To: IFRS Interpretations Committee  
IFRS Foundation  
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IFRIC POTENTIAL AGENDA ITEM REQUEST  

Issue:  
The application of IAS 19 par. 70-74 (attribution of retirement benefits to years of service) to a plan benefit formula (defined benefit plan) that includes a cap on retirement benefits paid.  

Scenario:  
1. In accordance with relevant legislation in [country], entities are legally required to pay a lump sum to employees who reach the retirement age (fulfil the requirements to receive a full old-age pension from their Public Funds) when in the entity’s service and are entitled to a full pension.  
2. This amount is payable only at the time when the employee meets the requirements for a full old-age pension. No benefit is required to be paid in the event of termination for any cause prior to retirement age (67 or 62), unless there is a common agreement between employer and employee.  
3. The amount of the retirement benefit lump sum (is determined as 40% or 50% of the amount payable in the event of dismissal compensation) depends on the length of service of the employee with the employer upon retirement.  
4. For newer employees the entitlement to Indemnity is capped – limited to 16 years of service.  
5. The table illustrates the calculation of dismissal compensation (in cases of employment agreements’ termination) and retirement lump sum (payable upon retirement age):
6. For clarification purposes we set out below three examples of the number of salaries that an employee, working with the same employer, is entitled to receive as a lump sum retirement benefit when he reaches retirement age (having met the above mention requirements):

   a) A 25-year-old employee (with normal retirement age at 67) joining on 01.01.2010 in employer X is entitled to get, at the age of 67, 12 salaries from employer X (provided he is employed at the age of 67 by employer X).

   b) A 57-year-old employee (with normal retirement age at 62) joining on 01.01.2010 in employer X is entitled to get, at the age of 62, 3 salaries from employer X (provided he is employed at the age of 62 by employer X and that he fulfills the criteria for a full pension scheme due to previous employment).

   c) A 35-year-old employee has joined on 01.01.2000 in employer X. On 01.01.2020 he resigns from employer X and is recruited by employer Y. The employee is entitled to get, at the age of 67, 8 salaries from employer Y (provided he is employed at the age of 67 by employer Y). The Law does not oblige employer X to pay any such benefit to the employee. The benefit is not transferrable by Law and is paid by the current employer, provided the employee is employed at retirement age by employer X and meets the requirements for a full old-age pension.

<table>
<thead>
<tr>
<th>Period working with the same employer</th>
<th>Number of monthly salaries that should be paid as a dismissal compensation (retirement benefit lump sum is calculated as 40% or 50% of this dismissal compensation)</th>
</tr>
</thead>
<tbody>
<tr>
<td>From 1 year and up to 4 years</td>
<td>2</td>
</tr>
<tr>
<td>From 4 years and up to 6 years</td>
<td>3</td>
</tr>
<tr>
<td>From 6 years and up to 8 years</td>
<td>4</td>
</tr>
<tr>
<td>From 8 years and up to 10 years</td>
<td>5</td>
</tr>
<tr>
<td>Upon completion of the 10th year</td>
<td>6</td>
</tr>
<tr>
<td>- // - 11th year</td>
<td>7</td>
</tr>
<tr>
<td>- // - 12th year</td>
<td>8</td>
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<td>- // - 13th year</td>
<td>9</td>
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<tr>
<td>- // - 14th year</td>
<td>10</td>
</tr>
<tr>
<td>- // - 15th year</td>
<td>11</td>
</tr>
<tr>
<td>Upon completion and over the 16th year</td>
<td>12</td>
</tr>
</tbody>
</table>
7. It is noted that the “salary” range based on which the lump sum retirement benefit is calculated is the salary paid to the employee at the date of his retirement.

**Question:**

To which periods of service should the benefit be attributed to in accordance with paragraph 70 of IAS 19 *Employee Benefits*? Does the retirement benefit attribution to years of service (par. 70-74 of IAS 19) include a vesting condition?

In this specific case, considering IAS 19, paragraph 70, should the present value of defined benefit obligations:

a) be attributed to the first 16 (or 28) years of service, which is the cap based on the [local] law, as after that, further service by the employee will lead to no material amount of further benefits, other than further salary increases? or

b) be attributed to the total years that the employee needs to stay with the employer to be entitled to the retirement benefits (up to the date when the employee meets the requirements for a full old-age pension)?

**View 1: attribute benefit on straight line basis from the date employment service begins until the vesting date (estimated retirement age)**

Proponents of view 1 believe that the lump sum retirement benefit should be attributed on a straight-line basis over the working life of an employee and until he/she fulfils the prerequisites needed in order to be eligible to a full old-age pension (e.g. until the employee reaches normal retirement age). Attribution commences from the date the employee is hired by the employer.

**Basis for view 1:**

- This view is mainly based on the fact that an employee cannot claim any part of the lump sum retirement benefit prior to the vesting of all prerequisites. More specifically, there is no obligation for any lump sum retirement benefit payments to the employee if he/she ceases employment for whatever reason before the entitlement to a full old-age pension (vesting date). Therefore, it is the employee’s service throughout the entire period up to the vesting date that gives rise to the post-employment benefit; even if the amount of the benefit is capped before the vesting date, service must be provided up to the vesting date in order for the employee to become entitled to the retirement benefit.

- Per IAS 19 paragraph 71, an entity attributes benefit to periods in which the obligation to provide post-employment benefits arises. That obligation arises as
employees render services in return for post-employment benefits that an entity expects to pay in future reporting periods.

- This view also considers that the applicable local law, for the obligatory lump sum retirement benefit, has no reference to vesting conditions before the retirement age. The cap derives from the table used for the calculation of this retirement benefit. The table is mainly used for the calculation of the dismissal compensation (in cases of employment agreements’ termination). Consequently, the cap of the table has no connection to the vesting conditions of the abovementioned law.

**View 2: attribute benefit from the date service employment begins up to the year where no additional benefits are accrued (ignoring the vesting date)**

Proponents of view 2 believe that lump sum retirement benefit should be attributed over the period prescribed in the table as per [local] Labour Law (up to the year that no additional benefits are accrued). Attribution commences from the date the employee is hired by the employer.

**Basis for view 2:**

- The employees have accrued their entitlement to the full lump sum retirement benefit amount entitled upon retirement after the completion of the years of service stated in the Plan’s formula (as per the table), therefore the full provision should be recorded as of the completion of the years beyond which, under the Plan formula, no material benefits accrue to the employee from further service, other than from further salary increases (paragraph 70 (b), paragraph 73).

- Based on IAS 19 paragraph 72, the determination of the retirement obligation does not take into account the vesting condition (employee service gives rise to an obligation under a defined benefit plan even if the benefits are conditional on future employment (in other words they are not vested).

- A straight-line basis is only permitted when benefits in later years will lead to materially higher level of benefit than in earlier years (paragraph 70).

- Attribution of service over the whole working life of an employee, would lead to a lower provision at any point in time, compared to what is determined based on the Plan formula, which is not in line with the principle of paragraph 70 as well as the examples in BC114.
Current practice:

Diversity has been noted among practitioners concerning the length of the period over which the obligation to provide the lump sum retirement benefit arises.

Following several discussions [amongst interested parties], there seems, based on the facts submitted, to be consensus that there are strong arguments to support View 1, however, some proponents believe that the relevant paragraphs of IAS 19 (70-73) are not entirely clear as to vesting conditions, and also the examples of the standard do not specifically address this case, thus it would not possible to enforce only view 1 and would also accept view 2.

Question to the Interpretations Committee

We have the following question to the Interpretations Committee:
In the context of the existing standards, does the Interpretations Committee support View 1 or View 2 as described above (or any other view)?

Reasons for the IFRIC to address the issue:

a. Is the issue widespread and has, or is expected to have, a material effect on those affected?
We believe it is appropriate to raise the issue to the IFRS Interpretation Committee for their views and feedback. The above described issue can have significant effect on companies’ financial statements and in the comparability of companies’ financial position. In addition, we believe that, even though paragraphs 70-73 of IAS 19 and the respective examples are not totally clear in order to address this specific case, the current practice of application of both views may not be appropriate.

b. Would financial reporting be improved through the elimination, or reduction, of diverse reporting methods?
Considering the potential material impact to many entities across a variety of industries, we believe that clarity is needed so that a consistent approach can be taken amongst IFRS reporting entities.

c. Can the issue be resolved efficiently within the confines of IFRS Standards and the Conceptual Framework for Financial Reporting?
Yes. We believe that consideration by the Committee is needed in this instance and that it can be resolved efficiently within the confines of IFRS Standards and the Conceptual Framework for Financial Reporting.

d. Is the issue sufficiently narrow in scope that the Interpretations Committee can address this issue in an efficient manner, but not so narrow that it is not cost-effective for the Interpretations Committee to undertake the due process that would be required when making changes to IFRS Standards?
We believe this issue is sufficiently narrow in scope that it can be addressed in an efficient manner.

e. Will the solution developed by the Interpretations Committee be effective for a reasonable time period? The Interpretations Committee will not add an item to its agenda if the issue is being addressed in a forthcoming Standard and/or if a short-term improvement is not justified.
We are unaware of any current or planned IASB project that will directly address this issue.

APPENDIX - Technical references

IAS 19 – Employee benefits

Paragraph 70:
“Attributing benefit to periods of service
In determining the present value of its defined benefit obligations and the related current service cost and, where applicable, past service cost, an entity shall attribute benefit to periods of service under the plan’s benefit formula. However, if an employee’s service in later years will lead to a materially higher level of benefit than in earlier years, an entity shall attribute benefit on a straight-line basis from:

(a) the date when service by the employee first leads to benefits under the plan (whether or not the benefits are conditional on further service) until
(b) the date when further service by the employee will lead to no material amount of further benefits under the plan, other than from further salary increases.”

Paragraph 71:
“The projected unit credit method requires an entity to attribute benefit to the current period (in order to determine current service cost) and the current and prior periods (in order to determine the present value of defined benefit obligations). An entity attributes benefit to periods in which the obligation to provide post-employment benefits arises. That obligation arises as employees render services in return for post-
employment benefits that an entity expects to pay in future reporting periods. Actuarial techniques allow an entity to measure that obligation with sufficient reliability to justify recognition of a liability.”

Paragraph 72:
“Employee service gives rise to an obligation under a defined benefit plan even if the benefits are conditional on future employment (in other words they are not vested). Employee service before the vesting date gives rise to a constructive obligation because, at the end of each successive reporting period, the amount of future service that an employee will have to render before becoming entitled to the benefit is reduced. In measuring its defined benefit obligation, an entity considers the probability that some employees may not satisfy any vesting requirements. Similarly, although some post-employment benefits, for example, post-employment medical benefits, become payable only if a specified event occurs when an employee is no longer employed, an obligation is created when the employee renders service that will provide entitlement to the benefit if the specified event occurs. The probability that the specified event will occur affects the measurement of the obligation but does not determine whether the obligation exists”.

Paragraph 73:
“The obligation increases until the date when further service by the employee will lead to no material amount of further benefits. Therefore, all benefit is attributed to periods ending on or before that date. Benefit is attributed to individual accounting periods under the plan's benefit formula. However, if an employee's service in later years will lead to a materially higher level of benefit than in earlier years, an entity attributes benefit on a straight-line basis until the date when further service by the employee will lead to no material amount of further benefits. That is because the employee's service throughout the entire period will ultimately lead to benefit at that higher level”

Example illustrating par. 73
“A plan pays a lump sum retirement benefit of CU2,000 to all employees who are still employed at the age of 55 after twenty years of service, or who are still employed at the age of 65, regardless of their length of service. For employees who join before the age of 35, service first leads to benefits under the plan at the age of 35 (an employee could leave at the age of 30 and return at the age of 33, with no effect on the amount or timing of benefits). Those benefits are conditional on further service. Also, service beyond the age of 55 will lead to no material amount of further benefits. For these employees, the entity attributes benefit of CU100 (CU2,000 divided by twenty) to each year from the age of 35 to the age of 55. For employees who join between the ages of 35 and 45, service beyond twenty years will lead to no material amount of further benefits. For these employees, the entity attributes benefit of 100 (2,000 divided by
twenty) to each of the first twenty years. For an employee who joins at the age of 55, service beyond ten years will lead to no material amount of further benefits. For this employee, the entity attributes benefit of CU200 (CU2,000 divided by ten) to each of the first ten years. For all employees, the current service cost and the present value of the obligation reflect the probability that the employee may not complete the necessary period of service.”

**Paragraph 74:**

“Where the amount of a benefit is a constant proportion of final salary for each year of service, future salary increases will affect the amount required to settle the obligation that exists for service before the end of the reporting period, but do not create an additional obligation. Therefore:

(a) for the purpose of paragraph 70(b), salary increases do not lead to further benefits, even though the amount of the benefits is dependent on final salary; and

(b) the amount of benefit attributed to each period is a constant proportion of the salary to which the benefit is linked”.

**END OF ORIGINAL SUBMISSION**
RESPONSE TO [IFRS Interpretations Committee Staff] COMMENTS

IFRIC [Staff] Comment No 1
The submission states that the ‘amount is payable only at the time when the employee meets the requirements for a full old-age pension’, but does not explain whether these requirements represent additional criteria that affect the accounting for the benefit applying IAS 19. Our comments below assume the only relevant condition is whether the employee is still employed at the time of retirement. Please could you confirm whether this is appropriate?

indicative response based on initial discussions
We confirm that the only relevant condition is whether the employee is still employed by the same employer at the time of retirement.

IFRIC [Staff] Comment No 2
According to the table in paragraph 5, the benefit is calculated as a function of the number of years the employee works for the same employer. For the purpose of this calculation, is the number of years of service calculated based:
• Only on the period of continuous current employment before the retirement date (current employment); or
• Current employment period and any prior period of employment with the same employer (current and previous employment)?
For example, assume an employee works for 10 years with a particular entity, leaves the entity for a number of years, and then subsequently rejoins that same entity working for an additional 5 years until retirement, in this example, would the employee be entitled to a benefit of 5 years (current employment) or 15 years (current and previous employment)?

indicative response based on initial discussions
We confirm that for the purpose of the benefit calculation, the number of years of service calculated is based only on the period of continuous current employment before the retirement date (current employment).

IFRIC [Staff] Comment No 3
At first glance, your fact pattern appears to be similar to example 2 illustrating paragraph 73 of IAS 19. We reproduce part of this example below:
“A plan pays a lump sum retirement benefit of CU2,000 to all employees who are still employed at the age of 55 after twenty years of service, or who are still employed at the age of 65, regardless of their length of service.
For employees who join before the age of 35, service first leads to benefits under the plan at the age of 35 (an employee could leave at the age of 30 and return at the age
of 33, with no effect on the amount or timing of benefits). Those benefits are conditional on further service. Also, service beyond the age of 55 will lead to no material amount of further benefits. For these employees, the entity attributes benefit of CU100 (CU2,000 divided by twenty) to each year from the age of 35 to the age of 55." [Emphasis added]

We were wondering if you have considered the relevance of this example when assessing the appropriate accounting for your fact pattern. If this example is not relevant to your fact pattern, we would be interested in understanding why this is the case and what differentiates your fact pattern from the one in the example.

indicative response based on initial discussions

In assessing the appropriate accounting for our fact pattern we largely considered the objective of IAS 19 (par.1), which is to recognize:
(a) a liability when an employee has provided service in exchange for employee benefits to be paid in the future; and
(b) an expense when the entity consumes the economic benefit arising from service provided by an employee in exchange for employee benefits.

Based on our assessment, judgement needs to be applied in each fact pattern regarding ‘when service by the employee first leads to benefits under the plan’ (IAS 19.70) and we believe this should be considered in the context of the provisions of the employee plan at hand, any related legal provisions and the intended employee service period for which the employee retirement benefits are earned. The decision as to ‘when service by the employee first leads to benefits under the plan’ would not in our view, just be a function of how the plan formula determines an amount.

In our fact pattern, the Plan formula provides for a specific scale to determine how benefit is “earned”, i.e. progressively, as opposed to requiring a minimum number of years of service for the employee to be entitled to this benefit on retirement. In our fact pattern, the employee receives a benefit at retirement age from his/her current employer in any case, irrespective of years of service. The only condition is that it is with the said employer on retirement. The amount to be received is calculated based on years of service with the same employer and this amount has a cap, which is calculated based on a formula.

Example 2 in paragraph 73 of IAS 19 has been considered during our assessment, however, one could argue (under View 1) is different from our fact pattern:
The first part of example 2 requires a minimum number of years of service [i.e. i) to still be employed at the age of 55 and ii) at that time to have completed 20 years of service] in order to receive any benefit (a lump sum, which is the same for all employees).

In our case the plan formula determined by the Law intends to determine the amount to be paid including setting a cap and not to indicate the years of service that an employee should complete in order to receive a full retirement benefit, nor to indicate
that the employee is not providing service in exchange for future benefits from the first year of service. We therefore believe that the start date of accruing benefit is the employment date, considering the probability that an employee may leave before retirement.

Consequently, the way we understand and interpret the IAS 19 requirements and its practical examples, to our fact pattern, is that the total cost of the post-employment benefits due to retirement should be accrued from the first year of employment, as there is legal obligation to accrue benefit, up to the year that further service will not lead to materially higher level of benefit. The probability of each employee leaving before retirement should be considered in the measurement.

The issue which is being debated in our fact pattern is whether the provision should effectively be built up to the 16th year of service or over the full years of service till retirement (subject in both cases to probability one could leave before retirement at which point the benefit does not become payable).

END OF SECOND SUBMISSION