

## DRAFT ENDORSEMENT ADVICE AND EFFECTS STUDY REPORT ON AMENDMENTS TO IAS 19 DEFINED BENEFIT PLANS: EMPLOYEE CONTRIBUTIONS

### INVITATION TO COMMENT ON EFRAG'S ASSESSMENTS

Comments should be sent to [commentletters@efrag.org](mailto:commentletters@efrag.org) by 17 January 2014

EFRAG has been asked by the European Commission to provide it with advice and supporting material on the limited scope amendments to IAS 19 *Employee Benefits* entitled *Defined Benefit Plans: Employee Contributions* ('the Amendment'). In order to do that, EFRAG has been carrying out an assessment of the Amendment against the technical criteria for endorsement set out in Regulation (EC) No 1606/2002 and has also been assessing the costs and benefits that would arise from its implementation in the European Union (the EU) and European Economic Area.

A summary of the Amendment is set out in Appendix 1.

Before finalising its two assessments, EFRAG would welcome your views on the issues set out below. Please note that all responses received will be placed on the public record, unless the respondent requests confidentiality. In the interest of transparency EFRAG will wish to discuss the responses it receives in a public meeting, so we would prefer to be able to publish all the responses received.

**EFRAG's initial assessments summarised in this questionnaire will be amended to reflect EFRAG's decisions on Appendix 2 and 3.**

1 Please provide the following details about yourself:

- (a) Your name or, if you are responding on behalf of an organisation or company, its name:

FRC

- (b) Are you a:

Preparer       User       Other (please specify)

Regul at or

- (c) Please provide a short description of your activity:

Fi nanci al regul at or and standar d set t er

- (d) Country where you are located:

UK

(e) Contact details including e-mail address:

j . guest @ r c . or g . uk

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2 EFRAG’s initial assessment of the Amendment is that it meets the technical criteria for endorsement. In other words, it is not contrary to the principle of true and fair view and it meets the criteria of understandability, relevance, reliability and comparability. EFRAG’s reasoning is set out in Appendix 2.

(a) Do you agree with this assessment?

Yes  No

If you do not, please explain why you do not agree and what you believe the implications of this should be for EFRAG’s endorsement advice.

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(b) Are there any issues that are not mentioned in Appendix 2 that you believe EFRAG should take into account in its technical evaluation of the Amendment? If there are, what are those issues and why do you believe they are relevant to the evaluation?

NO

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3 EFRAG is also assessing the costs that are likely to arise for preparers and for users on implementation of the Amendment in the EU, both in year one and in subsequent years. Some initial work has been carried out, and the responses to this Invitation to Comment will be used to complete the assessment.

The results of the initial assessment of costs are set out in paragraphs 6 and 9 of Appendix 3. To summarise, EFRAG’s initial assessment is that the Amendment is likely to result for preparers in ongoing cost savings and insignificant one-off costs of implementing the Amendment, and only in insignificant costs for users to bring information into a comparable format.

Do you agree with this assessment?

Yes  No

If you do not, please explain why you do not and (if possible) explain broadly what you believe the costs involved will be?

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- 4 In addition, EFRAG is assessing the benefits that are likely to be derived from the Amendment. The results of the initial assessment of benefits are set out in paragraph 12 of Appendix 3. To summarise, EFRAG’s initial assessment is that users and preparers are likely to benefit from the Amendment. The Amendment is likely to reduce the costs for preparers in preparing. The Amendment is likely to reduce the costs for users in analysing the required disclosures and in clarifying paragraph 93 of IAS 19 (2011) as the information does not need to be adjusted to a comparable format.

Do you agree with this assessment?

Yes  No

If you do not agree with this assessment, please provide your arguments and indicate how this should affect EFRAG’s endorsement advice?

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- 5 EFRAG’s initial assessment is that the benefits to be derived from implementing the Amendment in the EU and the European Economic Area as described in paragraph 4 above are likely to outweigh the costs involved as described in paragraph 3 above.

Do you agree with this assessment?

Yes  No

If you do not agree with this assessment, please provide your arguments and indicate how this should affect EFRAG’s endorsement advice?

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- 6 EFRAG is not aware of any other factors that should be taken into account in reaching a decision as to what endorsement advice it should give the European Commission on the Amendment.

Do you agree that there are no other factors?

Yes  No

If you do not agree, please provide your arguments and indicate how this should affect EFRAG’s endorsement advice?

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## **APPENDIX 1 A SUMMARY OF THE AMENDMENT**

### **Background**

- 1 In June 2011, the IASB issued the amended IAS 19 *Employee Benefits* (IAS 19 (2011)) to address a limited number of areas in most need of improvement. The amended IAS 19 (2011) became effective for annual periods beginning on or after 1 January 2013. Earlier application was permitted.
- 2 The IFRS Interpretations Committee was asked to clarify the accounting requirements set out in paragraph 93 of IAS 19 (2011) for employee or third party contributions to a defined benefit plan.

### **The issue**

- 3 IAS 19 (2011) requires attributing employee or third party contributions linked to service to periods of service as a negative benefit in accordance with paragraph 70 of IAS 19 (2011), and paragraph 93 clarifies that the net benefit is attributed in accordance with paragraph 70. Paragraph 93 of IAS 19 (2011) is ambiguous as it does not make clear whether entities should attribute employee contributions linked to service on a gross basis, or jointly with service cost on a net basis.
- 4 Paragraph 93 of IAS 19 (2011) implies that all employee contributions that are linked to service should be attributed to periods of service as a reduction of service cost. This leads to complex attribution calculations, the costs of which outweigh the benefits for simple plans that require contributions from employees.

### **What has changed?**

- 5 The Amendment clarifies the guidance on attributing employee or third party contributions linked to service and requires entities to attribute the contributions linked to service in accordance with paragraph 70 of IAS 19 (2011). Therefore, such contributions are attributed using plan’s contribution formula or on a straight line basis. Furthermore, the Amendment adds certain application guidance in an appendix.
- 6 The Amendment addresses the issue of complexity by introducing a practical expedient that permits an entity to recognise employee or third party contributions linked to service that are independent of the number of years of service, as a reduction in the service cost in the period in which the related service is rendered.

### **When does the Amendment become effective?**

- 7 The Amendment becomes effective for annual periods beginning on or after 1 July 2014. Earlier application is permitted.
- 8 The Amendment shall be applied by entities retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

## APPENDIX 2

### EFRAG’S TECHNICAL ASSESSMENT OF THE AMENDMENT AGAINST THE ENDORSEMENT CRITERIA

*This appendix sets out the basis for the conclusions reached, and for the recommendation made, by EFRAG on the Amendment.*

*In its comment letters to the IASB, EFRAG points out that such letters are submitted in EFRAG’s capacity of contributing to the IASB’s due process. They do not necessarily indicate the conclusions that would be reached by EFRAG in its capacity of advising the European Commission on endorsement of the definitive IFRS in the European Union and European Economic Area.*

*In the latter capacity, EFRAG’s role is to make a recommendation about endorsement based on its assessment of the final IFRS or Interpretation against the technical criteria for the European endorsement, as currently defined. These are explicit criteria which have been designed specifically for application in the endorsement process, and therefore the conclusions reached on endorsement may be different from those arrived at by EFRAG in developing its comments on proposed IFRSs or Interpretations. Another reason for a difference is that EFRAG’s thinking may evolve.*

#### **Does the accounting that results from the application of the Amendment meet the technical criteria for EU endorsement?**

- 1 EFRAG has considered whether the Amendment meets the technical requirements of the European Parliament and of the Council on the application of international accounting standards, as set out in Regulation (EC) No 1606/2002, in other words that the Amendment
  - (a) is not contrary to the principle of ‘true and fair view’ set out in Article 4(3) of Council Directive 2013/34/EU; and
  - (b) meets the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.

EFRAG also considered, based only on evidence brought to its attention by constituents, whether it would be not conducive to the European public good to adopt the Amendment.

#### *Relevance*

- 2 Information is relevant when it influences the economic decisions of users by helping them evaluate past, present or future events or by confirming or correcting their past evaluations.
- 3 EFRAG considered whether the Amendment would result in the provision of relevant information – in other words, information that has predictive value, confirmatory value or both – or whether it would result in the omission of relevant information.
- 4 EFRAG notes that the Amendment removes the ambiguity from paragraph 93 of IAS 19 (2011), which deals with employee or third party contributions linked to service. Therefore, it improves the ability of users to evaluate the performance of entities and enhances the quality of financial statements.
- 5 Furthermore, under the Amendment contributions from employees or third parties that are required by the terms of a defined benefit plan are post-employment

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benefits rather than short-term employee benefits. Consequently, such contributions should be attributed to periods of service as a reduction of service cost. This results in the recognition of service costs that only reflect an entity’s net share of the employee’s benefit and, therefore, improves the ability of users to evaluate the performance of the entity.

- 6 The Amendment addresses also a general concern about the complexity of the required calculations and introduces a practical expedient that permits an entity to recognise employee or third party contributions linked to service that are independent of the number of years of service, as a reduction in the service cost in the period in which the related service is rendered. This approach was common practice prior to the 2011 amendments to IAS 19. In EFRAG’s opinion, therefore, this approach will also provide relevant financial information to users of financial statements.
- 7 EFRAG’s initial assessment is that the Amendment would not result in the material omission of relevant information; and therefore it satisfies the relevance criterion.

### *Reliability*

- 8 EFRAG also considered the reliability of the information that will be provided by applying the Amendment. Information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully what it either purports to represent or could reasonably be expected to represent, and is complete within the bounds of materiality and cost.
- 9 There are a number of aspects to the notion of reliability: freedom from material error and bias, faithful representation, and completeness.
- 10 EFRAG believes that introduction of the practical expedient to paragraph 93 of IAS 19 (2011) reduces the complexity of calculations and will limit the use of judgement. In EFRAG’s opinion the Amendment does not raise any new issues and will limit the existing issues under IAS 19 (2011) regarding the reliability of accounting for employee contributions.
- 11 EFRAG’s overall initial assessment is that the Amendment would raise no concerns about risk of error or bias; and therefore it satisfies the reliability criterion.

### *Comparability*

- 12 The notion of comparability requires that like items and events are accounted for in a consistent way through time and by different entities, and that unlike items and events should be accounted for differently.
- 13 EFRAG has considered whether the Amendment results in transactions that are:
  - (a) economically similar being accounted for differently; or
  - (b) economically different being accounted for as if they are similar.
- 14 As noted in paragraph 4 above, the Amendment removes the ambiguity from paragraph 93 of IAS 19 (2011). Furthermore, the Amendment adds certain application guidance.
- 15 The Amendment introduces, as noted in paragraph 6 above, a practical expedient that could reduce comparability of financial information. EFRAG expects, however, that this practical expedient will be applied to simple contributory plans and will, therefore, have only an insignificant impact on the financial information.
- 16 In EFRAG’s opinion, therefore, the Amendment will improve comparability of financial information.

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- 17 The Amendment requires entities to apply the Amendment retrospectively in accordance to IAS 8. It allows entities to apply an accounting practice that was allowed under IAS 19 before the 2011 amendments (i.e. employee contributions independent of the number of years of service reduced the service cost in the period in which they were paid).
- 18 For the reasons stated above, EFRAG’s initial assessment is that the Amendment satisfies the comparability criterion.

*Understandability*

- 19 The notion of understandability requires that the financial information provided should be readily understandable by users with a reasonable knowledge of business and economic activity and accounting and the willingness to study the information with reasonable diligence.
- 20 Although there are a number of aspects to the notion of ‘understandability’, EFRAG believes that most of the aspects are covered by the discussion above about relevance, reliability and comparability.
- 21 As a result, EFRAG believes that the main additional issue it needs to consider, in assessing whether the information resulting from the application of the Amendment is understandable, is whether that information will be unduly complex.
- 22 The overall objective of the Amendment is to clarify and to simplify the requirements of paragraph 93 of IAS 19 (2011). EFRAG notes that the Amendment does not involve new concepts or notions and does not introduce any new complexities that may impair understandability rather it simplifies and clarifies the guidance in paragraphs 93 and 94 and adds application guidance.
- 23 EFRAG’s overall initial assessment is that the Amendment satisfies the understandability criterion in all material respects.

*True and Fair*

- 24 EFRAG’s initial assessment is that the information resulting from the application of the Amendment would not be contrary to the true and fair view principle.

*European public good*

- 25 EFRAG is not aware of any reason to believe that it is not conducive to the European public good to adopt the Amendment.

**Conclusion**

- 26 For the reasons set out above, EFRAG’s initial assessment is that the Amendment satisfies the technical criteria for EU endorsement and EFRAG should therefore recommend its endorsement.

## **APPENDIX 3**

### **EFRAG’S EVALUATION OF THE COSTS AND BENEFITS OF THE AMENDMENT**

- 1 EFRAG has also considered whether, and if so to what extent, implementing the Amendment in the EU and the European Economic Area might result in incremental costs for preparers and/or users, and whether those costs are likely to be exceeded by the benefits to be derived from its adoption.

#### **Cost for preparers**

- 2 EFRAG has carried out an initial assessment of the cost implications for preparers resulting from the Amendment.
- 3 EFRAG notes that the Amendment does not impose capturing or tracking new information as entities already collect this information for current accounting purposes.
- 4 EFRAG notes that before the 2011 amendments to IAS 19, contributions from employees or third parties were generally deducted from service cost without being attributed to periods of service. If contributions are independent of the number of years of service, the Amendment provides relief so that entities are permitted to deduct contributions from service cost in the period in which the service is rendered. EFRAG believes that the impact of retrospective application will therefore be minimal in those cases and entities will incur only insignificant one-off costs in adopting the Amendment and applying its requirements retrospectively.
- 5 Moreover, EFRAG believes that introduction of this practical expedient to paragraph 93 of IAS 19 (2011) is likely to reduce the ongoing costs arising from complex calculations on attributing the employee contributions to periods of service.
- 6 Overall, the EFRAG’s initial assessment is that the Amendment is likely to result in ongoing cost savings and insignificant one-off costs of implementing the Amendment.

#### **Costs for users**

- 7 EFRAG has carried out an initial assessment of the cost implications for users resulting from the Amendment.
- 8 EFRAG notes that the Amendment introduces an option to use a practical expedient to paragraph 93 of IAS 19 (2011) when accounting for employee contributions. EFRAG believes that this option is not likely to significantly affect the reported figures. Moreover, EFRAG notes that the Amendment reflects the common accounting practice for employee contributions under IAS 19 prior to 2011 amendments. EFRAG believes therefore that the Amendment is not likely to significantly affect the ongoing costs of users to bring the information on post-employment benefit plans into a comparable format.
- 9 Overall, EFRAG’s initial assessment is that the Amendment is likely to result only in insignificant costs for users to bring information into a comparable format.

#### **Benefits for preparers and users**

- 10 EFRAG has carried out an initial assessment of the benefits for users and preparers resulting from the Amendment.

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- 11 EFRAG’s initial assessment is that users and preparers will likely benefit from the Amendment as it clarifies the requirements of paragraph 93 of IAS 19 (2011) dealing with employee or third party contributions linked to service.
- 12 EFRAG’s initial assessment is that preparers will benefit from the practical expedient to paragraph 93 of IAS 19 (2011) introduced by the Amendment which is likely to reduce the ongoing costs arising from complex calculations on attributing the employee contributions to periods of service. Overall, EFRAG’s initial assessment is that users and preparers are likely to benefit from the Amendment. The Amendment is likely to reduce the costs for preparers in preparing. The Amendment is likely to reduce the costs for users in analysing the required disclosures and in clarifying paragraph 93 of IAS 19 (2011) as the information does not need to be adjusted to a comparable format.

*Conclusion*

- 13 EFRAG’s overall initial assessment is that the overall benefits for preparers and users are likely to outweigh one-off implementation costs for preparers and limited ongoing costs for users.