STAFF PAPER

15–16 May 2012

IFRS Interpretations Committee Meeting

Project	**IAS 19 *Employee benefits***
Paper topic	IFRIC Draft Interpretation D9

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Introduction

1. The IFRS Interpretations Committee (the Committee) received in March 2012 a request to clarify the accounting for contribution-based promises[1] under IAS 19 *Employee Benefits*. The request asks whether the revisions to IAS 19 in 2011 change the accounting for contribution-based promises. Agenda Paper 14 deals with that request. The staff also believe that one of the underlying questions in the submission is about how to account for these promises. This paper analyses that issue.

2. The objective of this Agenda paper is to provide the Committee with background on the work that has previously been done on contribution-based promises and to ask the Committee how it would like to proceed. The Committee has previously dealt with this issue in 2002-2006 and then ended up referring it to the Board. In 2004 it issued IFRIC Draft Interpretation D9 *Employee Benefit Plans with a Promised Return on Contributions or Notional Contributions* and in November 2006 it decided to pass the issue on to the Board to be included in the Board's project on Post-employment benefits.

[1] Contribution-based promises are a post-employment benefit promise by which the amount of benefits received by the employee depends on the actual return generate by the contributions. These promises may or may not have a guaranteed return.

3. The Committee has previously indicated to staff that it would like to revisit issues that it has passed on to the Board, but that have not been addressed or completed by the Board. This is such an issue.

4. This agenda paper includes:

   (a) background information on the issue;

      (i) IFRIC Draft Interpretation D9; and

      (ii) IASB project on Post-employment benefits.

   (b) staff preliminary analysis and questions for the Committee.

Background

5. In March 2012, the Committee received a request seeking clarification on accounting for contribution-based promises in accordance with IAS 19. Specifically the request sought clarification on how to measure the present value of the defined benefit obligation related to contribution-based promises.

6. The submitter understands that many preparers are currently accounting for contribution-based promises that provide for a minimum return according to IFRIC Draft Interpretation D9, despite the fact that no final interpretation was issued. This is, in the submitter's opinion, because the defined benefit methodology in IAS 19 was designed for benefits that do not depend on future return on assets and in the absence of specific guidance, preparers apply the guidance in D9 to these promises.

IFRIC Draft Interpretation D9

7. From 2002 until 2006 the Committee worked on issues related to IAS 19. One of these issues was on how to account for contribution-based promises. As a result of the Committee's work, it issued in July 2004 IFRIC Draft Interpretation D9 *Employee Benefit Plans with a Promised Return on Contributions or Notional*

Contributions[2]. D9 set out the accounting requirements for defined benefit plans when the benefit depends on future returns on assets, with or without an accompanying guarantee of a fixed return. In summary D9 proposed:

(a) For plans with a guarantee of a fixed return, the accounting for defined benefit plans under IAS 19 should apply.

(b) For a benefit that depends on future asset returns, the plan liability shall be measured at the fair value of the assets upon which the benefit is specified. If the benefit includes a specific margin on future asset returns, the effects of that margin shall be added to or deducted from the fair value.

(c) For plans with a combination of a guaranteed fixed return and a benefit that depends on future asset returns, the benefits should analysed into a fixed component and a variable component.

   (i) The fixed component comprises those benefits for which the amount that will ultimately be paid can be estimated without making assumptions about future returns on assets. The fixed component shall be accounted as a defined benefit plan under IAS 19.

   (ii) The variable component comprises those benefits for which an estimate of the amount that will ultimately be paid requires assumptions to be made about future returns on assets. The variable component shall be accounted for at the fair value of the assets upon which the benefit is specified. If the benefit includes a specific margin on future assets returns, the effects of that margin shall be added to or deducted from the fair value.

8. In March 2005 the Committee discussed the responses to D9. The comment letter analysis[3] indicated that the majority of respondents broadly supported the principle of defined benefit accounting of the plans that fall within its scope.

[2] Agenda paper 14B for this meeting: IFRIC DRAFT INTERPRETATION D9 *Employee Benefit Plans with a Promised Return on Contributions or Notional Contributions*

[3] Agenda paper 4a for the March 2005 meeting of IFRIC.

However, further clarification was requested about the scope of D9, and, in particular, on the distinction between defined contribution and defined benefit plans. In addition, a significant minority of the respondents disagreed with the detailed requirements of the proposed calculation methods and concerns were also raised about convergence with US GAAP.

9. The Committee continued the discussion of D9 in 2005, but in 2006 it decided to stop work on D9 and at its meeting in November 2006[4], the Committee referred the issue to the Board's project on Post-employment benefits. The Committee's decision was published in IFRIC *Update* for November 2006 and is included as Appendix A.

IASB's project on Post-employment benefits

10. In March 2008 the IASB issued the discussion paper *Preliminary Views on Amendments to IAS 19 Employee Benefits*. That paper included proposals on how to account for contribution-based promises. In the paper the Board outlined an approach to overcoming the measurement defect in IAS 19. The approach was based on defining a new category of promises—contribution-based promises—and measuring them at fair value assuming the terms of the benefit promise do not change. Chapter 7 of the discussion paper deals specifically with the measurement of contribution-based promises (that chapter is included in Agenda Paper 14C for this meeting).

11. The discussion paper also included discussions on promises similar to contribution-based promises. The promises discussed in the discussion paper were:

    (a) benefit promises in which any return on contributions is based on the return from an asset, a group of assets or an index; and

    (b) benefit promises in which the employee has the option to receive the higher of more than one specific return (in other words, the promise includes an embedded option or guarantee).

[4] Agenda paper 8 for the Novemer 2006 meeting of IFRIC.

12. The Board noted the problems in applying the projected unit credit method in IAS 19 to these kinds of promises. For example, the Board noted how projecting the benefit forward at an expected rate of return on the assets or index, and then discounting it back to present value using the rate specified in IAS 19, could result in a measurement of the benefit that would not be correct, because the discount rate would not reflect the risk of the assets.

13. The Board discussed the initial comment letter analysis[5] of responses to the discussion paper in November 2008. That analysis showed that most respondents were critical of the Board's proposals for contribution-based promises. Some stated that the proposals would cause more problems than the current requirements in IAS 19. In particular:

    (a) Respondents thought that the scope of contribution-based promises, as defined in the discussion paper, was too wide. They therefore proposed that the Board should restrict the scope to promises that are difficult to account for using IAS 19.

    (b) The measurement proposed represented a fundamental change in measurement for many post-employment benefit plans. Many respondents thought that it would be preferable, and possible, to deal with the troublesome promises within the existing framework of IAS 19.

14. At the January 2009 meeting the Board continued its discussion on post-employment benefits[6]. At that meeting, it decided to split the project into two parts and tentatively decided to publish two separate exposure drafts:

    (a) Part 1: Recognition and presentation of changes in the defined benefit obligation and in plan assets, disclosures, and other issues raised in the comment letters that can be addressed expeditiously. The Board completed Part 1 in June 2011 when it issued the revised IAS 19.

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[5] Agenda paper 6 for the November 2008 meeting of the IASB (paragraphs 25-43 discuss contribution-based promises).

[6] Agenda paper 16A for the January 2009 meeting of the IASB (paragraph 5 and paragraphs 23-30 discuss contribution-based promises).

(b) Part 2: Contribution-based promises, potentially as part of a comprehensive review of pension accounting.

15. The Board also decided to complete Part 1 before it would continue work on the issues included in Part 2. The decisions of the Board as they were published in IASB *Update* after the January 2009 meeting are included in Appendix B.

16. Since making this decision the Board has not addressed contribution-based promises.

Staff analysis and question to the Committee

17. From the work that the Committee and the IASB have already done, it seems that most agree that the accounting model in IAS 19 does not work sufficiently well for contribution-based promises. However, there seem to be different views on the kinds of plans that should be included within the scope of contribution-based promises. In addition, the proposals that have been put forward on the measurement of these promises have not gained general support.

18. There is, however, clearly a need to address the issue, particularly because the use of contribution-based promises seems to be increasing. The staff will give the Committee an oral update on this at the May meeting, based on the outreach it is currently undertaking with national standard-setters and regulators.

19. If the Board decides to carry out a comprehensive review of pension accounting, this would take many years to complete. It therefore seems that the Board will not deal with contribution-based promises in the near future.

20. In addition, the responses that were received to the Board's Request for Views *Agenda Consultation 2011* do not indicate that post-employment benefits (pension accounting) are one of the most urgent projects to deal with. Although a significant number of respondents expressed views on the issue, those views were split on whether this is an important project that needs urgent attention, or one of the potential projects that should have low priority or should not be addressed.

21. The following is taken from the comment letter analysis[7], presented to the Board in January 2012, of the responses to the agenda consultation:

> **Post-employment benefits (including pensions)**
>
> 54. Many respondents believe that this is a complex area, and current requirements need to be updated in a comprehensive project, but most believe that this should be a project for the long-term agenda of the IASB, not a high priority for the next three years.
>
> 55. Others believe that the current requirements are sufficient, and that a revision is unnecessary because of recent revisions in 2011.
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> 56. Some respondents believe that a distinction between liabilities and provisions in the conceptual framework is a necessary precursor for this project's reactivation.

22. There are some options open to the Committee if it wishes to address this issue:

(a) it could take a fresh look at how to account for contribution-based promises;

(b) reactivate the project on Draft Interpretation D9 and consider how it could be revised and completed, possibly with a re-exposure;.or

(c) address a more narrow scope issue within IAS 19, such as the problem caused by the use of one set of discount rates when projecting cash flows to measure the benefit obligation, and then discounting that obligation, with a different rate, to get the present value of the obligation.

23. The staff would therefore like to ask for the Committee's view on whether it would like to address this issue and, if so, which of the above options it would like staff to explore further and bring to the Committee at a future meeting.

[7] Agenda paper 5C for the January 2012 meeting of the IASB.

Questions for the Committee
1. Does the Committee wish to take on the issue of how to account for contribution-based promises? 2. If yes, how would it like to proceed with it?

Appendix A—IFRIC decision at the November 2006 meeting

A1. The decision of IFRIC to discontinue work on D9 and refer the issue to the Board.

> IFRIC Draft Interpretation D9 *Employee Benefits with a Promised Return on Contributions or Notional Contributions* was published in July 2004. It addressed how IAS 19 *Employee Benefits* should be applied to plans with a promised return on actual or notional contributions. Such plans may provide for a guarantee of a fixed return, a benefit that depends on future asset returns or a combination of both and are sometimes referred to as cash balance plans.
>
> The draft Interpretation proposed that these plans should be classified as defined benefit arrangements and, further, for plans with a combination of a guaranteed fixed return and a benefit that depends on future asset returns, the amount of the liability should be determined by analysing the benefits into a fixed component and a variable component. A defined benefit liability would be recognised in respect of the fixed component and an additional liability would be recognised to the extent that the liability in respect of the variable component exceeds the defined benefit liability at the balance sheet date.
>
> Most respondents to the draft Interpretation agreed that the types of plans addressed in D9 should be treated as defined benefit arrangements. However there was some disagreement in respect of the proposed methodology. A significant number of constituents believed that the issues would be more appropriately addressed as an amendment to the IAS 19 rather than as an Interpretation.
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> The IASB added a project on post-employment benefits to its agenda in 2006. Phase I of the project includes the accounting for intermediate risk plans (including cash

balance plans) and the definition of defined benefit and defined contribution plans. Phase I is expected to result in a standard within four years. [*The Board finished Phase 1 in June 2011]*

In light of the IASB's decision, the IFRIC agreed at this meeting to remove the project from its agenda. The IFRIC noted that the work it had completed would inform the Board's considerations of its project.

One matter identified in D9 concerning allocation of the effects of salary increases will be brought in due course to the Agenda Committee for consideration as a separate issue.

Appendix B—IASB decision at the January 2009 meeting

A2. The decision of the IASB to split the post-employment benefits project into two parts, as reported in IASB *Update* for January 2009.

> The Board tentatively decided to work from the proposals in the discussion paper (DP) Preliminary Views on Amendments to IAS 19 Employee Benefits and the responses to the DP towards two separate exposure drafts, as follows:
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> - Part 1: Recognition and presentation of changes in the defined benefit obligation and in plan assets, disclosures, and other issues raised in the comment letters that can be addressed expeditiously.
> - Part 2: Contribution-based promises, potentially as part of a comprehensive review of pension accounting.
>
> On part 1 the Board tentatively decided that entities should:
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> - disaggregate changes in the defined benefit obligation and in plan assets into employment, financing and remeasurement components, and recognise the components in the income statement. The Board will consider at a future meeting how to define those components.
> - disclose the employment and financing components either in the income statement or in the notes, and present the remeasurement component in the income statement. The Board plans to explore ways to present the remeasurement component in a way that distinguishes it from other items of profit or loss.

The Board will continue its discussion in February.