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IFRS Interpretations Committee Meeting

Project	**Exposure Draft *Defined Benefit Plans: Employee Contributions***
Paper topic	Comment letter analysis

CONTACT(S) Kazuhiro Sakaguchi ksakaguchi@ifrs.org +44 (0)20 7246 6930

Introduction

1. In March 2013, the IASB published for comment the Exposure Draft *Defined Benefit Plans: Employee Contributions* (Proposed amendments to IAS 19).[1] The issue originated from two submissions to the IFRS Interpretations Committee (the 'Interpretations Committee'), which recommended that the IASB amend the Standard. The comment period ended on 25 July 2013.

2. The purpose of this paper is to:

   (a) present a summary of comments received on the Exposure Draft; and

   (b) analyse the comments received and discuss the next steps.

Structure of this paper

3. This paper is organised as follows:

[1] http://www.ifrs.org/Current-Projects/IASB-Projects/Defined-Benefit-Plans-Employee-Contributions/Pages/IAS-19-Employee-Benefits.aspx

(a) summary of the issue;

(b) feedback summary;

(c) analysis of comments received on:

  (i) reduction in service cost (Question 1 of the Exposure Draft);

  (ii) attribution of negative benefit (Question 2 of the Exposure Draft); and

  (iii) other issues (Question 3 of the Exposure Draft)

(d) staff proposal for the revised wording of the proposed amendments;

(e) due process consideration; and

(f) Appendix A—Summary of characteristics of respondents.

Summary of the issue

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 percentage of pay and with employee contributions also based on a level percentage 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 the 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 Appendix 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.

IASB's proposed amendments

7. The IASB noted that contributions from employees or third parties to a defined benefit plan should be attributed to periods of service as a negative benefit. This is because the measurement of the DBO should consider the present value of those future contributions that relate to the employee's service before the reporting date. However, the IASB noted the general concern about the complexity of the required calculations and the potential confusion that these could introduce to practice.

8. Consequently, the IASB decided to add a practical expedient to paragraph 93. It proposes to amend paragraph 93 so that contributions from employees or third parties may be excluded from being attributed to periods of service as a negative benefit and recognised as a reduction in the service cost in that period if, and only if, they are linked solely to the employee's service rendered in the same period in which they are payable.

9. An example of a situation that qualifies for the practical expedient would be contributions that are a fixed percentage of an employee's salary, where the percentage of the employee's salary does not depend on the employee's number of years of service to the employer. In this case, the contributions are in proportion to the salary and thus it could be considered that they are linked solely to the employee's service rendered each year. On the other hand, if there is, for example, an increase in the percentage of the salary that an employee is required to contribute relative to the number of years of service, then higher contributions would be required in the latter years. These higher contributions could be considered to be linked not only to the service in the current year but also to the service in other years. In this second case, the contributions are not linked solely to the employee's service that is rendered in the same period in which the contributions are payable.

10. 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. This has caused confusion because paragraph 93 is unclear as to 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. The IASB observed that performing the test on the net benefit will result in added complexity. Depending on how the attribution test is applied, the outcome of the test may be influenced by changes in the assumptions from one year to another. Consequently, the IASB proposed to specify in paragraph 93 that the negative benefit from employee or third-party contributions should be

attributed to periods of service in the same way as the gross benefit is attributed in accordance with paragraph 70, when they are not recognised as a reduction in the service cost in the same period in which they are payable.

Feedback summary

11. 63 comment letters were received from six continents and global organisations including global accounting firms. A summary of the characteristics of the respondents is provided in Appendix A of this paper. All comment letters received can be found on the IASB's website.[2]

12. The IASB invited comments on the following specific questions:

Q1: The IASB proposes to amend IAS 19 to specify that contributions from employees or third parties set out in the formal terms of a defined benefit plan may be recognised as a reduction in the service cost in the same period in which they are payable if, and only if, they are linked solely to the employee's service rendered in that period. An example would be contributions that are a fixed percentage of an employee's salary, where the percentage of the employee's salary does not depend on the employee's number of years of service to the employer. Do you agree? Why or why not?

Q2: The IASB also proposes to address an inconsistency in the requirements that relate to how contributions from employees or third

[2] http://www.ifrs.org/Current-Projects/IASB-Projects/Defined-Benefit-Plans-Employee-Contributions/Exposure-Draf-March%202013/Pages/Comment-letters.aspx

parties should be attributed when they are not recognised as a reduction in the service cost in the same period in which they are payable. The IASB proposes to specify that the negative benefit from such contributions is attributed to periods of service in the same way as the gross benefit is attributed in accordance with paragraph 70. Do you agree? Why or why not?

Q3: Do you have any other comments on the proposals?

13. For Q1, almost all of the respondents supported the proposed practical expedient to reduce complexity of the required calculations. Only one respondent explicitly disagreed with the proposed amendments because they think that contributions from employees or third parties should be attributed to periods of service as the gross benefit is attributed in all cases.[3] For those who agreed, about half of them agreed with the proposed amendments as worded in the Exposure Draft, whereas others requested further clarification of the proposed wording or more examples or application guidance to be added. Some respondents commented on the accounting choice that the IASB proposes ("… may be recognised …").

14. For Q2, the vast majority of the respondents supported the proposed amendments as worded in the Exposure Draft. No respondent explicitly disagreed with the proposal. Some requested further clarification of the proposed wording or requested examples to be added when the proposed practical expedient is not applicable or an entity decides not to apply it.

15. For Q3, some respondents commented on the transition requirement.

[3] International Association of Consultants, Valuators and Analysts

Analysis of comments received on reduction in service cost (Question 1 of the Exposure Draft)

Whether the IASB should proceed with the proposed amendment

16. On the basis of the fact that the IASB received only one disagreement about the proposed amendments, we think that the IASB should proceed with the proposed amendment. In the following paragraphs, we have focused our analysis on the requests for further clarification of the proposed wording, the requests for more examples and other comments received.

Clarification of the proposed wording – wider scope

17. Some respondents requested a wider scope of the proposed amendments.

18. One respondent envisages other patterns of contribution that might be eligible and they think that, in introducing this practical expedient, the IASB was intending it to be widely available.[4] Accordingly, the respondent suggested the following wording (their suggested addition is underlined and suggested deletion is struck through):

> However, if, and only if, contributions from employees or third parties are payable at a level that reflects only the employee's service rendered in the period in respect of which they are payable, regardless of the length of service, ~~linked solely to the employee’s service rendered in the same period in which they are payable,~~ the contributions may be recognised as a reduction in the service cost in that period.

[4] The Institute of Chartered Accountants in England and Wales (ICAEW)

19. One respondent thinks that the proposed amendment could be too restrictive and suggested an alternative wording as follows (their suggested addition is underlined and suggested deletion is struck through):[5]

> However, if, and only if, contributions from employees or third parties are not obliged to contribute to reduce a deficit arising from losses on plan assets or actuarial losses, ~~linked solely to the employee's service rendered in the same period in which they are payable,~~ the contributions may be recognised as a reduction in the service cost in that period.

20. One respondent thinks that non-discretionary contributions that are linked to service, unless they are part of a risk sharing arrangement, should be recognised as a reduction in service cost in the period in which they are payable.[6] The respondent suggest that paragraph 93 is replaced with the following:

> 93 Non-discretionary contributions from employees or third parties are either set out in the formal terms of the plan or arise from a constructive obligation that goes beyond the terms of the plan. If they are part of a risk sharing arrangement, they should be reflected in the measurement of the defined benefit obligation and service cost in accordance with paragraphs 88 or 91. Other non-discretionary contributions shall be recognised as a reduction in the service cost in the period in which they are payable, provided they are linked to service. Contributions that are not linked to service reduce remeasurements of the net defined benefit liability

[5] Institute of Actuaries of Australia

[6] PwC

(asset). Contributions are linked to service except where they are paid after employment has ceased (for example, a co-pay or deductible for a post-retirement medical benefit).

In this respondent's view, the costs and difficulties of applying the attribution model by paragraph 93 are disproportionate and therefore the simplification should be available in a wide range of circumstances. Accordingly, if the IASB concludes that the attribution model required should be applied, other than in situations where the risks are shared, this respondent thinks that paragraph 93 should be replaced with the following:

93 Non-discretionary contributions from employees or third parties are either set out in the formal terms of the plan or arise from a constructive obligation that goes beyond the terms of the plan. If they are part of a risk sharing arrangement, they should be reflected in the measurement of the defined benefit obligation and service cost in accordance with paragraphs 88 or 91. Other non-discretionary contributions shall be recognised as a reduction in the service cost in the period in which they are payable, provided they are linked to service and not dependent on the number of years of service rendered by the employee. Contributions that are dependent on the number of years of service rendered by the employees shall be attributed to periods of service as a negative benefit in the same way that the gross benefit is attributed in accordance with paragraph 70. Contributions that are not linked to service reduce remeasurements of the net defined benefit liability (asset). Contributions are linked to service except where they are

paid after employment has ceased (for example, a co-pay or deductible for a post-retirement medical benefit).

21. We disagree with these arguments. In the development of the proposed amendment, the IASB noted that, in principle, contributions from employees or third parties to a defined benefit plan should be attributed to periods of service as a negative benefit, because the measurement of the DBO should consider those future contributions that relate to the employee's service before the reporting date.

22. In our view, the IASB's intention to provide a practical expedient was that **simple accounting should be applied to simple contributory plans (for example, where contributions are a fixed percentage of an employee's salary), whereas attribution of benefits to periods of service should be applied to complex contributory plans**. In other words, the IASB was not intending the practical expedient to be available simply because contributions are related to service or are not related to reducing a deficit.

23. In addition, we are concerned that widening the scope could result in changing the principles of the requirements in paragraph 93, which should be subject to a more thorough discussion. We note that the proposed amendments are a narrow-scope amendment. The objective of the narrow-scope amendment is to address diversity in practice as quickly as possible. Considering the objective, we think that the scope of the amendments should remain as narrow as possible.

Clarification of the proposed wording – age-based contributions

24. Some respondents requested more clarification about the applicability of the proposed practical expedient when the percentage of salary payable depends on the employee's age rather than their number of years of service (age-based

contributions).[7] Some of them think that the proposed practical expedient is intended for those types of arrangements.

25. One respondent stated that contributions in their jurisdiction typically depend on the age of an employee only, and not on the years of service.[8] For example, the employee's contributions to a plan are a fixed percentage of the employee salary, but the percentage varies depending on the age of the employee—three per cent for the age range 25–35, four per cent for the age range 36–50 and five per cent for the age range 51–65 (pension age). The respondent thinks that the proposed practical expedient can be applied to such contributions.

26. We note that, in the proposed amendments, an example of a situation that qualifies for the practical expedient is described as "contributions that are a fixed percentage of an employee's salary, so the percentage of the employee's salary does not depend on the employee's number of years of service to the employer".

27. In our view, the example indicates two criteria. One is whether contributions are a fixed percentage of salary and the other is whether the contributions depend on the years of service. Age-based contributions do not vary with years of service, however, the percentage varies depending on the age of the employee. It is not clear whether age-based contributions qualify for the proposed practical expedient (ie whether such contributions must meet either both or one of the criteria).

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[7] SwissHoldings, Argentina Federation of Professional Councils in Economic Sciences (FACPCE), BP p.l.c. Towers Watson, Deloitte, The Japanese Society of Certified Pension Actuaries and the Institute of Actuaries of Japan, The Swiss Institute of Certified Accountants and Tax Consultants Experts, Aon Hewitt Limited, NESTLE S.A., BDO IFR Advisory Limited, SPC, International Actuarial Association (IAA)

[8] The Swiss Institute of Certified Accountants and Tax Consultants Experts

28. It could be argued that age-based contributions are no different from contributions where the percentage of salary is relative to the number of years of service. This is because the increasing age could be considered as an approximation of the years of service.

29. It could also be argued that age-based contributions and contributions that are a fixed percentage of an employee's salary should be accounted for similarly, because both contributions do not depend on the years of service.

30. In our view, age-based contributions are different from contributions where the percentage of salary is relative to the number of years of service. Assume employee contributions that are four per cent of salary for the first ten years and then increase to six per cent thereafter in accordance with the terms of the plan. The increase to six per cent is not only related to the service in the current year, but is also related to the first ten years' service, which is a prerequisite for the change in contribution percentage. On the other hand, in age-based contributions, employees pay higher contributions when they become older, which is not dependent on the prior years' of service. In other words, the contributions paid each year are linked solely to the service for that period.

31. Consequently, we propose revising the wording so that age-based contributions are included in the scope of the proposed practical expedient.

Clarification of the proposed wording – linked to salary

32. Some respondents stated that contributions are linked to **salary** as well as service and, therefore, it is inaccurate to suggest that they are solely linked to service.[9]

33. We agree with this argument. The example provided in the proposed amendment is a situation where contributions are a fixed percentage of the employee's salary. It is obvious that the contributions in such cases are linked not only to service but also to salary. Consequently, we propose revising the wording to address this point.

Clarification of the proposed wording – contributions paid next year

34. One respondent thinks that the practical expedient should be applied to plans with employee contributions by which employees contribute parts of their bonus and the bonus for the current year service is paid in the next year. [10]

35. We agree with this argument. If contributions are linked solely to the service rendered in the year, the contributions should be accounted for in the same way regardless of the timing of the payment to reflect accrual accounting. Consequently, we propose revising the wording to address this point.

Clarification of the proposed wording – reduce deficit/risk sharing

36. Some respondents wondered whether employee contributions required in respect of a past service deficit would be considered linked solely to the service in each period.[11] Some questioned whether employee contributions would first be split

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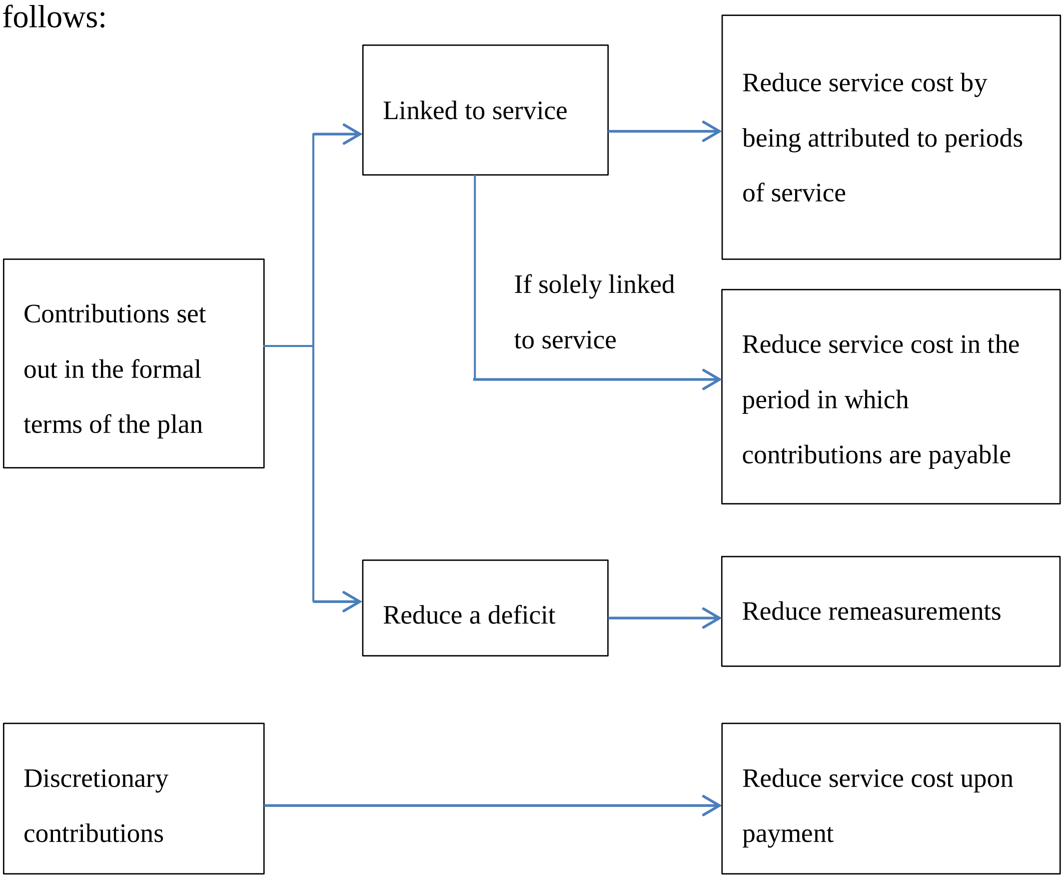
[9] Financial Reporting Council, Mercer, Canadian Accounting Standards Board (AcSB), Financial Executives International Canada (FEI Canada), etc.

[10] Accounting Standards Committee of Germany

[11] SwissHoldings, Aon Hewitt Limited, etc.

between contributions that reduce service cost and those that reduce remeasurements.

37. Paragraph 92 of IAS 19 states that contributions are either set out in the formal terms of the plan or are discretionary. It also states that discretionary contributions by employees or third parties reduce service cost upon payment of those contributions to the plan. Paragraph 93 of IAS 19 states that contributions 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) (for example, if the contributions are required to reduce a deficit arising from losses on plan assets or actuarial losses). The proposed amendments add one more category to the accounting. We think that these categories are described as follows:



38. Consequently, employee contributions required in respect of a past service deficit are different from those that are linked solely to service in each period. We think that IAS 19 is already clear on this point.

Clarification of the proposed wording – other

General

39. One respondent suggested some changes to the wording In their view it would avoid uncertainties on whether contributions should be bifurcated for the purpose of applying the practical expedient and makes clearer that entities could also apply the practical expedient when the contribution is paid in a reporting period after the service is rendered (their suggested addition is underlined and suggested deletion is struck through):[12]

> However, if, and only if, contributions from employees or third parties that are linked ~~solely~~ to ~~the employee's~~ service arise as a result of service rendered by employees in the same period in which they result ~~are~~ payable, the contributions may be recognised as a reduction in the service cost in that period.

40. We will consider this suggestion in conjunction with other changes in the wording that we have agreed to in the preceding paragraphs. We already agreed that entities should apply the practical expedient when the contribution is paid in a reporting period after the service is rendered.

Fixed amount

[12] EFRAG

41. One respondent wondered whether the proposed practical expedient should be applied to contributions that are a fixed amount regardless of the periods of service.[13]

42. We do not think such contributions are solely linked to the current year service. The same amount of contributions is required simply in accordance with the terms of the plan regardless of the employee's service for that year. It could be considered that such contributions are solely linked to the current year service if the salary does not change throughout the service period, which we think is a very rare situation. From a practical point of view, projecting forward and attributing to periods of service a fixed amount of contributions for each year should be relatively straight forward.

Limit of reduction in service cost

43. One respondent recommended that the negative benefit recognised as a reduction of service cost in the period should be limited to the sum of the current service cost and the past service cost that is included in service cost.[14] They acknowledge that it may be uncommon for contributions linked solely to employee's service in the current period to exceed those amounts, but, if they do, it should be clear that the excess should be a reduction of remeasurements and not taken directly to profit and loss.

44. We do not think that the excess should be a reduction of remeasurements because the excess is neither actuarial gains and losses, nor a return on plan assets nor a

[13] Austrian Financial Reporting and Auditing Committee (AFRAC)

[14] California Society of Certified Public Accountants (CALCPA)

change in the effect of asset ceiling.[15] Having said that, we think this is a hypothetical question. We note that no other respondent commented on this issue. Consequently, we do not think that the proposed amendments should address this issue.

Paragraph 92

45. One respondent suggested that the last sentence of paragraph 92 of IAS 19 be revised as follows (underlined):[16]

> Discretionary contributions by employees or third parties reduce the service cost upon payment of these contributions to the plan<u>, only if they are linked to the employee's service rendered</u>.

46. We disagree with this suggestion. Discretionary contributions are different from contributions set out in the formal terms of the plan, and the proposed amendments are intended to address accounting for the latter. We think it will cause confusion if we revise paragraph 92 as the respondent suggested.

Adding the term 'practical expedient'

[15] Paragraph 127 of IAS 19 states:

> Remeasurements of the net defined benefit liability (asset) comprise:
>
> (a) actuarial gains and losses;
>
> (b) the return on plan assets, excluding amounts included in net interest on the net defined benefit liability (asset); and
>
> (c) any change in the effect of the asset ceiling, excluding amounts included in net interest on the net defined benefit liability (asset).

[16] The Mexican Financial Reporting Standards Board (CINIF)

47. One respondent suggested a change in the proposed wording as follows (underlined) so that the exception introduced is clearly labelled:[17]

> However, <u>as a practical expedient,</u> if, and only if, contributions from employees or third parties are linked solely to the employee's service rendered in the same period in which they are payable, …

48. We disagree with this suggestion. Although this term is used in the core body of some IFRSs, we think that it is generally used in the Basis for Conclusions.

May or shall

49. One respondent suggested changing the word "may" to "shall" in the proposed amendment so that the consistency in application of the amendment is achieved.[18]

50. We disagree with this suggestion. IAS 19 is already effective and some entities may have changed their accounting policy so that contributions are attributed to periods of service using the benefit formula. If we were to require all entities to apply the proposed practical expedient, this might risk them having to change their practice again.

All contributions are solely linked to service

51. One respondent thinks that in everyday language all employee contributions that are payable during a year are arguably linked solely to service in that year, as they would not be paid if that service were not rendered.[19]

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[17] Chartered Accountants Ireland

[18] Provincial Auditor of Saskatchewan

[19] Towers Watson

52. The objective of the IASB when it introduced the requirement in the revised IAS 19 was to remove an inconsistency in the accounting for employee contributions and the gross benefit. The inconsistency arose because IAS 19 treats vested and unvested benefits equally, and resulted in entities recognising unvested benefits without recognising a portion of the future employee contributions that would offset those benefits. The requirements in the revised IAS 19 require an entity to recognise contributions that are conditional on future service consistently with the benefits that are conditional on future service (ie unvested benefits). In our view, employee contributions would not be solely linked to service in a given year if the amount of the contributions changes depending on prior service, even if those contributions are conditional on the employee providing service in that given year.

Actual or actuarially estimated amounts

53. One respondent stated that it is not clear whether the contribution amounts used under the practical expedient are actual amounts or actuarially estimated contribution amounts.[20]

54. The practical expedient is proposed so that entities do not have to include contributions in the calculations of the DBO. Consequently, the amount of contributions used under the proposed practical expedient is actual amounts. We think that this is clear from the proposed amendments because it states that contributions should be attributed to periods of service but then it further states that they may be reduced from service cost if they meet certain criteria.

Assessment

[20] The Japanese Society of Certified Pension Actuaries and the Institute of Actuaries of Japan

55. One respondent thinks that whether contributions qualify for the proposed practical expedient should be assessed after they are attributed to periods of service in accordance with paragraph 70 of IAS 19.[21] Accordingly, they suggested replacing the word "However" with "Under this attribution" in paragraph 93. In addition, this respondent thinks it is not clear how contributions that are linked to service, but not solely linked to service rendered in the period, should be accounted for.

56. We disagree with the suggested replacement because, as stated already, entities will not have to attribute contributions in accordance with paragraph 70 if the contributions qualify for the proposed practical expedient. For the respondent's second question, contributions that are not solely linked to service are attributed to periods of service in accordance with paragraph 70, which we think is clear in IAS 19.

Request for more examples

57. Some respondents requested more examples or application guidance to be added to paragraph 93.[22]

58. We disagree with this argument. The proposed amendments already include one example. We do not think that it is possible to cover all possible plans by examples. We propose the revised wording for the principle later in this paper based on respondents' comments, which we think provides clearer criteria as to what types of benefits would fall into the proposed practical expedient.

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[21] Mercer

[22] KPMG, Malaysian Accounting Standards Board, etc.

Other comments

Accounting Choice

59. Some respondents commented on the accounting choice that the IASB proposes ("… may be recognised …"). One respondent thinks that the accounting choice should only be introduced in exceptional circumstances.[23] Another wondered whether it was the IASB's intention to provide entities with the accounting choice.[24] One other requested clarification of whether the accounting choice can be made on a plan-by-plan basis or whether it must be applied to all eligible plans.[25]

60. As we stated already, the IASB noted that, in principle, contributions should be attributed to periods of service but decided to provide a limited relief if certain criteria are met. In addition, requiring the proposed practical expedient to all entities risks changing their practice again. Accordingly, in our view, it was the IASB's intention to provide the accounting choice in limited circumstances. We think that the accounting choice should be applied to all eligible plans if the plan qualifies for the proposed practical expedient, which we think is a natural consequence of the proposal.

Change in accounting or clarification

[23] AFRAC

[24] Swiss Institute of Certified Accountants and Tax Consultants Experts

[25] AcSB

61. Two respondents shared a view that the proposed amendments are a clarification rather than an amendment.[26] One respondent thinks that the wording in the proposed amendments can be read to imply that the proposed changes are a change in accounting, rather than a clarification.[27] This respondent thinks this would mean that applying the accounting set out in the proposed practical expedient under IAS 19 (before revision) would have been incorrect. With regard to this point, one respondent suggested that the IASB should better articulate the divergent views of the Interpretations Committee and the IASB.[28] In particular, the Basis for Conclusions should explain that the IASB, in addressing the proposed accounting for employee contributions, clarified how paragraph 93 of IAS 19 was intended to be applied in practice.

62. We note that the Interpretations Committee observed at its previous meeting that employee contributions that are linked solely to the employee's service rendered in the same period in which they are payable might be considered to reduce the cost of short-term employee benefits. The IASB observed that such contributions should reduce service cost because they form part of the post-employment benefit. Therefore, the IASB decided to clarify that accounting through the provision of a practical expedient. We will consider the wording in the Basis for Conclusions when we consider the final amendments.

[26] ESMA, Dutch Accounting Standards Board (DASB)

[27] Ernst & Young Global Limited

[28] EFRAG

Analysis of comments received on attribution of negative benefit (Question 2 of the Exposure Draft)

Whether the IASB should proceed with the proposed amendment

63. On the basis of the fact that the IASB received no explicit disagreement about the proposed amendments, we think that the IASB should proceed with the proposed amendment. In the following paragraphs, we have focused our analysis on the requests for further clarification of the proposed wording, the requests for more examples and other comments received.

Clarification of the proposed wording

General

64. Some respondents understand that the intention of the proposed amendments is for attribution to be determined for the gross benefit, and the negative benefit to be separately attributed to employee service periods following the same attribution pattern, with the resulting net amount reported as the current service cost, but the wording is not sufficiently clear.[29] One respondent suggested an alternative wording as follows:[30]

> Contributions from employees or third parties that are linked to service are attributed to periods of service as a negative benefit applying the same attribution method that paragraph 70 requires for the gross benefit.

65. We agree with this understanding and will consider revising the wording later in this paper so that the intention becomes clearer.

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[29] ICAEW, Towers Watson, EFRAG, Grant Thornton

[30] EFRAG

66. One respondent suggested an addition of a word (underlined), in order to clarify that the treatment set out in the second sentence of paragraph 93 does not apply to those contributions falling within the scope of the third sentence:[31]

> Contributions from employees or third parties that are linked to service are <u>generally</u> attributed to periods of service as a negative benefit…

67. We disagree with this suggestion, because the second sentence is about the principles of accounting for contributions from employees or third parties. We think that the phrase “However, if, and only if” at the beginning of the third sentence describes the intention of the proposed amendments well.

Plan level or individual level

68. One respondent questioned whether the attribution of contributions should be based on gross benefits at an individual level (and then the individual results aggregated to the plan level) or whether it occurs at the whole of the plan level.[32]

69. We think that attribution of contributions should be based on the gross benefit at the whole of the plan level. This is because paragraph 70 states that an entity shall attribute benefit to periods of service under the plan’s benefit formula. We also note that the proposed amendments refer to paragraph 70.

Request for example

70. Some respondents requested examples or guidance when the proposed practical expedient is not applicable or when an entity decides not to apply it.[33] For those

[31] KPMG IFRG Limited

[32] Institute of Actuaries of Australia

who made the request, some think that the examples in the Appendix of the Staff Paper 9 presented at the November 2012 Interpretations Committee meeting would be helpful.

71. We disagree with this argument. In our view, Standards should be precise in the principles rather than necessarily in the examples or methodology. In addition, we note that that Staff Paper is publicly available as an example for attribution of negative benefit when the proposed practical expedient is not applied.

Other comments

The term 'negative benefit'

72. One respondent stated that the term 'negative benefit' is not defined in IAS 19 and suggested using another term because neither from the employee's nor from the employer's point of view can the benefit be considered to be negative. [34]

73. We share this concern. We have been seeking a more appropriate wording but the attempt has not been successful. We will continue to do so when considering the final amendments.

Footnote to paragraph BC150

74. Two respondents stated that adding a footnote to paragraph BC150 as in the proposed amendments is not sufficient and suggested directly amending the wording in that paragraph. [35]

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[33] Accounting Standards of Germany (ASCG), Towers Watson, EFRAG, KPMG, Financial Executives International Canada (FEI Canada), Malaysian Accounting Standards Board (MASB), etc.

[34] Accounting Standards of Germany (ASCG)

75. We disagree with this argument. The Basis for Conclusions of IAS 19 is based on the decisions that the IASB made in developing IAS 19. The proposed amendments are not a correction, but rather a change of what the IASB stated previously. Consequently, we think that the footnote approach is more appropriate.

Paragraph BC143(b)

76. Two respondents suggested that paragraph BC143(b) of IAS 19, which also refers to 'net benefit', should also be addressed.[36]

77. We agree with this suggestion.

Discretionary contributions

78. One respondent requested clarification that only required contributions are considered to be a negative benefit, and are potentially subject to attribution in accordance with paragraph 70.[37] In other words, additional contributions made at the discretion of an employee (to purchase additional service or additional ancillary benefits) should have no effect until contributed.

79. As stated already, only contributions that are set out in the terms of the plan are either attributed to periods of service or reduced from service cost under the proposed practical expedient. Discretionary contributions reduce service cost upon payment.

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[35] Accounting Standards of Germany (ASCG), Institute and Faculty of Actuaries (IFoA) and Association of Consulting Actuaries (ACA)

[36] Accounting Standards of Germany (ASCG), Towers Watson

[37] Towers Watson

Difference in service cost and contributions

80. Some respondents noted that the use of attribution of negative benefit may result in a difference between the cumulative negative service cost recognised and the cumulative contributions received from the employee or third party, and suggested addressing the treatment of such a difference.[38]

81. The difference arises because employee contributions are included in the DBO measurement. An entity calculates the present value of the projected contributions in the DBO measurement, which may or may not be different from the undiscounted actual contributions received for the year. Employee contributions are part of the funding of the total benefits paid to employees and, therefore, the effect of employee contributions should increase or decrease the employer's gross obligation to the employees. Accordingly, we think that the difference should be part of the adjustment to the DBO, which is clear in IAS 19.

Salary sacrifice arrangement in a jurisdiction

82. One respondent thinks that the proposed amendments could be considered to be silent on a particular type of risk-sharing feature typically called 'salary sacrifice arrangements' that is widely used in its jurisdiction (refer to their comment letter for detail).[39] This respondent requested clarification about the accounting in the proposed amendments.

83. In our view, in the case of a salary sacrifice arrangement, the benefit is reclassified from one class of employee benefit, typically a short-term benefit

[38] FACPCE, Deloitte, AcSB

[39] German Institute of Pension Actuaries

such as salary, to another class of employee benefit, a defined benefit. We do not think that we should address a jurisdiction-specific plan in the final amendments.

Paragraph 141(f) of IAS 19

84. Paragraph 141(f) of IAS 19 requires a disclosure of contributions to the plan in the reconciliation for the net defined benefit liability (asset), showing separately those by the employer and those by the plan participants. One respondent requested clarification in the Basis for Conclusions of the final amendments that such separations need not be performed if there is insufficient data to do so.[40]

85. This refers to the judgement required in applying IAS 19 and we do not think that we should incorporate such wording in the final amendments. We note that a reasonable estimate should be made if it is necessary to meet the disclosure objectives.

Benefit formula for negative benefit

86. The principle in paragraph 70 is that the benefit formula is used to attribute the benefit unless the benefit is back-end loaded. Some respondents think that this suggests that the contributions (that do not qualify for the proposed practical expedient) should also be attributed in accordance with the benefit formula, but wondered how attribution in line with the benefit formula would be applied to a negative benefit.[41]

[40] International Actuarial Association (IAA)

[41] PwC, Institute and Faculty of Actuaries (IFoA) and Association of Consulting Actuaries (ACA), Ernst & Young Global Limited

87. One respondent provided an example that a plan promises the employee an annuity at age 60 of two per cent of each year salary that vests immediately.[42] In addition, the plan requires the employee to contribute five per cent of salary for the first 10 years of service. One acceptable view may be that the benefits promised are not considered to be back-end loaded (as they only increase based on the employee's future salary). As a result, the defined benefit obligation would be allocated based on the benefit formula.

88. With regard to this point, another respondent mentioned the situation in which paragraph 70 requires the attribution of gross benefits to years of service for a shorter period than the period for which contributions are paid by the employee.[43] For example, there may be situations in which the benefit formula determines that the attribution of benefits ends at the age of 60, whereas employee contributions need to be made until the retirement age of 65.

89. In our view, the benefit formula for employee contributions is the formula set out in the terms of the plan (ie five per cent of salary in the above example). The entity projects forward employee contributions to determine the future value, attributing that amount to periods of service and then discounts the amount related to current and prior service. This approach is the same approach that is used for the gross benefit, which is already clear in IAS 19.

90. We acknowledge that some respondents expressed several views about the benefit formula for employee contributions. We also acknowledge that anomalies may arise if paragraph 70 requires the gross benefit to be attributed according to the

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[42] Ernst & Young Global Limited

[43] AFRAC

plan's benefit formula and there is a difference between the benefit formula of the gross benefit and the benefit formula for employee contributions. This is a consequence of simplifying the attribution requirements by requiring paragraph 70 to be applied to the gross benefit and not the net benefit. In our view, the costs of applying paragraph 70 to the net benefit for all plans would outweigh the benefits of the better attribution that would be achieved in those limited circumstances.

91. In addition, we think that addressing this issue and possibly including some guidance would require a thorough review of IAS 19 or would at least go beyond the scope of this narrow-scope amendment. One possible way to address this is to not proceed with the proposed amendment and to require all contributions that do not qualify for the practical expedient to be attributed to periods of service on a 'net' basis (ie the current requirement of IAS 19). However, we do not think that is a desirable choice based on many responses that welcomed the 'gross' accounting.

Analysis of other comments received (Question 3 of the Exposure Draft)

Transition requirements

92. Two respondents questioned the practicability of retrospective application of the proposed amendments, because some calculations might require information that is not readily available.[44]

93. Our understanding is that in current practice employee contributions are generally reduced from service cost without being attributed to periods of service. The

[44] South African Institute of Chartered Accountants (SAICA), RSM International

proposed amendments intend to provide a relief so that most entities can continue to deduct contributions from service cost in the period in which they are payable. We therefore think that, in most cases, the impact of retrospective application would be minimal. Consequently, we propose retaining the requirement of retrospective application in the final amendments.

94. One respondent expected the transition provision to be applicable to the amendment to specify that reporting entities may implement the proposals at the same time as they first adopt the revised IAS 19.[45]

95. We note that the IASB included a clause of permitting earlier application in the proposed amendments. Because it did not receive any disagreement about the clause, we think that it should be included in the final amendment.

Other comments

Contributions and DBO/plan assets

96. One respondent stated that, while not their reading, some interpreted the wording in IAS 19 to mean that the accumulated value of employee contributions should be deducted from both the DBO and plan assets.[46] Therefore, this respondent thinks it would be useful to clarify that although the attributed employee contributions (negative benefit) are used in determining the current service cost (net benefit), the DBO should include the net benefits attributed to service to date and actual employee contributions to date, and the plan assets should include amounts arising from actual employee contributions. This respondent thinks that

[45] BT Group plc

[46] Towers Watson

Example 4 in the Appendix to Staff Paper 9 (as referred to in the preceding paragraph of this paper) was useful in illustrating this point.

97. We agree with the reading of this respondent and their concern. We could consider clarifying this point in the Basis for Conclusions of the final amendments.

Paragraph 94

98. One respondent thinks that, if paragraph 93 is amended, other paragraphs such as paragraph 94 should also be amended.[47,48]

99. Paragraph 94 is the requirement for employee or third-party contributions that are not within the scope of the proposed practical expedient. In our view, amending paragraph 94 is not necessary because the requirement would continue to be valid regardless of the proposed amendments to paragraph 93.

Test to zero-out service cost or DBO

100. One respondent commented that it would be useful if the Basis for Conclusions stated that, in general, a test need not be conducted to zero-out the (net) employer service cost or DBO if these become negative in individual cases, so that an aggregation is possible in determining the total (net) employer service cost and

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[47] The Japanese Society of Certified Pension Actuaries and the Institute of Actuaries of Japan

[48] Paragraph 94 of IAS 19 states:

> Changes in employee or third-party contributions in respect of service result in:
>
> (a) current and past service cost (if changes in employee contributions are not set out in the formal terms of a plan and do not arise from a constructive obligation); or
>
> (b) actuarial gains and losses (if changes in employee contributions are set out in the formal terms of a plan, or arise from a constructive obligation).

DBO.[49] In this respondent's view this is desirable, not least because the additional work required to carry out member-by-member calculations every year could in many cases be considerable. This respondent noted that this issue can arise not only as a result of financial conditions but also as a result of certain features of the benefit design (for example, lengthy vesting period).

101. In our view, the issue in the paragraph above is beyond the scope of the proposed amendments. In addition, we think that the approach raised by the respondent is not about the principles but about a methodology—something that requires the exercise of judgement. Consequently, we disagree with including such guidance in the final amendments.

Fundamental review

102. Some respondents do not think that the proposed amendments about the attribution of negative benefit provide a fundamental solution and requested a thorough review of IAS 19 on this issue.[50]

103. Some respondents think that the requirements of paragraph 93, even as amended by the proposed amendments, are unnecessarily complicated.[51] They also note that this will lead to a GAAP difference between IAS 19 and other accounting standards. They think that paragraph 93 should be amended more fundamentally so that the complications introduced by treating employee contributions as a negative benefit are removed and all employee contributions (other than in

[49] International Actuarial Association (IAA)

[50] Japanese Society of Certified Pension Actuaries and Institute of Actuaries of Japan, Japanese Institute of Certified Public Accountants

[51] Aon Hewitt, Institute and Faculty of Actuaries (IFoA) and Association of Consulting Actuaries (ACA)

relation to past service deficit or surplus) are recognised as a reduction in service cost in the period in which they are paid.

104. We disagree with these arguments. Although we acknowledge their suggestions about a fundamental review of IAS 19, doing so would result in withdrawing the proposed amendments. In other words, the accounting for contributions from employees or third parties would not be addressed at all until the fundamental review is completed. We think that we should proceed with the proposed amendments as quickly as possible based on the objective of a narrow-scope amendment. We note one respondent's comment:[52]

> Finally, we would urge the IASB to fast-track completion of this project so as to enable regional and national endorsement mechanisms to be completed before December year-end financial statements are being approved.

Staff proposal for the revised wording of the proposed amendments

105. In this paper, we have identified the following points to be considered in the proposed amendments toward the final amendments:

Paragraph 93

(a) age-based contributions should be included in the scope of the proposed practical expedient;

(b) it should be noted that contributions are linked to salary as well as service;

[52] KPMG IFRG Limited

(c) contributions, if qualified for the proposed practical expedient, should be accounted for in the same way regardless of the timing of the payment to reflect accrual accounting; and

(d) whether the attribution is based on straight-line or benefit formula should be determined for the gross benefit, and the negative benefit is to be separately attributed to employee service periods following either the straight-line or benefit formula as determined for the gross benefit, with the resulting net amount reported as the current service cost.

Paragraph 175

(e) no change is necessary.

Footnote of paragraph BC150

(f) the same clarification about attribution of negative benefit to be included in paragraph 93 should be included.

Paragraph BC143(b)

(g) the same footnote for paragraph BC150 should be added to the term ‘net benefit’.

106. On the basis of the analysis above, we think that the Interpretations Committee should propose to the IASB that the wording of the proposed amendment in paragraph 93 of IAS 19 should be revised as follows (new text is underlined and deleted text is struck through). They show changes from the proposed wording in the Exposure Draft.

Paragraph 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 are attributed to periods of service as a negative benefit applying the same attribution method that paragraph 70 requires for the gross benefit ~~in the same way that the gross benefit is attributed in accordance with paragraph 70~~. However, if, and only if, contributions from employees or third parties are linked only ~~solely~~ to the employee's salary and service rendered in the same period in which they are accrued ~~payable~~, and independent of the number of years of service, the contributions may be recognised as a reduction in the service cost in that period. An example would be contributions that are a fixed percentage of the employee's salary or contributions whose percentage depends on the employee's age, so the percentage of the employee's salary does not depend on the employee's number of years of service to the employer.

Footnote of paragraphs BC150 and BC143(b)

[1] *Defined Benefit Plans: Employee Contributions*, issued in [date to be inserted after exposure], addressed an inconsistency in the requirements that relate to how contributions from employees or third parties should be attributed when they are not recognised as

a reduction in the service cost in the same period in which they are accrued ~~payable~~. It specifies that the negative benefit from such contributions is attributed to periods of service applying the same attribution method that paragraph 70 requires for the gross benefit ~~in the same way that the gross benefit is attributed in accordance with paragraph 70~~. See paragraph BC5 of this Exposure Draft.

Question 1
Does the Interpretations Committee agree that it should propose to the IASB that the wording of the proposed amendments should be revised as above?

Due process consideration

Re-exposure

107. Paragraph 6.25 of the IASB and the IFRS Interpretations Committee *Due Process Handbook* (the '*Due Process Handbook*') sets out the following guidance on determining whether re-exposure is necessary:

> In considering whether there is a need for re-exposure, the IASB:
>
> (a) identifies substantial issues that emerged during the comment period on the Exposure Draft and that it had not previously considered;
>
> (b) assesses the evidence that it has considered;

(c) determines whether it has sufficiently understood the issues, implications and likely effects of the new requirements and actively sought the views of interested parties; and

(d) considers whether the various viewpoints were appropriately aired in the Exposure Draft and adequately discussed and reviewed in the Basis for Conclusions.

108. We note that the significant issues that respondents raised on the Exposure Draft are related to clarification of the wording (or scope) of the proposed amendments. Our analysis, which addresses substantial issues emerged from the comments received, is set out in this paper for consideration. In our view, re-exposure is not necessary based on the re-exposure criteria.

Effective date

109. The IASB's due process requirement states that "the mandatory effective date is set so that jurisdictions have sufficient time to incorporate the new requirements into their legal systems and those applying IFRS have sufficient time to prepare for the new requirements".[53]

110. IAS 19 is effective for annual periods beginning on or after 1 January 2013. The objective of the proposed amendments is to provide a relief in the accounting for contributions from employees or third parties. Consequently, we think that the mandatory effective date should be set as early as possible, while considering the fact that jurisdictions have sufficient time to prepare for the new requirements.

[53] Paragraph 6.35 of IASB and IFRS Interpretations Committee *Due Process Handbook*.

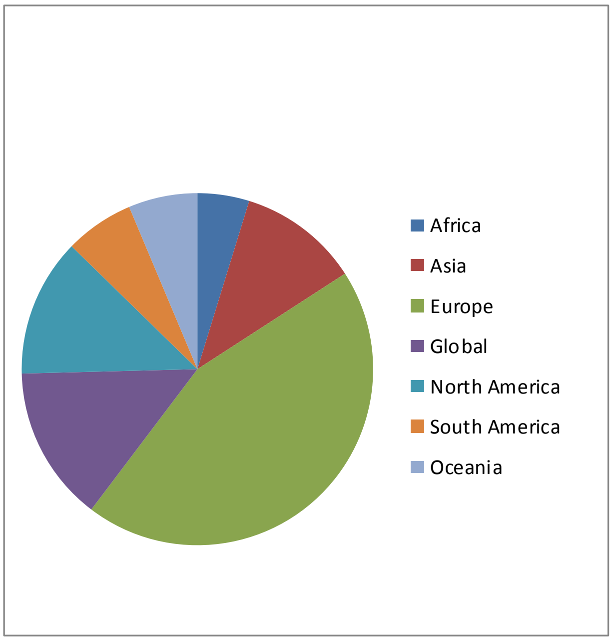
111. According to the IASB's work plan as at 29 July 2013,[54] the proposed amendments to IAS 19 *Defined Benefit Plans: Employee Contributions* is targeted to be finalised in Q4 2013. In this respect, we recommend that the mandatory effective date is set at 1 July 2014, with earlier application permitted, subject to the discussions at a future IASB meeting about the Interpretations Committee's proposal about the amendments.

Question 2
Does the Interpretations Committee agree that it should propose to the IASB that: (1) re-exposure is not necessary based on the re-exposure criteria; and (2) the mandatory effective date is set at 1 July 2014, with earlier application permitted, subject to the discussions at a future IASB meeting? If the Interpretations Committee does not agree with the above, what would be the alternative to propose to the IASB?

[54] http://www.ifrs.org/Current-Projects/IASB-Projects/Pages/IASB-Work-Plan.aspx

Appendix A—Summary of characteristics of respondents

Comment letter distribution by geographical area		
Africa	3	5%
Asia	7	11%
Europe	28	44%
Global	9	14%
North America	8	13%
South America	4	6%
Oceania	4	6%
	63	**100%**



Comment letter distribution by type of respondent		
Academia or Think tank	1	2%
Accountancy body	12	19%
Accounting firm	8	13%
Actuarial firm or body	8	13%
Individual	1	2%
Preparer / Industry	7	11%
Preparer / Representative body	5	8%
Regulator / Securities	1	2%
Standard-setting body	19	30%
User / representative body	1	2%
	63	**100%**