Meaning of the simplification offered by the IFRS for SMEs in measuring defined benefit plan that is in the form of a lump sum payment, which is paid immediately after retirement

Presented by

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The Subject

Paragraph 28.19 of the IFRS for SMEs offers some simplifications in measuring the defined benefit obligation with respect to current employees if an entity is not able, without undue cost or effort, to use the projected unit credit method to measure its obligation and cost under defined benefit plans. They are:

(a) ignore estimated future salary increases (i.e., assume current salaries continue until current employees are expected to begin receiving post-employment benefits).

(b) ignore future service of current employees (i.e., assume closure of the plan for existing as well as any new employees).

(c) ignore possible in-service mortality of current employees between the reporting date and the date employees are expected to begin receiving post-employment benefits (i.e., assume all current employees will receive the post-employment benefits). However, mortality after service (i.e., life expectancy) will still need to be considered.

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The issue (1/3)

- SOCPA received numerous inquiries about the meaning of the simplification stated in subparagraph 28.19(b) when the defined benefit plan is in the form of a lump sum amount at the date of retirement (e.g., final salary multiplied by the number of years of service).
- Most entities interpret subparagraph 28.19(b) by measuring their defined benefit obligation at the gross amount due to all of its employees assuming that all of them will retire at the reporting date.

The issue (2/3)

- However, such interpretation will render subparagraphs 28.19(a) and (c) meaningless in the case of a lump sum amount paid immediately after retirement. Moreover, such amount will not be discounted even there is high probability that employees will continue to render their services for many more years.

The issue (3/3)

- In a related matter, allowing the simplification in subparagraph 28.19(a) while requiring discounting will result in underestimating the obligation at the reporting dates as the factor that will increase the liability (salary increases) is ignored, whereas the factor that will reduce the liability (discount rate) is still applicable.

Our questions to the EEG Members (1/2)

1. Is the above interpretation correct? i.e., is it proper to assume that all employees will leave the service at the end of the reporting period?
   If it is not, what is the definition of "future service" in the context of subparagraph 28.19(b)? and how does ignoring such future service of current employees affect measuring defined benefit obligation, which will be paid in a lump sum payment immediately after retirement?

Our questions to the EEG Members (2/2)

2. Over which period the obligation would be discounted? (lump sum payment is paid immediately after retirement)
3. Is it appropriate to discount the obligation while ignoring estimated future salary increases?

Current practice

We have received numerous inquiries about the meaning of these simplifications when the defined benefit plan is in the form of a lump sum amount at the date of retirement. Without proper interpretation, some entities would measure their defined benefit obligation at gross amount, while some others would discount such obligation according to the original estimation of the employee retirement date.

Reasons why the IASB should address the issue (1/2)

1. The issue is widespread and has, or is expected to have, a material effect on those affected. The different practices will lead to material differences in reported employee benefit liability and expense among different entities. According to a publication by EY, "In many countries where IFRS for SMEs is permitted, entities may not necessarily have defined benefit pension schemes, but often pay a lump sum to employees on retirement. Usually, this is based on the number of years of employment and final salary levels."

2. Many examples in either IAS 19 (see examples after paragraphs 68, 71, 72, 73(1&2)) or IFRS for SMEs (see IFRS Foundation—Supporting Material for the 2015 IFRS for SMEs Standard , Module 28, examples 24, 26, 27, 28, 29, 30 and 31) are based on a lump sum payment after retirement (some examples state that such amount is "payable immediately after the employee leaves the entity").

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Reasons why the IASB should address the issue (2/2)

3. Financial reporting would be improved through the elimination, or reduction, of diverse reporting methods. Clarifying the requirements in subparagraph 28.19(b) will reduce diverse reporting methods.
4. The issue is sufficiently narrow in scope that it can be addressed in an efficient manner. Since the simplification offered in subparagraph 28.19(b) is interpreted differently by many entities, we believe it is important for the IASB to stand up to this matter.

Thank You!