

STAFF PAPER

February 2013

IASB Meeting

Project	Narrow scope amendments to IAS 19 <i>Employee Benefits</i>		
Paper topic	Measurement of the net DBO for post-employment benefit plans with employee contributions		
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Introduction and purpose

1. The IFRS Interpretations Committee (the Interpretations Committee) received two requests, in May and September 2012 respectively, seeking clarification of paragraph 93 of IAS 19 *Employee Benefits*. That paragraph refers to the accounting for employee contributions set out in the formal terms of a defined benefit plan. The submitters specifically request guidance on the accounting of employee contributions in respect of service. The Standard is effective from annual periods beginning on or after 1 January 2013.
2. The Interpretations Committee already discussed this issue at its September, November 2012 and January 2013 meetings. At its January 2013 meeting, the Interpretations Committee decided to propose to the IASB that the IASB should consider a narrow-scope amendment to IAS 19.
3. This agenda paper is organised as follows:
 - (a) submissions
 - (b) overview of the issue
 - (c) the Interpretations Committee's discussions to date
 - (d) proposal to amend IAS 19
 - (e) question for the IASB whether it agrees with the Interpretations Committee's proposal and the wording for the proposed amendments

- (f) Appendix A— proposed amendments to IAS 19
- (g) Appendix B—staff paper for the September 2012 Interpretations Committee’s meeting
- (h) Appendix C—staff paper for the November 2012 Interpretations Committee’s meeting
- (i) Appendix D—staff paper for the January 2013 Interpretations Committee’s meeting.

Submissions

4. The Interpretations Committee received two submissions in relation to paragraph 93 of IAS 19. The requirements in that paragraph were added as a result of the revisions to IAS 19 in 2011. The paragraph states (emphasis added):

Contributions from employees or third parties set out in the formal terms of the plan either reduce service cost (if they are linked to service), or reduce remeasurements of the net defined benefit liability (asset) (eg if the contributions are required to reduce a deficit arising from losses on plan assets or actuarial losses). **Contributions from employees or third parties in respect of service are attributed to periods of service as a negative benefit in accordance with paragraph 70 (ie the net benefit is attributed in accordance with that paragraph).**

5. The first submitter was concerned that:
- (a) the guidance in paragraph 93 would result in a change in measurement of the defined benefit obligations (DBO), as opposed to the IASB’s statement that measurement issues will be addressed in a later phase of the project, because the submitter thinks that in current practice employee contributions reduce the gross service cost in the period in which they are received. The submitter thinks that this is an unintended consequence of the language in that paragraph.
 - (b) as a result of applying the requirements in paragraph 93, even very simple contributory plans with a benefit based on a level percent of pay

and employee contributions also based on a level percent of pay may be considered back-end loaded if, as is common, the assumed salary growth rate is lower than the assumed discount rate. This is because, after allowing for the effect of interest on employee contributions, the pattern of employee contributions will be front-end loaded, causing the net benefit to be back-end loaded. Further complexity and cost are added when the attribution changes due to assumptions changes, most notably shifts in the relationship between the discount rate and the salary growth rate (for detail, please refer to Appendix A and B of the staff paper for the September 2012 Interpretations Committee meeting).

(c) retrospective application of IAS 19 might be difficult because data on employees' past contributions may no longer exist to determine the effect on the DBO of those contributions.

6. The second submitter stated that if employee contributions are based on a fixed percentage of salary and the actuarial assumptions for discount rate and estimated future salary increases are not the same, the reduction in service cost that is due to employee contributions (ie negative service cost) will not equal the cash contribution in each period. The second submitter asked how the difference between service cost and employee contributions should be presented in the financial statements.

Overview of the issue

7. Employee contributions to a defined benefit plan typically take the form of a reduction in the salary when the contribution is paid. Thus the benefit is reclassified from one class of employee benefit, typically a short-term benefit such as salary, to another class of employee benefit, a defined benefit. The attribution of short-term benefits and defined benefits in accordance with IAS 19 differ. Short-term benefits are attributed to periods of service when they are paid, and defined benefits are attributed to periods of service on a straight line basis or on the basis of the benefit formula, depending on the circumstances. Thus,

whether the contribution reduces short-term benefits or defined benefits affects the timing of recognition of both benefits.

8. We observe that, in some circumstances, the attribution of the contributions better reflects the underlying economics if it is attributed consistently with the benefit formula of the *defined benefit that it is funding*. For example, some medical benefits require the employee to contribute to the benefit payment at the time of that payment, thus accreting the estimated cost of the medical benefit reduced by the estimated contribution over the periods of service would better reflect the cost of that benefit to the entity, instead of reducing service cost at the time the benefit is paid for the full amount of the contribution. In this example, the short-term benefit will be recognised at the gross amount (which will equal the amount paid for all periods), while the defined benefit attributed to each period of service will be reduced for the effect of the attribution of the contribution.
9. We also observe that, in other cases, the attribution of the contributions better reflects the underlying economics if it is attributed consistently with the *short-term benefit that it is funded from*. For example, if salary is reduced by the same percentage each period regardless of any other factors, attributing the contribution to the period in which the contribution is paid better reflects the underlying economics, because there is no other relationship with the defined benefit. In this example, the short-term benefit recognised is reduced by the fixed contribution, which will equal the net amount paid, while the attribution of the defined benefit will remain unaffected by the contribution.
10. In short, the question is whether employee contributions are a reduction in cost to the entity of the short-term benefit (eg salary) or a reduction in cost to the entity of the defined (long-term) benefit. We note that employee contributions are still part of the post-employment benefits but that the accounting of these two alternative views results in a different pattern of recognition of cost to the entity.

The Interpretations Committee's discussions to date and proposal to amend IAS 19

11. At its September 2012 meeting¹, the Interpretations Committee tentatively observed that the proposals in the Exposure Draft for IAS 19 published in April 2010, the IASB's decision at its meetings in February 2011 and the requirements in paragraph 93 of IAS 19 are consistent with each other. In other words, there is no unintended consequence in the development of paragraph 93. However, we think that the wording in paragraph 93 is not clear enough (see further discussion below).
12. At its November 2012 meeting², the Interpretations Committee considered a number of examples illustrating the application of the requirements in paragraph 93 of IAS 19 and the effect of different discount rate and salary growth assumptions on the calculation of the net benefit. The Interpretations Committee was concerned that even a very simple contributory plan (eg a fixed percentage of salary) would be subject to a complex calculation for attributing the benefits to periods of service as a negative benefit.
13. At its January 2013 meeting³, the Interpretations Committee discussed, by considering some examples, whether certain types of employee contributions to a defined benefit plan reduce short-term employee benefits cost (for example salary) instead of reducing post-employment benefits cost. The Interpretations Committee observed that the wording in paragraph 93 of IAS 19 seemed to suggest that all employee contributions in respect of service should be attributed to periods of service as a negative benefit in accordance with paragraph 93 of IAS 19. However, employee contributions that are linked solely to the employee's service rendered in the same period in which they are paid (eg if the contributions are a fixed percentage of salary throughout the entire period of the employment) might also be considered to reduce the cost of short-term employee benefits.

¹ IFRIC Update September 2012: <http://media.ifrs.org/IFRICUpdateSep12.htm>

² IFRIC Update November 2012: <http://media.ifrs.org/2012/IFRIC/IFRIC-Update-November-2012.htm>

³ IFRIC Update January 2013: <http://media.ifrs.org/2013/IFRIC/January/IFRICUpdateJan2013.pdf>

14. The Interpretations Committee noted, however, that the existing wording in paragraph 93 of IAS 19 is not sufficiently clear to ensure that all entities reach the same interpretation as it did at this meeting. The Interpretations Committee further noted that, taking into account the effective date of IAS 19, this issue should be addressed urgently. Consequently, the Interpretations Committee decided to ask the IASB to clarify the wording in that paragraph to reflect the observations above through a narrow scope amendment.

Proposal to amend IAS 19

15. On the basis of the Interpretations Committee's observations and proposal, we have prepared the wording for the proposed amendments to paragraph 93 of IAS 19 in Appendix A of this agenda paper.
16. Under this proposal, contributions from employees or third parties that are linked to the employees' service are attributed to periods of service as a negative post-employment benefit, except when the contributions are linked solely to the employees' service rendered in the same period in which they are paid (eg if the contributions are a fixed percentage of salary throughout the entire period of the employment). If contributions from employees or third parties are linked solely to the employees' service rendered in the same period in which they are paid, the contributions are treated as a reduction in short-term employee benefit cost and accounted for in that same period.
17. We propose one more amendment to IAS19. Paragraph 93 first states that contributions from employees or third parties in respect of service are attributed to periods of service as a negative benefit in accordance with paragraph 70 and then states that the *net* benefit is attributed in accordance with paragraph 70. In addition, paragraph BC150(a) states that the back-end loading test and attribution in paragraph 70 should be based on the net benefit. This has caused confusion because paragraph 93 is unclear whether the back-end loading test in paragraph 70 should be performed on the net benefit or on the gross benefit and the negative benefit separately, while paragraph BC150(a) explicitly states that the back-end loading test and attribution in paragraph 70 should be based on the net benefit.

18. Furthermore, as noted by the first submission to the Interpretations Committee, performing the test on the net benefit results in added complexity. Depending on how the attribution test is applied, the outcome of the test may be influenced by changes in assumptions from one year to another.
19. Consequently, we propose removing the statements that refer to the net benefit from paragraph 93 and BC150(a) to avoid confusion and specifying in paragraph 93 that the negative benefit from employee contributions is attributed to periods of service consistently with the attribution of the gross benefit in accordance with paragraph 70. Doing so will ensure consistent attribution of the net benefit, thus achieving the outcome intended by the IASB while reducing the cost and complexity of its application.
20. In our view, it is not necessary to add a disclosure requirement related with this proposed amendment. This is because contributions from employees in the scope of paragraph 93 are contributions to a defined benefit plan and thus they are subject to the relevant disclosure requirements that are already set out in IAS 19 (for example, paragraph 141(f)).
21. We think that the amendments should apply retrospectively because this is the general approach to transition set out in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, and that entities should follow transition guidance that are already set out in IAS 19 where applicable.
22. We propose that the comment period for this Exposure Draft should be no less than 120 days, which is the normal comment period in accordance with the due process handbook.
23. In our view, although the existing wording in paragraph 93 of IAS 19 is not sufficiently clear, it is possible to read the current literature in paragraph 93 in the same way as the revised wording under this proposed amendments. However, according to the result of the outreach we conducted, there are concerns about diversity in the interpretation of paragraph 93 (refer to the staff paper for the September 2012 Interpretations Committee meeting). We think that this proposed amendment would help address the diversity that would otherwise be likely to arise.

Questions for the IASB

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Does the IASB agree with the Interpretations Committee's proposal to make a narrow-scope amendment to IAS 19?

If the IASB agrees with amending IAS 19, does the IASB agree:

- (1) with the wording for the proposed amendments prepared by the staff?
- (2) that it is not necessary to add a disclosure requirement related with this proposed amendment?
- (3) that the amendments should apply retrospectively?
- (4) that the comment period should be no less than 120 days?

Appendix A—Proposed changes to IAS 19

Amendments to IAS 19 *Employee Benefits*

Paragraph 93 is amended. Paragraph 175 is added. New text is underlined and deleted text is struck through. Paragraph 92 is presented for reference.

Post-employment benefits: defined benefit plans

Recognition and measurement: present value of defined benefit obligations and current service cost

Actuarial assumptions: salaries, benefits and medical costs

- 92 Some defined benefit plans require employees or third parties to contribute to the cost of the plan. Contributions by employees reduce the cost of the benefits to the entity. An entity considers whether third-party contributions reduce the cost of the benefits to the entity, or are a reimbursement right as described in paragraph 116. Contributions by employees or third parties are either set out in the formal terms of the plan (or arise from a constructive obligation that goes beyond those terms), or are discretionary. Discretionary contributions by employees or third parties reduce service cost upon payment of these contributions to the plan.
- 93 Contributions from employees or third parties set out in the formal terms of the plan either reduce service cost (if they are linked to service), or reduce remeasurements of the net defined benefit liability (asset) (eg if the contributions are required to reduce a deficit arising from losses on plan assets or actuarial losses). Contributions from employees or third parties that are linked to service in respect of service are attributed to periods of service as a negative benefit consistently with the attribution of the gross benefit in accordance with paragraph 70 (ie the net benefit is attributed in accordance with that paragraph), except when the contributions are linked solely to the employee's service rendered in the same period in which they are paid (eg if the contributions are a fixed percentage of salary throughout the entire period of the employment). If contributions from employees or third parties are linked solely to the employee's service rendered in the same period in which they are paid, the contributions are treated as a reduction in short-term employee benefit cost and accounted for in that same period.

Effective date

- 175 *Defined Benefit Plans: Employee Contributions* (Amendments to IAS 19), issued in [date to be inserted after exposure], amended paragraph 93. An entity shall apply that paragraph for annual periods beginning on or after [date to be inserted after exposure] retrospectively in accordance with IAS 8 *Accounting Policies*,

Changes in Accounting Estimates and Errors. Earlier application is permitted. If an entity applies this Standard for an earlier period, it shall disclose that fact.

Amendments to Basis for Conclusions on IAS 19 *Employee Benefits*

Paragraph BC150 is amended. New text is underlined and deleted text is struck through.

Post-employment benefits

Defined benefit plans: recognition and measurement

Actuarial assumptions—risk-sharing: amendments issued in 2011

Other clarifications

BC150 The Board clarified the following points in the light of responses to the 2010 ED:

- (a) Contributions from employees that are linked to service ~~in respect of service~~ should be attributed to periods of service in accordance with paragraph 70 using the benefit formula, or on a straight-line basis ~~(ie the back-end loading test and attribution in paragraph 70 should be based on the net benefit)~~. This reflects the Board's view that contributions from employees can be viewed as a negative benefit. In addition, the Board noted that a portion of future employee contributions may be connected with salary increases included in the defined benefit obligation. Applying the same method of attribution to that portion of the contribution and the salary increases avoids an inconsistency.

Basis for Conclusions on proposed amendments to IAS 19

This Basis for Conclusions accompanies, but is not part of, the proposed amendments.

Contributions from employees or third parties: amendments issued in 2013

- BC1 The IFRS Interpretations Committee (the Interpretations Committee) received two requests, in May and September 2012 respectively, seeking guidance on the accounting of employee contributions in respect of service in accordance with paragraph 93. The Interpretations Committee observed that contributions from employees or third parties that are linked solely to the employee's service rendered in the same period in which they are paid (eg if the contributions are a fixed percentage of salary throughout the entire period of the employment) are treated as a reduction in short-term employee benefit cost and accounted for in that same period. However, the Interpretations Committee thought that the existing wording in paragraph 93 is not sufficiently clear, and so it asked the IASB to clarify the wording in that paragraph to reflect the observations above through a narrow scope amendment.
- BC2 In February 2013 the IASB discussed the Interpretations Committee's proposal and agreed to propose a narrow scope amendment to IAS 19. The IASB observed that the defined benefits are only paid after retirement, however, if the contributions are linked solely to each year's service, the employee's salary could be considered to be settled with a reduced net amount in exchange for the employee's service for that year. For example, if employee contributions are a fixed percentage of salary throughout the entire period of the employment, the contributions are in proportion to salary and thus linked solely to the employee's service rendered each year. On the other hand, for example, if there is a stepped increase (or decrease) in the percentage of employee contributions based on the number of years of service, it would result in higher (or lower) contributions in the latter years that could be considered linked to service in earlier (or latter) years. In other words, the increase (or decrease) in the percentage is not only related to the service in the current year, but also related to other years' service.
- BC3 Consequently, the IASB proposes amending paragraph 93 to exclude contributions from employees or third parties that are linked solely to the employee's service rendered in the same period in which they are paid (eg if the contributions are a fixed percentage of salary throughout the entire period of the employment) from being attributed to periods of service as a negative post-employment benefit. If contributions from employees or third parties are linked solely to the employee's service rendered in the same period in which they are paid, the contributions are treated as a reduction in short-term employee benefit cost and accounted for in that same period.

- BC4 The IASB considered whether it should require disclosure of the amount reduced in short-term employee benefit cost that arises from applying the proposed amendment, but decided that it should not do so. It noted that contributions from employees or third parties in the scope of paragraph 93 are contributions to a defined benefit plan and thus they are subject to the relevant disclosure requirements that are already set out in IAS 19 (for example, paragraph 141(f)).
- BC5 In the discussion of the proposed amendments above, the IASB observed that paragraph 93 first states that contributions from employees or third parties in respect of service are attributed to periods of service as a negative benefit in accordance with paragraph 70 and then states that the net benefit is attributed in accordance with paragraph 70. In addition, paragraph BC150(a) states that the back-end loading test and attribution in paragraph 70 should be based on the net benefit. This has caused confusion because paragraph 93 is unclear whether the back-end loading test in paragraph 70 should be performed on the net benefit or on the gross benefit and the negative benefit separately, while paragraph BC150(a) explicitly states that the back-end loading test and attribution in paragraph 70 should be based on the net benefit. The IASB observed that performing the test on the net benefit results in added complexity. Depending on how the attribution test is applied, the outcome of the test may be influenced by changes in assumptions from one year to another. Consequently, the IASB proposes removing the statements that refer to the net benefit from paragraph 93 and BC150(a) to avoid confusion and specifying in paragraph 93 that the negative benefit from employee contributions is attributed to periods of service consistently with the attribution of the gross benefit in accordance with paragraph 70.