STAFF PAPER

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IFRS Interpretations Committee Meeting

Project	**IAS 19 Employee benefits**		
Paper topic	IFRIC Draft Interpretation D9		
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International Financial Reporting Interpretations Committee

IFRIC

IFRIC DRAFT INTERPRETATION D9

Employee Benefit Plans with a Promised Return on Contributions or Notional Contributions

Comments to be received by 21 September 2004

IFRIC Draft Interpretation D9 *Employee Benefit Plans with a Promised Return on Contributions or Notional Contributions* is published by the International Accounting Standards Board (IASB) for comment only. Comments on the draft Interpretation should be submitted in writing so as to be received by **21 September 2004**.

All responses will be put on the public record unless the respondent requests confidentiality. However, such requests will not normally be granted unless supported by good reason, such as commercial confidence. If commentators respond by fax or email, it would be helpful if they could also send a hard copy of their response by post. Comments should preferably be sent by email to: **CommentLetters@iasb.org** or addressed to:

D9 Comment Letters
International Accounting Standards Board
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This draft Interpretation is available from www.iasb.org

INVITATION TO COMMENT

The International Accounting Standards Board's International Financial Reporting Interpretations Committee (IFRIC) invites comments on any aspect of this draft Interpretation *Employee Benefit Plans with a Promised Return on Contributions or Notional Contributions*. It would particularly welcome answers to the question below. Comments are most helpful if they indicate the specific paragraph to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.

Comments should be submitted in writing so as to be received no later than 21 September 2004.

Question

The draft Interpretation sets out, inter alia, 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 applying IAS 19 *Employee Benefits* to the benefits that depend on future returns on assets, the draft Interpretation requires specified changes in the plan liability* to be treated as actuarial gains and losses. The entity's accounting policy on the recognition of actuarial gains and losses, therefore, applies. (Paragraph 9)

Do you agree with this approach, or do you believe that changes in the plan liability for benefits that depend on future asset returns should not be treated as actuarial gains and losses, and should therefore be recognised immediately?

* In this draft Interpretation, for ease of reference and understanding, the term 'plan liability' is used to refer to the defined benefit obligation.

IFRIC ***International Financial Reporting Interpretations***

Committee

IFRIC DRAFT INTERPRETATION D9

Employee Benefit Plans with a Promised Return on Contributions or Notional Contributions

IFRIC [draft] Interpretation X *Employee Benefit Plans with a Promised Return on Contributions or Notional Contributions* ([draft] IFRIC X) is set out in paragraphs 1-19. [Draft] IFRIC X is accompanied by Illustrative Examples and a Basis for Conclusions. The scope and authority of Interpretations are set out in paragraphs 1 and 8-10 of the IFRIC *Preface*.

Reference

- IAS 19 *Employee Benefits*

Background

1 This [draft] Interpretation provides guidance on how to apply the requirements of IAS 19 to an employee benefit plan with a promised return on actual or notional contributions. A promised return is either a guaranteed return of a fixed amount (or rate)* or a promise of a variable return based on specified assets or indices. Such plans could be funded or unfunded and the benefits vested or unvested. Examples of such plans are:

(a) a plan in which a contribution is made each year based on the employee's current salary and the employee receives a benefit (a lump sum or an annuity) equal to the contributions plus the higher of (i) the actual return generated on the contributions and (ii) a minimum fixed return on the contributions over the period to when the benefit is paid; and

(b) a plan in which the promised benefit is a notional contribution each year plus a return on the notional contribution that is the higher of (i) the return based on specified assets, for example the return on quoted bonds, and (ii) a fixed return, for example 4 per cent. The plan may or may not hold assets.

Issues

2 The issues addressed in this [draft] Interpretation are:

* The minimum fixed return may be a positive return, or it may provide protection against any loss of capital (ie the return will not be less than zero) or against a loss exceeding a fixed minimum loss.

(a) is an employee benefit plan with a promised return on actual or notional contributions a defined benefit plan or a defined contribution plan under IAS 19?

(b) how do the requirements of IAS 19 apply to such a plan? In particular, how should the following benefits be treated:

(i) a guarantee of a fixed return,

(ii) a benefit that depends on future asset returns, and

(iii) a combination of (i) and (ii)?

Consensus

3 An employee benefit plan with a promised return on contributions or notional contributions is a defined benefit plan under IAS 19.

A guarantee of a fixed return

4 A benefit of contributions or notional contributions plus a guarantee of a fixed return shall be accounted for in accordance with the defined benefit methodology set out in IAS 19 by:

(a) calculating the benefit to be paid in the future by projecting forward the contributions or notional contributions at the guaranteed fixed rate of return;

(b) allocating the benefit to periods of service;

(c) discounting the benefits allocated to the current and prior periods at the rate specified in IAS 19 to arrive at the plan liability, current service cost and interest cost; and

(d) recognising any actuarial gains and losses in accordance with the entity's accounting policy.

5 Any plan assets shall be measured and recognised in accordance with IAS 19.

A benefit that depends on future asset returns

6 The plan liability for a benefit that depends on future asset returns shall be measured at the fair value at the balance sheet date of the assets upon which the benefit is specified (whether plan assets or notional assets[*]), subject to paragraphs 7 and 8. No projection forward of the benefits shall be made, and discounting of the benefit is not therefore required.

7 If the benefits are unvested at the balance sheet date, the measurement of the plan liability shall be determined by the extent to which they are expected to vest in the future. As a result, if sufficient forfeitures are expected to occur, an entity may recognise a net asset arising from the plan.

8 If the benefits include a specified margin on future asset returns, when the plan liability is measured the effect of the margin shall be added to or deducted from, as appropriate, the fair value of the assets at the balance sheet date.

9 For the purposes of recognition, the change in the plan liability shall be analysed into an expected increase and an actuarial gain or loss. The expected increase is equal to the expected return, as defined in IAS 19, on the assets upon which the benefit is specified. The entity's accounting policy on the recognition of actuarial gains and losses applies.

10 Any plan assets shall be measured and recognised in accordance with IAS 19.

11 The change in the recognised defined benefit asset or liability shall be presented as a single amount. It shall not be analysed into components, for example those representing service cost or interest cost.

[*] Notional assets are assets other than plan assets, as defined in IAS 19, or reference indices.

A combination of a guaranteed fixed return and a benefit that depends on future asset returns

12 The requirements for defined benefit accounting in IAS 19 shall be applied to plans with a combination of a guaranteed fixed return and a benefit that depends on future asset returns by analysing the benefits into a fixed component and a variable component. 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 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. Examples of fixed and variable components are given in the Illustrative Examples.

13 The defined benefit asset or liability that would arise from the fixed component alone shall be measured and recognised in accordance with paragraphs 4 and 5.[*†]

14 The defined benefit asset (or liability) that would arise from the variable component alone shall be calculated in accordance with paragraphs 6-10.[‡]

15 An additional plan liability shall be recognised to the extent that the defined benefit asset (or liability) calculated in accordance with paragraph 14 is smaller (or greater) than the defined benefit asset (or liability) recognised in accordance with paragraph 13.

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[*] When the fixed component depends on a guaranteed amount as set out in the fifth example in paragraph IE2 of the Illustrative Examples, the benefit projection required by paragraph 4 is based on the guaranteed amount rather than the contributions or notional contributions.

[†] The limit on the amount that can be recognised as an asset in accordance with paragraph 58(b) of IAS 19 applies to the net defined benefit asset that arises from the combination of the fixed and variable components, not to the defined benefit asset that would arise from the fixed component alone.

[‡] Except when the variable component depends on a guaranteed amount as set out in the fifth example in paragraph IE2 of the Illustrative Examples, in which case the variable component shall be measured at the guaranteed amount.

16 The initial recognition of the additional variable component liability and any subsequent changes in it shall be disclosed as a single separate additional component of the pension cost.

17 Any plan assets shall be measured and recognised in accordance with IAS 19.

Effective date

18 An entity shall apply this [draft] Interpretation for annual periods beginning on or after [date to be set at 3 months after the Interpretation is finalised]. Earlier application is encouraged. If an entity applies this [draft] Interpretation for a period beginning before [above date], it shall disclose that fact.

Transition

19 At the date of the beginning of the earliest comparative period presented in the financial statements in which this [draft] Interpretation is applied to a plan for the first time and results in a different measure of the net employee benefit asset or liability from that previously calculated, an entity shall measure and recognise the net employee benefit asset or liability under the plan in accordance with IAS 19 as interpreted by this [draft] Interpretation, except that no actuarial gains or losses shall remain unrecognised. The change from any previously recognised net employee benefit asset or liability shall be an adjustment to opening retained earnings. The transitional provisions in IAS 19 do not apply.

Illustrative Examples

These [draft] examples accompany, but are not part of, the [draft] Interpretation.

Examples of fixed components and variable components

IE1 The table below sets out examples of employee benefit plans with a promised return on actual or notional contributions and analyses them into their fixed and variable components. The two components may overlap. In particular, the actual or notional contributions may form part of both components.

IE2 Example 1 is a plan with a fixed component only. Examples 2 and 3 are plans with a variable component only. Examples 4-6 are plans with a combination of fixed and variable components.

Example	Fixed component	Variable component
1 A plan that provides a benefit equal to specified contributions plus a return of 4 per cent a year over a specified future period.	All benefits.	None
2 An unfunded plan that provides a benefit of an amount equal to specified notional contributions plus or minus the return on specified assets with a variable return.	None	Notional contributions plus or minus the return on specified assets.

3 A funded plan that provides a benefit of an amount equal to contributions plus or minus the return on specified assets with a variable return. The plan is not obliged to invest the contributions in the assets upon which the specified return depends.	None	Contributions plus or minus the return on specified assets.
4 A plan that provides a benefit equal to specified contributions plus or minus the higher *over a specified future period of* (i) growth on the assets in which the contributions are invested and (ii) a specified fixed return on the contributions.	Contributions plus or minus the specified fixed return.	Contributions plus or minus the return on the assets.
5 A plan that provides a benefit equal to specified contributions plus or minus the higher *in each year* of (i) growth on the assets in which the contributions are invested and (ii) a specified fixed return on the contributions.	The guaranteed amount plus or minus the specified fixed return, where the guaranteed amount is the total of the contributions to date plus or minus the cumulative compound growth thereon based on the higher in each year to date of (i) growth on the assets in which the contributions were invested and (ii) the specified fixed return on the contributions.*	The guaranteed amount plus or minus any actual return on the guaranteed amount.

6 An unfunded plan that provides a benefit of an amount equal to specified notional contributions plus or minus the higher of (i) the return on specified assets with variable returns and (ii) a specified fixed return.	Notional contributions plus or minus the specified fixed return.	Notional contributions plus or minus the return on the specified assets.

* If the promised return is the higher *in each year* of (a) growth on the assets in which the contributions are invested and (b) a specified fixed return on the contributions, by the balance sheet date the amount which the promised return applies to is not just the contributions but also the higher of (i) growth on the assets in which the contributions are invested and (ii) the specified fixed return on the contributions for each year to the balance sheet date.

Numerical example

IE3 Consider a plan under which a contribution of 10 per cent of current salary is paid and the employees receive the higher of the actual return on plan assets and an annual return on the contribution of 4 per cent per year over the period to when the benefits are paid. Assume also that expected salary increases are 7 per cent per year and the contributions are due and are made at the beginning of the year.

IE4 The fixed component of the plan is the contributions plus the guaranteed 4 per cent return. The variable component is the contributions plus the actual return on plan assets. The fixed component benefits projected over an expected service life of five years are as follows.

	Year 1	Year 2	Year 3	Year 4	Year 5	Total per the benefit formula	Benefit allocated on a straight-line basis*
Year 1 benefit	100.0 (contribution) 4.0 (return)	4.2† (return)	4.3 (return)	4.5 (return)	4.7 (return)	121.7	128.9
Year 2 benefit		107.0§ 4.3	4.5	4.6	4.8	125.2	128.9
Year 3 benefit			114.5 4.6	4.8	5.0	128.9	128.9
Year 4 benefit				122.5 4.9	5.1	132.5	128.9
Year 5 benefit					131.1 5.2	136.3	129.0
Total benefit						644.6	644.6

* Paragraph 67 of IAS 19 requires benefits to be allocated on a straight-line basis if the benefit formula attributes materially higher benefits to later periods of service. For the purposes of this example, it is assumed that the benefits attributed to later years of service are materially higher.

† 4.2 is the return of 4% on the asset balance of 104 (100 plus 4) at the end of year 1.

§ The contribution has increased by 7% since year 1 because of salary increases.

IE5 The example assumes a discount rate of 5 per cent in some years and 3 per cent in others. The projected benefits discounted back at 5 per cent are as follows:

	Year 1	Year 2	Year 3	Year 4	Year 5
Opening liability	0	106.1	222.8	350.9	491.1
Service cost*	101.0	106.1	111.4	116.9	122.8
Interest cost†	5.1	10.6	16.7	23.3	30.7
Closing liability	106.1	222.8	350.9	491.1	644.6

* These figures are calculated by discounting at 5% the figures in the final column of the table in paragraph IE4.

† These figures are calculated as 5% of the total of the opening liability plus the service cost for the year.

IE6 The projected benefits discounted back at 3 per cent are as follows:

	Year 1	Year 2	Year 3	Year 4	Year 5
Opening liability	0	114.5	235.9	364.5	500.6
Service cost*	111.2	114.5	118.0	121.5	125.2
Interest cost†	3.3	6.9	10.6	14.6	18.8
Closing liability	114.5	235.9	364.5	500.6	644.6

* These figures are calculated by discounting at 3% the figures in the final column of the table in paragraph IE4.

† These figures are calculated as 3% of the total of the opening liability plus the service cost for the year.

IE7 Suppose that in year 1 the discount rate was 5 per cent, the expected return was 5.5 per cent and there were no actuarial gains and losses on the plan liabilities or plan assets, ie the actual return on assets equalled the expected return. The pension cost components would be as follows:

	Fixed component liability	Additional variable component liability	Plan assets	Surplus/(deficit)
Opening balance	0	0	0	0
Contribution			100.0*	100.0
Service cost	(101.0)†			(101.0)
Interest cost	(5.1)†			(5.1)
Expected return on assets			5.5	5.5
Change in additional variable component liability		0		0
Closing balance	(106.1)	0	105.5	(0.6)

* See table in paragraph IE4.

† See table in paragraph IE5.

IE8 The present value of the variable component liability is the value of the plan assets at the balance sheet date, giving a defined benefit asset or liability for the variable component alone of nil. That is not greater than the defined benefit liability for the fixed component alone.* No additional liability arises, therefore, under paragraph 15 of the [draft] Interpretation. A deficit arises in the plan even though the contributions were paid and the return generated (5.5) was greater than the guaranteed fixed return (4.0). This occurs in this example because the allocation of benefits allocates a higher cost to the first period. It could also occur if the discount rate were lower than the fixed return.

IE9 Next consider the following year, with the same discount rate, an expected return on assets of 5 per cent and an actuarial gain on the assets of 31.1.

* In this example, for simplicity, it is assumed that the entity's accounting policy is to recognise all actuarial gains and losses immediately.

	Fixed component liability	Additional variable component liability	Plan assets	Surplus/(deficit)
Opening balance	(106.1)	0	105.5	(0.6)
Contribution			107.0	107.0
Service cost	(106.1)			(106.1)
Interest cost	(10.6)			(10.6)
Expected return on assets			10.6*	10.6
Actuarial gain on assets			31.1	31.1
Change in additional variable component liability		(31.4)		(34.1)
Closing balance	(222.8)	(31.4)	254.2	0

* (105.5+107) x 5.0%

IE10 The variable component liability is 254.2, equal to the plan assets, so the defined benefit asset or liability arising from the variable component alone is nil. That is smaller than the defined benefit asset of 31.4 (254.2-222.8) that would arise from the fixed component alone, so an additional liability for that amount is recognised.

IE11 In the third year, assume that the discount rate changes at the end of the year to 3 per cent, the expected rate of return on assets is 6 per cent and there is an actuarial gain on the assets of 8.5.

	Fixed component liability	Additional variable component liability	Plan assets	Surplus/(deficit)
Opening balance	(222.8)	(31.4)	254.2	0
Contribution			114.5	114.5
Service cost	(111.4)*			(111.4)
Interest cost	(16.7)*			(16.7)
Expected return on assets			22.1	22.1
Actuarial loss on the minimum guarantee liability	(13.6)†			(13.6)
Actuarial gain on assets			8.5	8.5
Change in variable component liability		(3.4)		(3.4)
Closing balance	(364.5)§	(34.8)	399.3	0

* The amounts are from the table in paragraph IE5 because the discount rate assumption changed at the end of the year.

† This arises because of the change in the discount rate.

§ See closing liability in year 3 in table in paragraph IE6.

IE12 The variable component liability is 399.3, equal to the plan assets, so the defined benefit asset or liability arising from the variable component alone is nil. That is smaller than the defined benefit asset of 34.8 (399.3-364.5) that would arise from the fixed component alone. An additional liability for that amount is recognised by recognising an additional component of cost of 3.4.

IE13 Assume in the fourth year that the discount rate is 3 per cent, the expected return is 5.5 per cent and there is an actuarial loss on the assets of 71.7.

	Fixed component liability	Additional variable component liability	Plan assets	Surplus/(deficit)
Opening balance	(364.5)	(34.8)	399.3	0
Contribution			122.5	122.5
Service cost	(121.5)*			(121.5)
Interest cost	(14.6)*			(14.6)
Expected return on assets			28.7	28.7
Actuarial loss on assets			(71.7)	(71.7)
Change in variable component liability		34.8		34.8
Closing balance	(500.6)	0	478.8	(21.8)

* See table in paragraph IE6.

IE14 The defined benefit asset or liability that would arise from the variable component alone is nil. That is not greater than the defined benefit liability of 21.8 that arises from the fixed component alone. The additional variable component liability is therefore reduced to zero by recognising a gain of 34.8 as an additional component of cost.

IE15 Finally, in the fifth year, the discount rate is 3 per cent, the expected return is 4 per cent and there is an actuarial loss on the assets of 10.

	Fixed component liability	Additional variable component liability	Plan assets	Surplus/(deficit)
Opening balance	(500.6)	0	478.8	(21.8)
Contribution			131.1	131.1
Service cost	(125.2)			(125.2)
Interest cost	(18.8)			(18.8)
Expected return on assets			24.4	24.4
Actuarial loss on assets			(10.0)	(10.0)
Change in variable component liability		0		0
Closing balance	(644.6)	0	624.3	(20.3)

IE16 The defined benefit asset or liability that would arise from the variable component alone is nil. That is not greater than the defined benefit liability of 20.3 that arises from the fixed component alone. There is, therefore, no additional variable component liability. The deficit in the plan of 20.3 at the time at which the benefits are due to be paid is the amount by which the cumulative return of 49.2[*] has fallen below the minimum guaranteed fixed return of 69.5.[†]

[*] 5.5 in year 1, 10.6 plus 31.1 in year 2, 22.1 plus 8.5 in year 3, 28.7 minus 71.7 in year 4 and 24.4 minus 10.0 in year 5.

[†] See table in paragraph IE4: there is a cumulative guaranteed fixed return of 21.7 for the first year's contribution, 18.2 on the second year's contribution, 14.4 on the third year's contribution, 10.0 on the fourth year's contribution and 5.2 on the fifth year's contribution.

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, the draft Interpretation.

BC1 This Basis for Conclusions summarises the IFRIC´s considerations in reaching its consensus. Individual IFRIC members gave greater weight to some factors than to others.

BC2 The IFRIC was asked for guidance on how IAS 19 *Employee Benefits* should be applied to employee benefit plans with a promised return on actual or notional contributions. Commentators held different views on whether these plans should be regarded as defined contribution plans or defined benefit plans. Further, if they were regarded as defined benefit plans, applying the methodology in IAS 19 raises particular issues (see paragraph BC8). The IFRIC first considered funded plans that would be defined contribution plans but for the existence of a guarantee for a minimum fixed return. The IFRIC then extended its conclusions to funded or unfunded plans that promised a fixed return or a variable return based on a specified group of assets, ie all plans that promise a return on actual or notional contributions.

Defined contribution or defined benefit plans

BC3 The IFRIC agreed that plans that promise a return on actual or notional contributions are defined benefit plans under IAS 19. IAS 19 defines defined contribution plans as plans under which the entity has no legal or constructive obligation to pay further contributions relating to past service. Defined benefit plans are plans that are not defined contribution plans. The promise of a specified return (whether fixed or variable) means that the entity may have to make additional contributions relating to past service. For example, examples 2 and 3 in paragraph IE2 are defined benefit plans because, unless the plan is required to invest in the assets upon which the return is specified, the plan assets (if any) may not provide the specified return and the entity may therefore need to make additional contributions.

BC4 The IFRIC considered whether, even though a plan with a promised return is a defined benefit plan, the plan should be treated as a defined

contribution plan* under IAS 19 with any guarantee of a fixed return treated as an embedded derivative that should be accounted for separately under IAS 39 *Financial Instruments: Recognition and Measurement*, ie measured at fair value with changes in fair value recognised in profit or loss. The IFRIC noted that such an approach would result in significantly different measurement, recognition and presentation from accounting for the plan as a defined benefit plan under IAS 19.

BC5 The IFRIC concluded that an employee benefit plan with a promised return should not be treated as a defined contribution plan with any guarantee of a fixed return accounted for separately, for two reasons. First, the IFRIC noted that plans with a guaranteed fixed return are fundamentally defined benefit in nature. If the benefits under a plan were simply a lump sum comprising fixed contributions plus a fixed return, for example 100 a year plus 4 per cent return, there would be no doubt under IAS 19 that the plan would be classified and treated as a defined benefit plan. The IFRIC saw no reason why the provision of an additional benefit (any excess return over 4 per cent) should change its treatment. From the point of view of the employer, these are 'normal' defined benefit plans with additional downside risk.

BC6 The second reason is that the IFRIC was concerned about creating a distinction between defined benefit plans that should be treated as defined benefit plans and defined benefit plans that should be treated as defined contribution plans with an embedded derivative. The IFRIC could envisage that many (if not all) defined benefit plans could be analysed into a defined contribution plan with one or more embedded derivatives. For example, a final salary plan could be analysed as a defined contribution plan with a cap on the benefits payable equal to the final salary promise and a guarantee of the final salary promise. The IFRIC doubts whether a clear distinction could be made between those plans for which separation of the embedded derivative(s) was thought appropriate, leaving only a defined contribution plan to be accounted for under IAS 19, and those for which separation of the embedded derivative(s) was not thought appropriate.

* The accounting would be based on notional contributions for unfunded plans.

Application of defined benefit accounting

BC7 Having agreed that the appropriate approach was to treat employee benefit plans with a promised return as defined benefit plans under IAS 19, the IFRIC then considered how the defined benefit methodology should be applied. IAS 19 requires the benefits promised under the plan to be projected forward, allocated to periods of service and then discounted back.

BC8 Four main issues arose:

(a) how to project forward a benefit of a fixed guarantee;

(b) how to allocate the benefits under the plan to periods of service;

(c) how to treat a benefit that depends on future asset returns; and

(d) how to treat a benefit that combines a fixed guarantee and benefits that depend on future asset returns.

Projecting forward benefit of a fixed guarantee

BC9 The IFRIC agreed that there were no particular problems in applying the requirements of IAS 19 in projecting forward the benefit of a fixed guarantee. IAS 19 requires an entity to make an estimate of the amount of benefit that employees have earned in return for their service to date. That benefit can be calculated by projecting forward the contributions or notional contributions at the guaranteed fixed rate of return.

Allocation of benefits

BC10 Paragraph 67 of IAS 19 requires benefits to be allocated to periods of service according to the benefit formula, unless the benefit formula allocates a materially higher level of benefit to later years of service in which case a straight-line allocation should be made. The question arises whether expected increases in salary should be taken into account in determining whether a benefit formula expressed in terms of

current salary allocates a materially higher level of benefits to later years of service.

BC11 The IFRIC noted that IAS 19 requires the measurement of plan liabilities to take into account expected future salaries. The IFRIC agreed that this requirement implies that the assessment required in paragraph 67 of IAS 19 of whether higher levels of benefit are attributed to later years of service should also take into account expected future salaries. Otherwise, different allocations could be required for the same benefits depending on how they are expressed in terms of a benefit formula.

Benefits that depend on future asset returns

BC12 When considering a benefit that depends on future assets, the IFRIC considered whether the benefit should be projected forward at an expected rate of return on the assets and discounted back to a present value. This would be consistent with the defined benefit methodology set out in IAS 19. However, there are problems with this approach because the defined benefit methodology in IAS 19 was designed for benefits that do not depend on future returns on assets. For the methodology to work for such benefits, the discount rate would need to be one appropriate for the benefits, ie one commensurate with their risk. The discount rate prescribed by IAS 19, a high quality corporate bond rate, is not generally appropriate for the benefits that depend on future returns on assets.*

BC13 Instead the IFRIC followed the approach required by paragraph 85(b) of IAS 19, which states that the measurement of the plan liability should reflect actuarial gains that have already been recognised when the entity is obliged to use any resulting surplus for the benefit of plan participants.

BC14 The principle underlying this requirement is that the *present value* of the plan liability for the use of the 'surplus' (ie the surplus in the plan before considering how it must be used) is the amount of the 'surplus' at the balance sheet date.† The IFRIC agreed that the same principle

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* It might be appropriate if the benefit was a return based on high quality corporate bonds.

† Otherwise, IAS 19 would require the plan liability to be measured based on a projection forward of the expected future returns on the 'surplus' discounted back to a present value, rather than on the value of the 'surplus' at the balance sheet date.

applies to any benefits that depend on future returns on assets. In other words, the plan liability for such benefits should be determined by the fair value at the balance sheet date of the assets or notional assets upon which the benefit depends.

BC15 The IFRIC considered how the options for deferred recognition of actuarial gains and losses should affect the plan liability for benefits that depend on future returns on assets. The IFRIC has significant reservations about these options. However, its concerns are general and could not be addressed in this draft Interpretation. The IFRIC concluded that the options are a fundamental part of defined benefit accounting under IAS 19 and, therefore, that when the application of defined benefit accounting to the benefits in question is interpreted, those options should be available for changes in the plan liability for benefits that depend on future returns on assets.

BC16 The IFRIC next considered whether a plan liability for benefits that depend on future asset returns arises if the benefits are not vested. The IFRIC agreed that it does so because (a) IAS 19 requires unvested benefits to be accrued over the service lives of the employees and (b) the plan liability set up for the benefits does not represent the amount that would be paid if employees left service at the balance sheet date. Rather, as noted above, it is the present value of the amount expected to be paid at the date the employees are expected to leave. The possibility that some benefits may not vest is reflected in the measurement of the plan liability.

BC17 The IFRIC also considered the measurement of the plan liability for a benefit that depends on future asset returns plus or minus a specified margin, for example a benefit that includes a promise of the return on an equity index plus two hundred basis points. The IFRIC agreed that the measurement of the plan liability should include the effect of the specified margin. Otherwise the plan liability for a benefit that included a specified margin would be measured at the same amount as the plan liability for a benefit that does not include a specified margin, although the benefits are clearly economically different.

BC18 The IFRIC considered whether the change in the plan liability for benefits that depend on future asset returns should be presented as a single amount or analysed into the components of cost that arise under the traditional defined benefit accounting methodology in IAS 19. Subject to adjustments arising from the options for deferred recognition

and unvested benefits, presentation of a single amount would be equivalent to defined contribution accounting. The IFRIC agreed that analysing the change in the plan liability into the traditional components of defined benefit cost would be unduly complex.

A combination of a fixed guarantee and benefits that depend on future returns on assets

BC19 For plans that promise a combination of a fixed guarantee and benefits that depend on future returns on assets, the IFRIC noted that the benefits could be analysed into a fixed and a variable component. The fixed component comprises benefits the amount of which can be estimated without making assumptions about future returns on assets. The variable component comprises benefits an estimate of which requires assumptions to be made about future returns on assets.

BC20 The IFRIC considered whether, in a plan that contains a fixed and a variable component, the benefits should be projected forward using (i) the higher of the expected variable rate of return and the fixed rate of return or (ii) the fixed rate of return. Paragraph 73 of IAS 19 requires the actuarial assumptions to be the best estimates of the variables that will determine the ultimate cost of providing the benefits. Some argue that this means that the benefits must be projected forward at the higher of the expected variable rate of return and the fixed rate of return, because that is the best estimate of what the benefit will ultimately be. However, as noted above, the discount rate specified in IAS 19 is not appropriate for benefits that have been projected forward at an expected rate of return on assets. Given this, the IFRIC concluded that the best approach under IAS 19 is to account for only the fixed guarantee using the methodology for defined benefit plans. The contributions or notional contributions are, therefore, projected forward using the fixed return and discounted back to a present value as required under IAS 19.

BC21 This calculation does not include any impact of the variable component of the plan. The IFRIC agreed that the variable component liability should also be calculated on a stand-alone basis, as discussed in paragraphs BC12-BC18. If the liability under the variable component is higher than that recognised under the fixed component, that higher liability should be recognised. In order to accommodate the deferred recognition options, the methodology compares the net recognised

asset or liability (rather than the gross plan liability) that would arise under the two components on a stand-alone basis, and recognises an additional plan liability to arrive at the higher net liability (or smaller net asset).

BC22 The IFRIC considered how changes in the net asset or liability should be presented, either as the components of cost that arise under the defined benefit accounting methodology applied to the fixed component or as a single amount arising from the methodology applied to the variable component.

BC23 The IFRIC agreed that the accounting for the plan should not switch between the traditional defined benefit methodology and presentation (when the fixed component net liability is higher) and the traditional defined contribution methodology and presentation (when the variable component net liability is higher). Rather, the traditional defined benefit methodology and presentation of the fixed component should continue whichever component gives the higher net liability. Then, if the variable component net liability is higher, an additional liability should be recognised to arrive at that higher figure. The initial recognition of that additional liability and the subsequent recognition of any changes in it would be presented as a single additional component of the defined benefit cost.

BC24 The IFRIC noted that this approach acknowledges the fundamental nature of the plan as a defined benefit plan under IAS 19 but avoids the complexity and arbitrary nature of any allocation of the additional liability to the components of cost arising under defined benefit accounting.

BC25 Finally, the IFRIC considered whether recognition should be given to the fact that, in a plan that comprises both a fixed and a variable component, both components always have value. Recognising a net liability that is simply the higher of the liabilities under the two components always ignores one component of the plan. However, the ignored component always has some value for the members of the plan. When the net liability under the fixed component is higher than the net liability under the variable component, the variable component has value for the members of the plan—it gives them the chance to participate in higher returns in the future. Similarly, when the variable component net liability is higher than the fixed component net liability,

the fixed component has value for the members—it provides protection against future losses.

BC26 The IFRIC concluded that recognising a value for the component of the plan that does not give rise to the higher liability at the balance sheet date would be inconsistent with the approach to defined benefit accounting in IAS 19. The methodology for defined benefit accounting in IAS 19 treats the assumptions at the balance sheet date as if they are fixed and will not change in the future. In other words, the methodology gives a point estimate at the balance sheet date without valuing the likelihood of future changes in assumptions. It is consistent with that approach to recognise the higher of the amounts under the two components in the plan without recognising any additional amounts for the possibility that the relative values of the liabilities may change in the future.