contract starts for an employee at the later of when (1) he / she reaches a minimum age (which is usually determined in accordance with the requirements outlined in the specific terms within an individual company's Old-age-part-time-work arrangement), and (2) he / she signs an individual Old-age-part-time-work contract with the employer.

- The employee can sign the Old-age-part-time-work contract before he / she is eligible to begin working under the Old-age-part-time-work arrangement. An employee is eligible to begin working under the Old-age-part-time-work arrangement upon attaining the age such that upon completion of the Old-age-part-time-work period, he / she will be eligible for the normal government retirement benefits (differing for the various countries - e.g. 65 years for men and 63 years for women).
- The arrangement requires that an employer allows participation in the Old-age-part-time-work arrangement without restriction until participation reaches e.g. 5 percent of the total work force. After 5 percent participation is achieved, an employer has, at its discretion, the right to determine whether employees are accepted into the Old-age-part-time-work arrangement.
- In most cases, an employee is required to work for a minimum period of time with the present employer before being eligible for the Old-age-part-time-work arrangement; prior employment required with the present employer in some instances amounts to 12 years of service before becoming eligible.

B. Possible views of the accounting for Old-age-part-time-work arrangements in accordance with IAS 19 (2011)

The amendments of IAS 19 as issued by the IASB in June 2011 and as far as they relate to the improvements in the accounting for termination benefits – among other things – were expected by many constituents to reduce differences between IFRSs and US GAAP¹ (i.e. that the additional compensation under IFRSs no longer needs to be treated as a *termination benefit*). However, the discussions started subsequent to the issuance of IAS 19 (2011) indicate the existence of three fundamentally different views on how to account for Old-age-part-time-work arrangements in line with IAS 19 (2011).

The three different views as lined out below mainly arose because on the one hand the definition of ‘termination benefits’ in IAS 19.8 (2011) did not change – as far as it relates to content and disregarding some minor wording changes – as compared to the definition in IAS 19.7 (1998)². On the other hand, IAS 19 (2011) introduces in paragraph 162 two

¹ Please note that in the FASB’s Accounting Standards Codification **Topic 715-30-55: No. 81-86** (formerly: EITF Abstract No. 05-5) the issue is being dealt with referring to a specific Old-age-part-time-work arrangement. In accordance with that guidance and in contrast to the view displayed in section B of this PAIR, additional compensation should be recognised over the period from the point at which the employee signs the Old-age-part-time-work contract until the end of the active service period.

² In this context it should be noted that at least in Germany additional compensation in the context of Old-age-part-time-work in accordance with IAS 19 (1998) is categorised as termination benefit as promulgated by the HFA (Auditing and Accounting Board of the Institute of Public Auditors in Germany) in their guidance on the corresponding IFRS accounting treatment (Statement on Accounting No. 3 (**IDW RS HFA 3**) as issued in 1998). This view has also been confirmed by the German Accounting Interpretations Committee (AIC) in its **AIC Position Paper** issued in January 2006 (‘IFRS Accounting for Additional Compensation under German *Altersteilzeit* Partial and Early Retirement Arrangements in

indicators that an employee benefit is not provided in exchange for termination of employment. According to the first of the two indicators (IAS 19.162 (a) (2011)), that is the case if ‘the benefit is conditional on future service being provided’. By purpose the following discussion excludes further analysis of the second indicator in IAS 19.162 (b) (2011), according to which benefits are provided in exchange for services, when ‘the employee benefit plan is provided in accordance with the terms of an employee benefit plan.’ This is because Old-age-part-time-work arrangements provided in accordance with the terms of an employee benefit plan will according to IAS 19.163 – sentence 4 (2011) only be categorised as termination benefits, ‘if they both result from an entity’s decision to terminate an employee’s employment and are not conditional on future service being provided.’ Therefore, even if Old-age-part-time-work arrangements are provided in accordance with the terms of an employee benefit plan, it needs to be clarified whether or not they are conditional on future service being provided. This question, however, shall be the focus of the issue.

The supposed ‘contradiction’ between definition and indicator arose from the issuance of IAS 19 (2011), which is considered to be a new situation as compared with the requirements of IAS 19 (1998).

The three views can be characterised as follows:

- View 1 – additional compensation in the context of Old-age-part-time-work arrangements from an economic perspective remains to be classified as termination benefits (since they are provided to the employee for the (early) termination of the employee’s employment) and, therefore, needs to be accounted for as *termination benefits* as defined in IAS 19 (2011) since the definition of *termination benefits* with regards to its content did not change as compared to IAS 19 (1998).
- View 2 – due to the changed guidance for termination benefits (please refer to the new guidance in IAS 19.159-164 (2011)) additional compensation in the context of Old-age-part-time-work arrangements does not fall into the category of *termination benefits* anymore.
- View 3 – considering individual facts and circumstances either View 1 or View 2 needs to be followed.

The arguments supporting each of the three views are further detailed and discussed in

the Light of EITF Issue No. 05-5’). The main reason to categorise additional compensation as termination benefits under IAS 19 (1998) in these two documents is based on the predominant argument that from an economical point of view the additional compensation is clearly provided in order to get the employees to accept the (early) termination of their employment, and therefore, does not represent a compensation for employee services received or to be received. This view needs to be seen in light of the fact that in IAS 19 (1998) the definition of the ‘termination benefits’ had not been accompanied by indicators as now included in IAS 19 (2011). Whether or not a benefit has to be categorized as ‘termination benefit’ in line with IAS 19 (1998) has to be determined based on the definition in paragraph 7 of the standard only.

the following.

View 1 – Additional compensations (Old-age-part-time-work arrangements) are *termination benefits* (IAS 19 (2011))

This view is based on the economical substance of Old-age-part-time-work arrangements, i.e. the additional compensation provided under this scheme. According to the proponents of this view the additional compensation is provided to the employees if they accept the (early) termination of their employment and therefore additional compensation is termination benefit. In other words: the additional compensation does not represent a benefit (an increased pay) for future services.

Although the wording used to define the term *termination benefit* in IAS 19 (2011) has slightly changed as compared to IAS 19 (1998), the content did not change. On that basis, the proponents of view 1 see no reason to question the current interpretation of additional compensation within Old-age-part-time-work arrangements as *termination benefits* in line with IAS 19 (please refer to footnote 2 of this document). This viewpoint is further underpinned by the observation that neither the basis for conclusions nor any other part of the revised standard as issued in June 2011 provides evidence that it is the IASB's intention to pursue any such change (as an example please refer to page 19 of the 'Project Summary and Feedback Statement', where reference is made only to the recognition of *termination benefits*). Under both, IAS 19 (1998) and IAS 19 (2011) the predominant objective of Old-age-part-time-work arrangements is to terminate older employees at an earlier date than it would be possible without recourse to Old-age-part-time-work arrangements (and possibly to replace them by younger employees).

The new guidance in IAS 19.162 f. (2011) is considered to be a clarification of the above basic principle and according to which benefits are considered to be *termination benefits* in the meaning of IAS 19 if the benefit is provided for the termination of employment and not for future service to be provided. Thus, the existing understanding of *termination benefits* is not changed by IAS 19.162 f. (2011).

Proponents of View 1 also make reference to the illustrating example in IAS 19.170 (2011) and compare it to a scenario under the Old-age-part-time-work arrangements. The incremental benefits that employees according to the example in IAS 19.170 (2011) will receive – if they provide services for the full ten-months period – are in exchange for additional future services provided over that period when compared to the other employees terminated immediately. Not treating these incremental benefits as *termination benefits* is in line with IAS 19 (2011) since these incremental benefits are truly paid for future services being provided. The example also perfectly illustrates the meaning of the indicator in IAS 19 162 (a) (2011) although a slightly different wording is used, i.e. "... conditional on future services ...".

In contrast, in line with an Old-age-part-time-work arrangement the employee receives higher payments (due to the additional compensation in addition to the regular pay) although the service provided is less than the employee would need to provide if the Old-age-part-time-work arrangement had not been agreed. This supports again the view, that the additional compensation is not for future (additional) services but for the fact that the employee accepts to leave the company earlier than without an Old-age-part-time-work agreement, thus it represents a *termination benefit*. Or, expressed another way, it makes clear that the additional compensation is not provided for the employee's future services and are therefore – in substance – not 'stay bonuses' as is the case in the afore-mentioned example).

View 2 – Additional compensations (Old-age-part-time-work arrangements) are not *termination benefits* (IAS 19 (2011))

According to this view the additional compensation in the context of Old-age-part-time-work arrangements does not fall into the category *termination benefits*, but is normally considered to be *other long-term employee benefits* or – if the given requirements are met, which in exceptional instances may be the case – *short-term employee benefits*.

This view is mainly supported as follows:

- IAS 19.162 (2011) lists two indicators according to which an employee benefit is provided in exchange for services (in contrast to: 'for the termination of the employment'), and thus, the additional compensation is not a termination benefit.
- According to the first indicator (IAS 19.162 (a) (2011)) the additional compensation within an Old-age-part-time-work program is not a termination benefit, since the benefit (the additional compensation) is conditional on future service to be provided by the employee during the active service period. In this context the indicator is understood in a way, that the additional compensation must not be provided for these future services, but it is required that the employee has to provide future services, for which the employer 'locks in' the employee, i.e. the payment must be independent from any future service.
- This view also gives consideration to the IASB's intention with respect to the changes in the amended IAS 19 (2011). The changes were initiated by the short-term project to converge IFRSs with US GAAP as mentioned already in the ED *Amendments to IAS 37 Provisions, Contingent Liabilities and Contingent Assets and IAS 19 Employee Benefits* issued in June 2005 (please refer to the BC with respect to the proposed changes to IAS 19).

View 3 – The treatment of additional compensation (Old-age-part-time-work arrangements) depends on the individual facts and circumstances

According to the third view it is argued that based on individual (pertinent) facts and circumstances either View 1 or View 2 should be followed.

Individual facts and circumstances supporting View 1 – as examples – could be:

- from an employment law perspective, in a specific country it may hardly be possible to lay-off employees at the age of 57 or above; therefore Old-age-part-time-work arrangements are used as a means to facilitate personnel layoffs with seniority not being a requirement to qualify for it,
- an entity internally plans to close a factory in six years and, according to the plan, at that time the employment of all of the remaining employees working at the factory shall be terminated. Simply due to cost considerations it is favorable for the entity to get older employees immediately into Old-age-part-time-work agreements, which are scheduled to be completed at the time of the factory's closure, rather than providing termination payments to them at the end of the six year's period.

Individual facts and circumstances supporting View 2 – as examples – could be:

- Old-age-part-time-work is offered as part of an union agreement or a company agreement and is available for more than a short period and there is more than a short period between the offer and the expected date of actual termination (please note that Old-age-part-time-work in practice normally is agreed for a period of four to six years (consisting of 2 or 3 years service period and 2 or 3 years inactive period, respectively),
- in order for an employee to qualify for the Old-age-part-time-work program, he or she must meet certain seniority requirements – or in other words – must be with the company for a given period of time (e.g.: before signing an Old-age-part-time-work contract – according to a company employee benefit plan –, the employee must be with the company for at least 10 years).

II. Current practice: diversity in practice

Based on controversial discussions observed in jurisdictions, in which Old-age-part-time-work arrangements are in use, there appear to be strong indications that significantly divergent interpretations will emerge once IAS 19 (2011) will be applied.

III. Reasons for the IFRS IC to address the issue:

a) Is the issue widespread and has it practical relevance?

Based on investigations and inquiries made, it was confirmed that the issue as described in this document is widespread and of practical relevance. Based on our

investigations several European countries and a few countries in other areas will be subject to the issue.

b) Does the issue involve significantly divergent interpretations (either emerging or already existing in practice)?

As outlined above – there are currently three views in discussion, which lead to the expectation that significantly divergent interpretations will emerge.

c) Would financial reporting be improved through elimination of the diversity?

Financial reporting would greatly be improved by clarifying this issue since the magnitude of Old-age-part-time-work arrangements – specifically if based on union agreements with far reaching impacts – can be significant for single prepares. If divergent interpretations and practices will not be prevented, information about a reporting entity may not be compared with similar information about other entities. Therefore, an appropriate clarification would enhance comparability among companies' financial reporting.

d) Is the issue sufficiently narrow in scope to be capable of interpretation within the confines of IFRSs and *Framework for the Preparation and Presentation of Financial Statements*, but not so narrow that it is inefficient to apply the interpretation process?

We are of the opinion that the issue is sufficiently narrow in order to be addressed by the IFRS IC.

e) If the issue relates to current or planned IASB project, is there a pressing need for guidance sooner than would be expected from the IASB project? (The IFRS IC will not add an item to its agenda if an IASB project is expected to resolve the issue in a shorter period than the IFRS IC would require to complete its due process).

N.A.