STAFF PAPER

September 2019

IASB® Meeting

Project	Comprehensive review of the *IFRS for SMEs*® Standard		
Paper topic	New IFRS Standards—IAS 19 *Employee Benefits*		
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Purpose

1. At this meeting we are asking the Board if the Request for Information that will be issued as part of the 2019 Comprehensive Review of the *IFRS for SMEs* Standard (2019 Review) should seek views on:

   (a) whether and how the requirements of Section 28 *Employee Benefits* of the *IFRS for SMEs* Standard should be aligned with IAS 19 *Employee Benefits* as revised in 2011; and

   (b) current practice and issues in applying the simplifications for measuring defined benefit obligations under the 'undue cost or effort' exemption in paragraph 19 of Section 28 of the *IFRS for SMEs* Standard.

2. The objective of the Request for Information is to obtain evidence that will assist the Board in deciding whether and how to develop an exposure draft of amendments to the *IFRS for SMEs* Standard.

Summary of staff recommendations

3. The staff recommends that the Board seek views in the Request for Information on:

(a) whether and how Section 28 of the *IFRS for SMEs* Standard could be aligned with IAS 19 as amended in 2011 on the following matters:

(i) requiring entities that apply the *IFRS for SMEs* Standard to present remeasurements of defined benefit plans in other comprehensive income;

(ii) defining remeasurements in a manner consistent with IAS 19; and

(b) current practice and issues in applying the simplifications for measuring defined benefit obligations applying the 'undue cost or effort' exemption to paragraph 28.19 of the *IFRS for SMEs* Standard.

4. Appendix A summarises staff analysis on whether the Board should seek views in the Request for Information on aligning the requirements Section 28 of the *IFRS for SMEs* Standard with IAS 19.

Structure of this paper

5. The paper is structured as follows:

(a) Background (paragraphs 6-8);

(b) Defined benefit plans (paragraphs 9-29);

(c) Termination benefits (paragraphs 30-40);

(d) Applying the simplifications for measuring defined benefit obligations under the 'undue cost or effort' exemption (paragraphs 41-48);

(e) Other issues (paragraphs 49-62);

(f) Staff recommendations and questions for the Board;

(g) Appendix A—Summary of staff analysis.

Background

6. Section 28 of the *IFRS for SMEs* Standard and IAS 19 prescribe the accounting and disclosure requirements for employee benefits. Employee benefits include:

(a) short-term employee benefits;

(b) post-employment benefits, which may be classified as:

  (i) defined contribution plans; or

  (ii) defined benefit plans;

(c) other long-term employee benefits; and

(d) termination benefits.

7. The 2011 amendments to IAS 19 introduced substantial changes to the accounting requirements for only defined benefit plans and termination benefits.

8. The 2011 amendments did not introduce substantial changes to the requirements for short-term employee benefits (except for amending the definition), defined contribution plans and other long-term employee benefits; the requirements for these areas in the *IFRS for SMEs* Standard requirements are aligned with those in IAS 19. Therefore, the analysis in this paper focuses on defined benefit plans and termination benefits only.

Defined benefit plans

Overview of the 2011 amendments to IAS 19

9. The 2011 amendments made targeted improvements in the following areas:

(a) the recognition of changes in the net defined benefit liability (asset);

(b) plan amendments, curtailments and settlements;

(c) miscellaneous issues, including:

  (i) the classification of short-term and long-term employee benefits;

  (ii) current estimates of mortality rates;

  (iii) tax and administration costs;

  (iv) risk-sharing and conditional indexation features; and

(d) disclosure requirements for defined benefit plans.

10. The main changes were:

(a) the elimination of the so-called ‘corridor’, which permitted an entity to defer recognition of some changes in the defined benefit obligation; and

(b) the elimination of the accounting policy option to present actuarial gains and losses either in profit or loss or in other comprehensive income (presentation changes).

11. IAS 19 now requires that an entity:

(a) determine the following amounts to be presented in profit or loss:

(i) current service cost;

(ii) net interest on the net defined liability (asset);

(iii) any past service cost and gain or loss on settlement; and

(b) determine the remeasurements of the net defined liability (asset) to be presented in other comprehensive income.

Overview of selected requirements of Section 28 of the **IFRS for SMEs** *Standard*

12. Paragraph 28.14 of the *IFRS for SMEs* Standard requires an entity to recognise:

(a) a liability for its obligations under defined benefit plans net of plan assets; and

(b) the net change in that liability during the period as the cost of its defined benefit plan during that period.

13. Paragraph 28.18 requires an entity to use the projected unit credit method to measure its defined benefit obligations. If an entity cannot use the projected unit credit method without undue cost or effort, paragraph 28.19 permits entities to apply a simplified measurement. These simplifications are discussed in paragraphs 28.38-28.45 of the *IFRS for SMEs* Standard.

14. Paragraph 28.22 requires an entity to measure its plan assets at fair value at the reporting date.

15. Paragraph 28.24 requires an entity to recognise all actuarial gains and losses in profit or loss or in other comprehensive income. Therefore, it does not permit the use of the 'corridor' approach.

Applying the alignment principles

16. At its May 2019 meeting,[1] the Board tentatively decided that to determine whether and how to align the *IFRS for SMEs* Standard with new and amended IFRS Standards, it would apply three principles:

    (a) relevance;

    (b) simplicity; and

    (c) faithful representation.

17. The following paragraphs apply the alignment principles to assist the Board in determining whether and how to align the *IFRS for SMEs* Standard with the amendments to IAS 19 (2011).

18. Section 28 does not permit deferred recognition of the changes in the defined benefit liability; consequently, no action is needed to align Section 28 with the amendment that eliminated the corridor approach.

Principle 1—Relevance

19. When considering whether to align the presentational changes in the defined benefit obligation with that required by IAS 19 (2011), there are two issues to consider:

    (a) whether to require that some changes are presented in profit or loss and other changes are presented in other comprehensive income, which would entail eliminating the presentation option in Section 28; and

    (b) whether to require separate presentation of remeasurements as defined in IAS 19 or actuarial gains and losses.

20. In finalising the 2011 amendments to IAS 19, the Board noted that:

[1] See ***May 2019 Agenda Paper 30A***.

(a) eliminating options makes it easier to compare entities and improves financial reporting;[2] and

(b) although presenting changes included in the remeasurements may provide more information to users about the uncertainty and risk of future cash flows, doing so means that entities provide less information about the likely amount and timing of those cash flows.[3]

21. For these reasons, the Board confirmed its decision to remove the presentation option and require that an entity recognises remeasurements in other comprehensive income.

22. The *Conceptual Framework for Financial Reporting* states that[4], because the statement of profit and loss is the primary source of information about an entity's financial performance for the period, all income and expenses are, in principle, included in that statement. However, the Board may decide that income or expenses arising from a change in the current value of an asset or liability are to be included in other comprehensive income when doing so results in providing more relevant information or a more faithful representation of the entity's financial performance in the period.

23. Due to the long-term nature of defined benefit liabilities, actuarial gains and losses may reverse over time, therefore presenting actuarial gains and losses outside profit or loss may provide more relevant information about the full life cost to the entity of providing the benefits.

24. The staff notes that paragraph 28.24 of the Standard refers to the presentation of actuarial gains and losses, whereas, IAS 19 (2011) refers to the presentation of remeasurements, which include the following:

(a) actuarial gains and losses;

(b) returns on plan assets, excluding amounts included in net interest on the net defined liability (asset); and

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[2] Paragraph 93 of the Basis for Conclusions of IAS 19.

[3] Paragraph 88 of the Basis for Conclusions of IAS 19.

[4] Paragraph 7.17 of the *Conceptual Framework for Financial Reporting.*

(c) any change in the effect of the asset ceiling, excluding amounts included in the net interest on the net defined liability (asset).

25. The staff's view is that presenting all changes in the fair value of plan assets in profit or loss, while including actuarial gains and losses in other comprehensive income, could create a presentation mismatch. This argument provides support for amending the wording in paragraph 28.24 of the Standard and referring to remeasurements to be defined in a manner consistent with IAS 19 (2011).

Principle 2—Simplicity

26. Eliminating accounting options is in itself a simplification.

27. Referring to remeasurements instead of actuarial gains and losses, as required by IAS 19 (2011), will provide entities with a simpler way to determine net interest. Many respondents to the 2013 Exposure Draft *IFRS for SMEs—Proposed amendments to the International Financial Reporting Standard for Small and Medium-sized Entities*[5] asserted that such changes would simplify the requirements in the *IFRS for SMEs* Standard.[6]

28. The staff notes that in theory it may be simpler to require entities to present all components of the cost of a defined benefit plan in profit or loss, because entities would not need to determine separate components. However, Section 28 already requires that entities disclose actuarial gains and losses recognised during the period. The staff concluded that the proposed changes would not add complexity compared to the current requirements.

Principle 3—Faithful representation

29. The recommended change will not affect the measurement of the entity's net defined benefit liability (asset). The staff's view is that the recommended changes do not affect the faithful representation of defined benefit plans.

[5] Exposure Draft *IFRS for SMEs—Proposed amendments to the International Financial Reporting Standard for Small and Medium-sized Entities*, published in October 2013.

[6] See paragraph 73(c) of ***May 2014 Agenda Paper 15A***.

Termination benefits

Overview of the 2011 amendments to IAS 19

30. The 2011 amendments made targeted improvements to:

    (a) the timing of recognition of termination benefits; and

    (b) the interaction among plan amendments, curtailments, settlements and restructuring costs.

31. Before the 2011 amendments, IAS 19 required an entity to recognise termination benefits when the entity was demonstrably committed to providing those benefits.

32. The amendments changed the timing of the recognition of termination benefits as follows:

    (a) if the termination benefits are provided as part of a restructuring as defined under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, the benefits should be recognised at the earlier of:

        (i) when the entity can no longer withdraw the offer of those benefits; and

        (ii) when the entity recognises the related restructuring costs; and

    (b) in all other cases, when the entity can no longer withdraw the offer of those benefits.

Overview of Section 28 of the IFRS for SMEs *Standard*

33. Paragraph 28.33 of the Standard states that an entity shall recognise termination benefits when the entity is demonstrably committed to either:

    (a) terminate the employment of an employee or a group of employees before the normal retirement date; or

    (b) provide termination benefits as a result of an offer made in order to encourage voluntary redundancy.

34. The requirements in Section 28 of the Standard are aligned with IAS 19 as it stood prior to the 2011 amendments.

Applying the alignment principles

Principle 1—Relevance

35. When finalising the 2011 amendments, the Board concluded that an entity's inability to withdraw the offer of benefits is the deciding factor for the timing of recognition, because as long as the entity has the discretion to withdraw the offer, a liability does not exist.

36. The Board also decided it would be appropriate to align the recognition requirements for termination benefits and any related restructuring costs since they often occur together.

37. The staff notes that paragraph 28.35 of the Standard indicates the entity's inability to withdraw the offer as a necessary condition for recognition. Therefore, aligning the wording in Section 28 with IAS 19 (2011) is more of a clarification than a modification.

38. The staff is persuaded that aligning the criteria would be an improvement and offer a clearer basis for recognition. The current formulation in IAS 19 (2011) requires an unavoidable obligation to the counterparty rather than an assessment of the commitment of the entity, which may involve judgment.

Principle 2—Simplicity

39. The staff's view is that the proposed modifications provide helpful clarification and enhance simplicity.

Principle 3—Faithful representation

40. The staff's view is that the proposed modifications would enable an entity to provide information that faithfully represents its liabilities by ensuring it recognises a liability for termination benefits only when the entity has an obligation it has no practical ability to avoid.

Applying the simplifications for measuring defined benefit obligations under the 'undue cost or effort' exemption

41. The measurement requirements for a defined benefit obligation in Section 28 are based on the principles in IAS 19. An entity shall:

    (a) include the benefits attributable to the services rendered in the current and prior periods (paragraph 28.16);

    (b) measure the defined benefit obligation on a discounted basis, that is, at the present value of the outflows that will be required to settle the obligation (paragraph 28.17); and

    (c) include in the measurement unvested benefits and consider the probability of some employees failing to meet the vesting conditions (paragraph 28.26).

42. Paragraph 28.19 of the Standard allows entities to adopt simplifications to the measurement of the defined benefit obligation if they cannot use the projected unit credit method without undue cost or effort. In particular, entities are permitted to ignore:

    (a) estimated future salary increases (that is, they can assume current salaries continue until current employees are expected to begin receiving benefits);

    (b) future service (that is, they can assume closure of the plan); and

    (c) possible in-service mortality between the reporting date and the date when the employees are expected to begin receiving benefits.

43. However, entities are still required to consider life expectancy and include both vested and unvested benefits in the measurement.

44. The purpose of the simplifications was to retain the IAS 19 measurement principles but reduce the need to engage external specialists[7].

[7] Paragraph BC125 of the Basis for Conclusions of the *IFRS for SMEs* Standard.

45. The feedback from some stakeholders is that the simplifications in paragraph 28.19 of the Standard are unclear. One stakeholder asked about a lump sum payable at the date of retirement (a portion of the final year's salary multiplied by the number of years in service). The stakeholder's question was whether the application of paragraph 28.19 of the Standard implies the discounting of the obligation. The stakeholder noted that not requiring an entity to discount the obligation would ignore the fact that the benefit is not payable at the reporting date and could be paid many years later. Also, if the entity is both ignoring future salary increases and discounting the obligation, the liability will be underestimated.

46. The staff acknowledges that there is an element of tension between ignoring future service and considering unvested benefits—often, vesting conditions are linked to length of service. Moreover, some benefits become payable when the employee leaves service rather than at the legal retirement age—if an entity is unable to project reliably future service, it may also be unable to project the expected settlement date.

47. One additional issue in relation to paragraph 28.19 of the Standard is whether an entity that applies paragraph 28.19 needs to apply all the simplifications or could choose only some—for instance, whether an entity could consider salary progression and ignore future service.

48. Initial feedback indicated that defined benefit plans and other post-employment benefits are not common transactions among entities applying the *IFRS for SMEs* Standard, so the staff recognises the need for caution in considering whether to amend the simplified measurement requirements. On the other hand, feedback indicates that in some jurisdictions, there is divergence in practice in applying paragraph 28.19 of the Standard. Therefore, the staff recommends it would be helpful to seek evidence using the Request for Information on simplified measurement—how commonly it is used, in relation to what type of plans and what the application issues are. The Board should then consider, using feedback from respondents, whether and how to amend paragraph 28.19 of the Standard in a way that is helpful to stakeholders.

Other issues

49. The 2011 amendments, and other amendments issued in November 2013 and February 2018, introduced changes in other areas of IAS 19. The staff recommends that the Board seek views on not aligning the *IFRS for SMEs* Standard with those changes.

50. The following paragraphs explain the rationale for this recommendation.

Miscellaneous issues

51. The amendments issued in 2011 also clarified how entities should consider some specific features of defined benefit plans that reportedly gave rise to divergent application in practice, such as risk-sharing features.

52. The staff notes that the measurement principle in the *IFRS for SMEs* Standard is consistent with IAS 19 (2011). However, the guidance is less detailed compared to that in IAS 19 (2011), for instance, the guidance on how to determine the appropriate discount rate or make other actuarial assumptions.

53. The staff's view is that the 2011 amendments on these issues did not modify the general measurement principle relating to defined benefit plans but simply provided additional guidance applicable to specific cases. In this regard, the Request for Information published as part of the 2012 Comprehensive Review of the *IFRS for SMEs* Standard noted that because Section 28 included simplifications to the previous version of IAS 19, the other changes the 2011 amendments introduced to the IFRS Standards did not directly relate to the requirements in Section 28 of the Standard.

54. The staff recommends that the Board not seek views on including this additional guidance in the *IFRS for SMEs* Standard. If the guidance were included, the Board would need to consider whether additional related simplifications should be permitted.

55. As noted in paragraph 6, the amendments clarified the definition of short-term employee benefits. Short-term benefits are now defined as:

> …employee benefits (other than termination benefits) *that are expected to be settled wholly* [emphasis added] within twelve months after the end of the period in which the employees render the related service.

56. Prior to the amendments, short-term benefits were defined as:

> …employee benefits (other than termination benefits) *which fall due wholly* [emphasis added] within twelve months after the end of the period in which the employees render the related service.

57. The staff will consider this clarification at the next stage of the review if the Board decides to proceed to an exposure draft.

Disclosure requirements for defined benefit plans

58. The 2011 amendments to the disclosure requirements in IAS 19 related to:

    (a) introducing disclosure objectives;

    (b) additional information on the risk to which the defined benefit plan exposes the entity; and

    (c) additional information on the amount, timing and uncertainty of future cash flows, including sensitivity analyses.

59. The staff notes that some of these amendments would also be relevant for the financial statements prepared applying the *IFRS for SMEs* Standard. For instance, paragraph 28.41(a) of the Standard requires a general description of the type of plan but does not explicitly refer to plan-specific risks or the significant concentration of risk.

60. The Board is considering potential changes to the disclosure requirements in IAS 19 (2011) in the context of its Disclosure Initiative—Targeted Standards-level Review of Disclosures project. The staff advises waiting until the completion of that project to consider whether changes should be made to the disclosure requirements of Section 28 of the Standard. The staff acknowledges

that the proposed amendments to paragraph 28.24 of the Standard would require consequential amendments to the disclosure requirements in paragraph 28.41.

Other amendments issued after 2011

61. The table in Appendix A includes, for completeness, other amendments to IAS 19 that were issued after 2011, including:

    (a) *Defined Benefit Plans: Employee Contributions—Amendments to IAS 19* issued in November 2013 to simplify the accounting requirements for contributions from employees or third parties when applied to simple contributory plans; and

    (b) *Plan Amendment, Curtailment or Settlement—Amendments to IAS 19* issued in February 2018 to clarify how entities determine pension costs for the remainder of the reporting period when a defined benefit plan is amended, curtailed or settled.

62. The staff notes that these amendments were already discussed at the July 2019[8] Board meeting. At that meeting, the Board tentatively agreed with the staff's recommendation that the Request for Information should seek views on not aligning the *IFRS for SMEs* Standard with those amendments.

Staff recommendations and questions for the Board

Question 1

Does the Board agree with the staff recommendation to seek views in the Request for Information on aligning Section 28 *Employee Benefits* of the *IFRS for SMEs* Standard with IAS 19 *Employee Benefits* on the following matters:

(a) whether to require entities that apply the *IFRS for SMEs* Standard to present remeasurements of defined benefit plans in other comprehensive income;

[8] See Appendix A, Table 2 of ***July 2019 Agenda Paper 30E***.

(b) whether to define remeasurements in a manner consistent with IAS 19; and

(c) whether to align the recognition requirements for termination benefits with those in IAS 19?

Question 2

Does the Board agree with the staff recommendation to consult in the Request for Information on current practice and application issues relating to the use of the simplifications permitted in paragraph 19 of Section 28 of the *IFRS for SMEs* Standard under the ‘undue cost or effort’ exemption?

Question 3

Does the Board agree with the staff recommendation to seek views on not aligning Section 28 of the *IFRS for SMEs* Standard with the other amendments made to IAS 19 in 2011?

Appendix A—Summary of staff analysis

Source of change	Topic	Changes to IAS 19	Section 28 requirements	Analysis performed
2011 amendments	Short-term employee benefits	Short-term benefits are defined as: employee benefits (other than termination benefits) *that are expected to be settled wholly* [emphasis added] within twelve months after the end of the period in which the employees render the related service.	Short-term benefits are defined as: employee benefits (other than termination benefits) *which fall due wholly* [emphasis added] within twelve months after the end of the period in which the employees render the related service.	Consider change in wording; if drafting an exposure draft (paragraph 57).
	Defined benefit plans – measurement	An entity is required to recognise all changes in the net defined liability (asset) in the period in which those changes occur. The 2011 amendments eliminated the option to leave actuarial gains and losses unrecognised if they were within a 'corridor'.	An entity is required to recognise all actuarial gains and losses in the period in which they occur.	Requirements are aligned. No action needed (paragraph 18).
	Defined benefit plans – presentation of changes	An entity shall recognise remeasurements of the net defined liability (asset) in other comprehensive income.	An entity has the option to recognise all actuarial gains or losses either in profit or loss or in other comprehensive income.	Seek views in the Request for Information (RFI) on aligning the requirements (paragraph 25).

Source of change	Topic	Changes to IAS 19	Section 28 requirements	Analysis performed
	Defined benefit plans – disclosures	The amendments introduce disclosure objectives, and require additional information about the risk to which the defined benefit plan exposes the entity; and the amount, timing and uncertainty of future cash flows, including sensitivity analyses.	Simplified disclosure requirements.	Wait for the completion of the Targeted Standards-level Review of Disclosures project (paragraph 60).
	Termination benefits - recognition	An entity shall recognise termination benefits at the earlier of the date when the entity can no longer withdraw the offer of those benefit; and the date when the entity recognises a provision for a restructuring that involves the payment of termination benefits.	An entity shall recognise termination benefits only when an entity is demonstrably committed either to terminate the employment of an employee before the normal retirement date or to provide termination benefits as a result of an offer made to encourage voluntary redundancy. An entity is demonstrably committed when it has a detailed formal plan and is without realistic possibility of withdrawal from the plan.	Seek views in the RFI on aligning the requirements (paragraph 38).

Source of change	Topic	Changes to IAS 19	Section 28 requirements	Analysis performed
November 2013 Amendments	Defined benefit plans – contribution from employees or third parties	If the amount of the contributions is independent of the number of years of service, an entity is permitted to recognise such contributions as a reduction in the service cost in the period in which the related service is rendered, instead of attributing the contributions to the periods of service.	No specific requirements for contributions from employees or third parties.	No action needed – the Board considered this topic in July 2019 (paragraph 62).
February 2018 Amendments	Defined benefit plans – plan amendment, curtailment or settlement	The amendments require that, when a defined benefit plan amended, curtailed or settled, entities use updated actuarial assumptions to determine the current service cost and net interest for the remainder of the annual period.	No specific requirements to determine service cost and net interest in case of a plan amendment, curtailment or settlement.	No action needed - the Board considered this topic in July 2019 (paragraph 62).