

**DRAFT ENDORSEMENT ADVICE AND EFFECTS STUDY REPORT ON IAS 19
EMPLOYEE BENEFITS (AS AMENDED IN JUNE 2011)**

INVITATION TO COMMENT ON EFRAG'S ASSESSMENTS

Comments should be sent to commentletters@efrag.org or
uploaded via our website by **29 September 2011**

EFRAG has been asked by the European Commission to provide it with advice and supporting material on IAS 19 *Employee Benefits*, as amended in June 2011 (IAS 19 (2011)). In order to do that, EFRAG has been carrying out an assessment of IAS 19 (2011) 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 IAS 19 (2011) 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.

Please note that IAS 19 (2011) refers to IFRS 13 *Fair value Measurements*, which will be subject to a separate endorsement process.

EFRAG 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:

CNC - Comissão de Normalização Contabilística

(b) Are you a:

Preparer User Other (please specify)

Public Authority

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

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Accounting Standard Setter

(d) Country where you are located:

Portugal

(e) Contact details including e-mail address:

cecnc@igf.min-financas.pt

2 EFRAG's initial assessment of IAS 19 (2011) 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.

(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 IAS 19 (2011)? If there are, what are those issues and why do you believe they are relevant to the evaluation?

No further comments

3 EFRAG is also assessing the costs that are likely to arise for preparers and for users on implementation of IAS 19 (2011) 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.

4 The results of the initial assessment of costs are set out in paragraphs 1-12 of Appendix 3. To summarise, EFRAG's initial assessment is that the Amendments are likely to result in an increase in costs for preparers (mainly one-off costs) and in cost savings for users.

Do you agree with this assessment?

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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?

- 5 In addition, EFRAG is assessing the benefits that are likely to be derived from IAS 19 (2011). The results of the initial assessment of benefits are set out in paragraphs 13-17 of Appendix 3. To summarise, EFRAG's initial assessment is that that users and preparers are likely to benefit from the Amendments.

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?

- 6 EFRAG has tentatively concluded that the benefits to be derived from implementing IAS 19 (2011) in the EU as described in paragraph 5 above are likely to outweigh the costs involved as described in paragraph 4 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?

- 7 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 IAS 19 (2011).

Do you agree that there are no other factors?

Yes No

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

APPENDIX 1

A SUMMARY OF IAS 19 (2011)

Background

- 1 IAS 19 *Employee Benefits* sets out accounting requirements for various types of benefits provided by an employer to its employees, including post-employment and termination benefits. Employee benefits may have a significant impact on an entity's financial position and performance, and usually draw special attention of users of the financial statements. Accounting for employee benefits, particularly for post-employment defined benefit plans, is a complex issue involving numerous judgements and complicated calculations. The Amendments made to IAS 19 in 2011 relate primarily to accounting for post-employment defined benefit plans and termination benefits.

The issue

- 2 Existing accounting options for recognition of actuarial gains and losses in relation to defined benefit plans and diverging interpretations of some definitions resulted in a lack of comparability between entities, which attracted significant concerns of the user community. To address these concerns, the IASB undertook a short-term project to improve the reporting requirements for post-employment defined benefit plans and termination benefits.

What has changed?

- 3 The Amendments made to IAS 19 in June 2011 are detailed below:

Immediate recognition of all changes in the net liability or asset – Elimination of the 'corridor approach' and elimination of options in the presentation of actuarial gains and losses

- 4 Entities will be required to recognise all changes in the present value of the defined benefit obligation and in the fair value of plan assets in the period, in which those changes occur. Before the Amendments, three options were permitted for the recognition of actuarial gains and losses:
 - (a) No recognition of actuarial gains and losses if they were within a 'corridor' and deferred recognition of those outside the corridor.
 - (b) Immediate recognition in profit or loss.
 - (c) Immediate Recognition in other comprehensive income.

The amendments require immediate recognition of actuarial gains and losses in other comprehensive income.

Disaggregation and presentation of defined benefit cost components

- 5 Entities will be required to disaggregate and recognise defined benefit cost as follows:
 - (a) Service cost relating to the cost of the services received – in profit or loss,

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- (b) Net interest on the net defined benefit liability (asset), representing the financing effect of paying for the benefits in advance or in arrears – in profit or loss, and
- (c) Remeasurements, representing the period to period fluctuations in the amounts of defined benefit obligations and plan assets – in other comprehensive income.

Redefining the components of defined benefit cost

- 6 The service cost component will include current service cost, past service cost and any gain or loss on settlement. The changes in demographic assumptions will remain included in the remeasurements component together with other actuarial gains and losses and will be excluded from the service cost.
- 7 The net interest will be determined by multiplying the net defined benefit liability (asset) by the discount rate used to determine the defined benefit obligation. Before the Amendments, the expected return of plan assets was required to be used.
- 8 The remeasurements will comprise the actuarial gains and losses on the defined benefit obligation, the difference between the actual total return on assets and the interest income on plan assets calculated based on the discount rate used to determine the defined benefit obligation, as well as any changes in the effect of the asset ceiling excluding the amount included in net interest. This definition of remeasurements differs from the definition of actuarial gains and losses in IAS 19 before the Amendments because the introduction of the net interest approach has changed the disaggregation of the return on plan assets and the effect of the asset ceiling.

Treatment of plan amendments, curtailments and settlements

- 9 An entity will be required to recognise both vested and unvested past service costs in the period of the plan amendment that gives rise to the past service cost. Before the amendment, IAS 19 required immediate recognition of vested past service costs, while unvested past service costs would be recognised over the vesting period. Plan amendments and curtailments will be recognised when they occur. Previously, curtailments were recognised when an entity was demonstrably committed to make a reduction in the number of employees covered by the plan. IAS 19 (2011) treats plan amendments and curtailments in the same way.
- 10 IAS 19 (2011) states that a settlement is a transaction that eliminates all further legal or constructive obligations for part or all of the benefits provided under a defined benefit plan, other than a payment of benefits to, or on behalf of, employees that is set out in the terms of the plan and included in the actuarial assumptions. Therefore, IAS 19 (2011) clarifies that a settlement is a payment of benefits that is not set out in the terms of the plan. The payment of benefits that are set out in the terms of the plan, including terms that provide members with options on the nature of benefit payment such as an option to take a lump sum instead of an annuity, would be included in the actuarial assumptions. As a consequence, any difference between an estimated benefit payment and the actual benefit payment is an actuarial gain or loss.

Risk sharing

- 11 One of the objectives of the IAS 19 (2011) was to harmonise and clarify areas where there was diversity in current practice. One of these areas is the accounting

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for risk sharing features such as employee contributions, conditional indexation and variable benefits.

- 12 Under IAS 19 (2011):
- (a) The effect of employee and third-party contributions should be considered in determining the defined benefit cost, the present value of the defined benefit obligation and the measurement of any reimbursement right.
 - (b) The benefit to be attributed to periods of service is net of the effect of any employee contributions in respect of service.
 - (c) Any conditional indexation should be reflected in the measurement of the defined benefit obligation.
 - (d) The present value of the defined benefit obligations should reflect any existing limits on the legal and constructive obligation to pay additional contributions.

Taxes and administration costs

- 13 IAS 19 (2011) clarifies that the estimate of the defined benefit obligation includes the present value of taxes payable by the plan if they relate to service before the reporting date or are imposed on benefits resulting from that service. Other taxes should reduce the return on plan assets.
- 14 The recognition of administration costs depends on their nature. Administration costs relating to the management of plan assets will be deducted from the total return on plan assets. Other administration costs will be recognised when the administration services are provided. Previously, IAS 19 did not specify which administration costs had to be included in the actuarial assumptions used to measure the obligation and which had to be deducted from the estimated return on assets in profit or loss.

Recognition and measurement of termination benefits

- 15 IAS 19 (2011) requires an entity to recognise termination benefits at the earlier of the following dates:
- (a) When it can no longer withdraw an offer, i.e., when an employee accepts the offer or when the entity communicates a termination plan to the affected employees, or
 - (b) When the entity recognises costs for a restructuring that involves the payment of termination benefits.

Previously, an entity had to recognise termination benefits when it was demonstrably committed to providing those benefits (i.e. when the entity had a detailed formal plan and did have a realistic possibility of withdrawal).

- 16 Termination benefits will be measured as short-term or long-term benefits depending on their nature. Previously, termination benefits that were due more than twelve months after the reporting period had to be discounted. IAS 19 did not provide further measurement guidance.

Disclosures

- 17 The disclosure objectives have been reviewed to focus on the matters most relevant to users of the employer's financial statements. Some new disclosures will be required to meet these revised objectives, including additional information about the exposure to risk and information about asset-liability matching strategies. For a multi-employer plan, IAS 19 (2011) requires an entity to provide a description of any withdrawal or wind-up agreement and to indicate the level of its participation in a multi-employer plan.

Other long-term and short-term benefits

- 18 IAS 19 (2011) clarifies
- (a) that the classification of employee benefits as short-term employee benefits should depend on when the whole amounts resulting from that type of benefit are expected to be settled; and
 - (b) that an entity should revisit the classification of a short-term employee benefit if the benefit no longer meets the definition of a short-term employee benefit.

Transitional provisions

- 19 An entity should apply IAS 19 (2011) retrospectively in accordance with IAS 8 with two exceptions:
- (a) An entity needs not to adjust the carrying amount of assets outside the scope of IAS 19 (2011) for changes in employee benefits costs that were included in the carrying amount before the date of initial application.
 - (b) Comparative information for the disclosures required by paragraph 145 about the sensitivity of the defined benefit obligation is not needed in financial statements for periods beginning before 1 January 2014.

When does the IAS 19 (2011) become effective?

- 20 IAS 19 (2011) becomes effective for financial years beginning on or after 1 January 2013. Earlier application is permitted.

APPENDIX 2

EFRAG'S TECHNICAL ASSESSMENT OF THE AMENDMENT AGAINST THE ENDORSEMENT CRITERIA

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 IAS 19 *Employee Benefits* (as amended in June 2011) meet the technical criteria for EU endorsement?

- 1 EFRAG has considered whether the IAS 19 *Employee Benefits* (as amended in June 2011) 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 IAS 19 *Employee Benefits* (as amended in June 2011):
 - (a) Is not contrary to the principle of 'true and fair view' set out in Article 16(3) of Council Directive 83/349/EEC and Article 2(3) of Council Directive 78/660/EEC; 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 whether it would be conducive to the European public good to adopt the IAS 19 *Employee Benefits* (as amended in June 2011).

*Approach adopted for the technical evaluation of the IAS 19 *Employee Benefits* (as amended in June 2011)*

- 2 The Amendments to IAS 19 *Employee Benefits* mainly introduce changes to the recognition, presentation and disclosure requirements for defined benefit plans. The Amendments to IAS 19, as described in Appendix 1, have been assessed in the following five groups, based on their nature and impact:

Group A: Amendments related to presentation and disclosures

- Disaggregation of defined benefit cost components.
- Disclosures.

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Group B: Amendments related to recognition and measurement of the liability

- Immediate recognition of all changes in the net liability or asset. Elimination of the 'corridor approach' and elimination of options in the presentation of actuarial gains and losses. Requirement to present the remeasurements component in other comprehensive income and hence elimination of options in the presentation of actuarial gains and losses.
- Presentation of the service cost and net interest income (expense) in profit or loss.

Group C: Measurement of the pension cost recognised in profit and loss

- Redefining the components of defined benefit cost – Determining the net interest cost.

Group D: Amendments related to significant changes in the conditions or extinguishment of the benefit or employment relationship

- Treatment of plan amendments, curtailments and settlements.
- Recognition of termination benefits.

Group E: Transitional provisions

3 EFRAG notes that, the remaining Amendments listed below are clarifications or corrections. EFRAG believes these Amendments will make the standard easier to implement consistently, without having other impacts. Those Amendments, which are not discussed specifically in this Appendix, are related to:

- Multiemployer plans.
- Other long-term and short-term benefits.
- Risk-sharing programmes, conditional indexation, taxes and administration costs.
- Measurement of termination benefits.
- Entities that participate in state plans or defined benefit plans that share risks between various entities under common control.
- Mortality assumptions.

Group A: Amendments related to presentation and disclosures

- Disaggregation of defined benefit cost components.
- Disclosures.

Relevance

- 4 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.
- 5 EFRAG considered whether the Amendments in Group A 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.
- 6 Under the new requirements, the change in the net defined benefit liability (asset) is disaggregated into a service cost, a net interest and a remeasurements component. This approach is similar to the previous disaggregation but replaces the expected return on assets and the interest cost on the defined benefit obligation with a single net interest component. The new approach treats the net defined liability (asset) similar to a receivable or payable as it is considered equivalent to an amount owed to or from the plan. As a consequence of this new approach, a deficit will result in interest expense and a surplus in interest income, reflecting the financing element of the amount owed to or from the plan. Previously, a deficit could result in net finance income if the expected return on plan assets exceeded the interest cost on the defined benefit obligation. In addition, the distinction between service cost, net interest and remeasurements makes it possible to distinguish the effect of facts related with the performance by the employees (service cost) from the effects due to the time and from changes in the components that represent the period-to-period fluctuations in the long-term value of the defined benefit obligation and plan assets. Therefore, the disaggregation is consistent with the accounting model of IAS 19 and provides more useful information to users.
- 7 That disaggregation is also reflected in the amended disclosures provisions when requiring certain reconciliations to explain the amounts in an entity's financial statements arising from its defined benefit plans. Those amended disclosures also require additional information about the exposure to risk and information about the asset-liability matching strategies. That information provides an insight into an entity's future cash flow needs and the cash flows available to an entity from the amount owed from the plan. The proposed disclosures also highlight the risks arising from the pension plans and the matching strategies of the company. Thus information resulting from the Amendments in Group A will be relevant for the users of financial statements.
- 8 EFRAG's overall initial assessment is that the Amendments in Group A would result in the provision of relevant information; and therefore they satisfy the relevance criterion.

Reliability

- 9 EFRAG also considered the reliability of the information that will be provided by applying the Amendments in Group A. Information has the quality of reliability when it is free from material error and bias and can be depended upon by users to

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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.

- 10 There are a number of aspects to the notion of reliability: freedom from material error and bias, faithful representation, and completeness. In EFRAG's view, the Amendments in Group A do not raise any significant issues concerning reliability.
- 11 EFRAG notes that the disaggregation requires information consistent with the accounting model of IAS 19. Also this information would likely be closely related to an entity's internal reporting. Additionally, in managing its risk-exposures, an entity would most likely already monitor the information required by the amended disclosures. Furthermore, the disclosure requirements are of a similar nature to those already required by IFRS 7 *Financial Instruments: Disclosures* and IAS 39 *Financial Instruments: Recognition and Disclosure*.
- 12 For the reasons stated above, EFRAG's overall initial assessment is that the Amendments in Group A satisfy the reliability criterion.

Comparability

- 13 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.
- 14 EFRAG has considered whether the Amendments in Group A result in transactions that are:
 - (a) economically similar being accounted for differently; or
 - (b) transactions which are economically different being accounted for as if they were similar.
- 15 Although the Board has finally decided not to specify where in profit or loss an entity should present the service cost and finance cost components (presentation should be within the boundaries of IAS 1 *Presentation of Financial Statements*, in the way that is most relevant to the entity), the Amendments reduce the areas where there could be a choice. Therefore EFRAG believes that the Amendments result in similar plans and defined benefit costs being disclosed and disaggregated in a comparable manner.

Group B: Amendments related to recognition and measurement of the liability

- Immediate recognition of all changes in the net liability or asset. Elimination of the 'corridor approach' and elimination of options in the presentation of actuarial gains and losses. Recognition of the remeasurements component in other comprehensive income.
- Presentation of the service cost and net interest income (expense) in profit or loss.

Relevance and Reliability

- 16 The recognition of the remeasurements component in other comprehensive income acknowledges the fact that the underlying reasons and causes of period-to-period fluctuations in the long-term value of the defined benefit obligation and plan assets

in long-term value are different in nature from the factors that cause changes in the other components of pension costs. If such changes in non-recurring components are recognised in profit and loss of an entity that may be unhelpful for users of financial statements in assessing performance on its operational activities. That makes relevant such recognition in other comprehensive income. Apart from this point, the relevance and reliability of information are not significantly affected by the Amendments in Group B.

Comparability

- 17 The Amendments in Group B address existing divergent practice in respect of recognising the actuarial gains and losses arising from defined benefit plans through the removal of the options previously contained in IAS 19. The previous options allowed entities with three options for the recognition of actuarial gains and losses: immediate recognition in profit or loss or in other comprehensive income, or deferred recognition for actuarial gains and losses outside the corridor through profit or loss with unrecognised actuarial gains and losses that were within the corridor. The Amendments in Group B require entities to recognise all the changes in the period in which those changes occur through other comprehensive income. This will bring consistency in accounting for the actuarial gains and losses, now included in the remeasurements component, and therefore will increase comparability between entities. Therefore, EFRAG's overall initial assessment is that the Amendments in Group B satisfy the comparability criterion.

Group C: Measurement of the pension cost recognised in profit and loss

- Redefining the components of defined benefit cost – Determining the net interest cost.

Relevance

- 18 For similar reasons for those explained for Group A, EFRAG's overall initial assessment is that the Amendments in Group C would satisfy the relevance criterion as the Amendments focus the attention on the time value. The net interest component will provide relevant information regarding the financing effect of the net defined liability (asset). Entities with deficits will recognise accordingly an interest expense in profit or loss. Otherwise, entities will recognise interest income, reflecting the financing element of the amount owed to or from the plan in both situations.

Reliability

- 19 EFRAG notes that the objective of the net interest approach is to provide more understandable information of the economic cost (or benefit) of a defined benefit liability (asset) than would be the case if finance income and expenses were to be determined separately on the plan assets and the defined benefit obligation using different discounting rates for each of those. Under the net interest approach the entity discounts the economic benefits that it expects to receive from the plan or from the employees in the form of reductions in future contributions or as refunds using the same rate as for the defined benefit liability, i.e., a discount rate determined by reference to market yields on high quality corporate bonds (or government bonds if a deep market does not exist). This discount rate can be determined in a more objective way and might not include a return that is not simply attributable to the passage of time when compared to the expected return on plan assets as previously used. However, EFRAG continues to believe that entities

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would benefit from guidance on estimating a market yield and, in particular, guidance that resolves the issues that arise if there is not a deep market for high quality corporate bonds in an entity's jurisdiction.

- 20 The expected return approach reflects the expected performance of the assets by the management and not the actual performance. The net interest approach results in recognition of interest income when the plan has a surplus (and interest cost when the plan has a deficit), while the difference between the expected and actual performance on plan assets is recognised in other comprehensive income. This avoids the reliability concern that would have arisen if an entity were to be required to separate the change in the fair value of plan assets between a net interest and an investing component. For the reasons above, EFRAG's overall initial assessment is that the net interest approach satisfies the reliability criterion.

Comparability

- 21 As indicated, the Amendments require entities to calculate net interest on the net defined benefit liability (asset) using the same discount rate used to measure the defined benefit obligation. Entities applying the same discount rate to their liabilities, will determine consistently their financing cost (benefit). This approach will result in greater consistency between entities and removes the subjectivity involved in determining the expected return on assets.
- 22 For the reasons stated above, EFRAG's overall initial assessment is that Group C of Amendments satisfies the comparability criterion.

Group D: Amendments related to the significant changes in the conditions or extinguishment of the benefit or employment relationship

- Treatment of plan amendments, curtailments and settlements.
- Recognition of termination benefits.

Relevance

- 23 As explained in Appendix 1, the Amendments require immediate recognition of all past service costs. Recognising unvested past service costs immediately is consistent with the recognition of unvested current service costs that IAS 19 treats as an obligation (for example, paragraph 44 of IAS 19). Although EFRAG believes that this recognition is inconsistent with IFRS 2, it believes that internal consistency within IAS 19 (2011) is preferable. In addition, recognition of unvested past service costs over the vesting period gives rise to concerns about the potential for accounting arbitrage.
- 24 EFRAG expects that the level of information provided to users of financial statements under the new Amendments will be similar to that presented under the previous requirements for plan amendments, curtailments, settlements and termination benefits. IAS 1 requires disclosure of employee benefits expense. Furthermore, when items of expense are material, that standard requires an entity to disclose their nature and amount separately. As a result, the relevance of information will not be affected by the Amendments included in group D.

Reliability

- 25 Before these Amendments, an entity recognised curtailments resulting from a significant reduction in the number of employees covered by the plan when it was demonstrably committed to making the reduction. The Amendments require an entity to recognise termination benefits at the earlier of when it can no longer withdraw an offer and when it recognises costs of a restructuring that also includes termination benefits. Thus the changes reduce the need for the exercise of judgement by removing the “demonstrably committed” criteria; an area still requiring judgement is when a restructuring takes place, but this is the same as the existing criteria under IAS37.
- 26 For the above reasons EFRAG's overall initial assessment is that the Amendments in Group D satisfy the reliability criterion.

Comparability

- 27 Entities will have to recognise the effects of plan amendments, curtailments and settlements in profit or loss as part of the service cost component. As a consequence of this change, their definitions have been reviewed. Sometimes there is an overlap between the definitions of settlements, curtailments and plan amendments and the transactions usually happen at the same time, so it can be difficult to allocate the gains and losses between them. In other cases it is difficult to distinguish their effects. To introduce a single accounting treatment for these types of transactions when they occur at the same time reduces practical difficulties and diversity in practice.
- 28 The above changes will improve consistency in accounting and therefore will increase comparability between entities. Therefore, EFRAG's initial assessment is that the Amendments in Group D satisfy the comparability criterion.

Group E: Transitional provisions

Relevance, reliability and comparability

- 29 EFRAG believes that retrospective application is generally preferable where practicable. IAS 19 (2011) requires full retrospective application with two minor exceptions regarding capitalised employee benefit costs and disclosures about sensitivity. The impact on the relevance of the financial information of these exceptions is insignificant in both cases. Also, the exception regarding disclosures provides for the staged introduction of the underlying disclosures and only affects financial statements in the first two years of application of the standard, but not thereafter.
- 30 Initial application of the new requirements in IAS 19 (2011) may require entities to reconstruct or recalculate certain information (e.g. tax impact on the employee benefit obligation), which may raise concerns about the reliability and comparability of the information. However, EFRAG believes that IAS 19 (2011) does not require significant new information over and above that which is already available to entities currently applying IAS 19.
- 31 Therefore, the transitional provisions do not give rise to any significant concerns about the relevance, reliability and comparability of the information produced under IAS 19 (2011).

Amendments A, B, C, D and E

Understandability

- 32 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.
- 33 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. For example, information that represents something as similar when it is in fact dissimilar is not comparable, and that lack of comparability will mean it is also not understandable, and vice versa.
- 34 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 Amendments is understandable, is whether that information will be unduly complex.
- 35 EFRAG notes that the Amendments do not involve new concepts or notions other than those used hitherto. The Amendments themselves do not introduce any new complexities that may impair understandability. The overall objective of the Amendments is to ensure that financial statements provide users with a clear picture of an entity's commitments resulting from defined benefit plans.
- 36 In EFRAG's view, the Amendments do not introduce any new complexities that may impair understandability. Therefore, EFRAG's initial assessment is that the Amendments satisfy the understandability criterion.

True and Fair

- 37 EFRAG has tentatively concluded that the information resulting from the application of the IAS 19 (as amended in June 2011) would not be contrary to the true and fair view principle.

European public good

- 38 EFRAG is not aware of any reason to believe that it is not conducive to the European public good to adopt IAS 19 (as amended in June 2011).

Conclusion

- 39 For the reasons set out above, EFRAG's has tentatively decided that the IAS 19 (as amended in June 2011) 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 IAS 19 (2011)

- 1 EFRAG has also considered whether, and if so to what extent, implementing IAS 19 (2011) in the EU 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 their adoption.

Cost for preparers

- 2 EFRAG has carried out an initial assessment of the cost implications for preparers resulting from IAS 19 (2011).
- 3 EFRAG notes that most of the changes introduced to IAS 19 do not require capturing or tracking any *new* information. The current IAS 19 already requires entities to obtain most of the information needed to comply with the revised standard. Most of the changes require presenting the *existing* information in a different way or clarify the factors to consider in performing a calculation based on the *existing* information. However, the following changes to IAS 19 may require capturing or tracking of new information:
 - (a) Net interest: entities will be required to determine the appropriate interest rate and the changes in the net asset/liability during the year.
 - (b) Disclosures: entities may be required to collect more data for the increased number of disclosures.
 - (c) Accounting for schemes with risk-sharing: entities would be required to estimate the expected future employee contributions.
 - (d) Termination benefits linked to restructurings: more detailed information could be required for their recognition (triggering event, characteristics of the restructuring plan, etc).
- 4 It is expected that preparers will have to incur one-off costs to familiarise themselves with the new requirements, to train their employees and to reconstruct information in order to apply the Amendments retrospectively, however these costs are not expected to be significant.
- 5 The new presentation and disclosure requirements will lead to one-off costs of adjusting the information and accounting systems, but these incremental costs are not expected to be significant.
- 6 Except for the new disclosure requirements, no incremental costs are expected in relation to documentation of new business processes, controls or accounting policies. However, certain entities will incur costs in applying those Amendments that reduce diverse practices that existed under IAS 19 before. Those will depend on the extent to which its current practices differ from the requirements under IAS 19 (2011).
- 7 Except for the additional effort to prepare, review and audit the increased number of disclosures, no significant incremental ongoing costs are expected to arise, because most of the changes to IAS 19 are not associated with new information.

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Also, certain recognition, measurement and presentation requirements have been simplified.

- 8 Some of the changes to IAS 19, such as the elimination of the corridor approach, could result in a minor reduction in costs as the revised guidance requires less information to be kept. Based on the above, EFRAG's initial assessment is that IAS 19 (2011) would involve some ongoing incremental costs (those included in paragraph 7) compared to the existing requirements. Some one-off costs (those included from paragraphs 4 to 6) are expected on the implementation of IAS 19 (2011), however they are not expected to be significant.

Costs for users

- 9 EFRAG has carried out an initial assessment of the cost implications for users resulting from IAS 19 (2011).
- 10 As noted above, except for the enhanced disclosure requirements, most of the changes to IAS 19 do not result in any fundamentally new information. The objective of the project was to provide more transparency and to simplify the accounting for employee benefits, therefore users' costs associated with the analysis of information are expected to be reduced. For example, these are the cases with the elimination of the deferred recognition of gains and losses and of the changes in the net asset/liability; and with the elimination of the options.
- 11 The increased number of disclosures, which could add to complexity, may require additional time and effort to analyse. Apart from this fact, IAS 19 (2011) is not expected to result in any incremental costs for users in order to incorporate the new requirements in their analysis.
- 12 Based on the above, EFRAG's initial assessment is that IAS 19 (2011) is likely to result in cost savings for users.

Benefits for preparers and users

- 13 EFRAG has carried out an initial assessment of the benefits for users and preparers resulting from IAS 19 (2011).
- 14 As indicated above, IAS 19 (2011) eliminates options in the recognition, measurement and presentation of employee benefits, and requires entities to recognise all changes in the pension costs and/or in the asset/liability as they occur. Previously, under the deferred recognition approach the statement of financial position may not always have reflected the surplus or deficit in the pension plan. In addition, in accordance with IAS 19 (2011) gains and losses will be presented in a more uniform way after elimination of presentation options. As a result, IAS 19 (2011) would make it easier for users to analyse and compare financial information about employee benefits.
- 15 The new disclosure requirements would assist users in forecasting future cash flows, and in analysing company's strategies and risks related to the pension plan.
- 16 IAS 19 (2011) is also expected to result in several benefits for preparers associated with cost savings following the simplification of the accounting model for defined benefits schemes (e.g., elimination of the corridor approach) and the removal of accounting options. IAS 19 (2011) also allows preparers to align their accounting for pension schemes with risk-sharing features closer with the underlying economic substance of those schemes, thereby resulting in better quality financial reporting.

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- 17 Overall, EFRAG's initial assessment is that users and preparers are likely to benefit from IAS 19 (2011).

Conclusion

- 18 EFRAG's overall assessment is that the overall benefits for preparers and users of IAS 19 (2011) are likely to outweigh one-off incremental costs and ongoing costs for preparers and users associated with understanding and implementation of IAS 19 (2011).

APPENDIX 4

DISSENTING OPINION

- 1 One EFRAG TEG member dissents from recommending endorsement of IAS 19 (2011). This is because this EFRAG TEG member believes there are concerns with the revised IAS 19, and specifically it:
 - (a) Introduces a new difference in pension costs between different defined benefit solutions as well as between defined benefit and defined contribution pension schemes.
 - (b) Exaggerates the difference in size of pension liability and the size of the pension cost between entities having pension liabilities in markets with or without a liquid corporate bond market.
 - (c) Is implemented at a time when the accounting for life insurance liabilities is heavily debated including measurement and presentation as well as the choice of discount rate. This EFRAG TEG member considers pension costs and life insurance liabilities to be highly related to each other and they should be considered in parallel, not in isolation, which further questions the relevance of endorsing the revised IAS 19 before deciding on the endorsement of a revised standard for insurance contracts.
- 2 This EFRAG TEG member shares the view of the Board that the current standard IAS 19 Employee Benefits is complex. However, this EFRAG TEG member believes that a comprehensive and fundamental review of the entire standard should be made instead of the piecemeal changes now suggested. When that comprehensive and fundamental review is made, conclusions drawn in the insurance projects should be considered due to the similarities between the two standards.

Introduces a new difference in pension costs between different defined benefit solutions as well as between defined benefit and defined contribution pension schemes

- 3 This EFRAG TEG member considers that a problem with the standard is the differences in measurement models between defined benefit and contribution pension schemes. This EFRAG TEG member is concerned that the Board's proposal exaggerates rather than removes these differences.
- 4 This EFRAG TEG member argues that the pension costs, presently, have the same items recognised in profit or loss when companies choose the option of recognising all gains and losses in profit or loss immediately, regardless of if the pension scheme is funded or not and regardless if the plan is classified as defined contribution or defined benefit. For entities currently using the corridor approach, the amounts recognised in profit or loss would similarly become equal when considering the overall effect over time. This would only therefore not be the case for entities that currently recognise actuarial gains and losses in other comprehensive income. The items are service costs, interest and returns on assets supporting the liabilities. In the premiums to the life insurance company these items are netted when the insurance company calculates its premiums, in the unfunded plan, the return on the assets is presented with other similar assets and not directly in connection to the pension costs and finally, for funded pension schemes, this information is presented gross as disclosures.

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- 5 By introducing the interest on the net asset/liability this consistent principle for what is recognised in profit or loss has been removed and this EFRAG TEG member fails to see this as an improvement of IAS 19 and fails to see the logic in presenting a return being equal regardless of the investment strategy.

Exaggerate the difference in size of pension liability and the size of the pension cost between entities having pension liabilities in markets with or without a liquid corporate bond market

- 6 This EFRAG TEG member also believes that a revision of the standard should have included a revised guidance on determination of the rate for discounting pension obligations and a review of the current requirement to link benefits to future salary increases.
- 7 This EFRAG TEG member believes that it is essential that Amendments in the measurement model for defined benefit plans do not further deteriorate users' ability to make a durable estimate of the pension impact on the comprehensive income. As pension plans are long-term in nature it is necessary to have some kind of allocation mechanism for actuarial gains and losses on both obligations and plan assets. In the view of this EFRAG TEG member, the current corridor method has been a practical way to achieve such allocation. Since the 10% rule is arbitrary, if at all amending IAS 19, the Board should have considered to keep the basic principles of the current allocation mechanism, but abandoned the corridor. This would have functioned as one "adjusted amortised cost methodology" which could have been considered as an alternative also in the insurance project; being an alternative between constant and current discount rates, reflecting the long term nature of pension liabilities. This EFRAG TEG member believes that the IASC may have had good arguments for the present deferral methodologies used since the present and the revised IAS 19 uses an inconsistent modeling technique (for defined benefit schemes) by comparing the current value of an asset portfolio with current value of future obligations.
- 8 Furthermore, this EFRAG TEG member fails to understand the logic in the thinking of the Board when replacing expected return on plan assets with the discount rate of the liabilities. The Board argues that the use of the discount rate best reflects the net liability/asset, but at the same time several new disclosures are implemented that focuses on the actual assets of the funded pension plan, i.e. a gross perspective. Keeping the expected return, in the view of this EFRAG TEG member, would have been a better reflection of the actual investments and the long-term economics of the plan. To use the same discount rate for both assets and liabilities as decided by the IASB is highly arbitrary and result in a systematic miscalculation of the actual pension cost. This EFRAG TEG member understands that the determination of the expected yield requires management judgment and may encourage abuse. However, management judgment is crucial to other accounting estimates and assumptions.
- 9 With regard to the discount rate it is important to consider that there are several countries in the world that do not have deep markets in high quality corporate bonds. In such circumstances, the present, and the revised, standard requires entities to use government bond rates when determining their pension obligation. This EFRAG TEG member strongly believes that there is a need to review the issue of determination of discount rate in order to create a level playing field between countries that have deep markets in corporate bonds and those that do not. As now revised, countries without a liquid corporate bond market where the interest rates for corporate bonds are higher than corresponding government bond rates will:

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- (a) Have higher pension liabilities (i.e. higher deficit or less positive net value), and therefore also,
 - (b) Have higher pension costs by the fact that the interest expense/interest income will be calculated based on a higher liability or lower asset and the lower net asset/higher liability will also be negatively affected by the use of a lower interest rate.
- 10 As a final remark, this EFRAG TEG member also questions the relevance of remeasuring plan assets. Plan assets may consist of equity instruments, interest bearing instruments, or perhaps real estate that may be measured at cost or amortised cost according to other IFRSs. It is not obvious for this EFRAG TEG member why the treatment of those assets should be different depending on whether they are held by a pension trust, directly owned by the entity in an unfunded defined benefit solution, or owned by a life insurance company in a defined contribution scheme.
- 11 The same point could be made as regards pension obligations. Those liabilities are long term and there is normally no trading intent. The basic measurement basis for liabilities outside of IAS 19 is normally amortised cost. Therefore, this EFRAG TEG member questions why changes in estimates should be recognised immediately instead of been amortised during the remaining time of service (e.g. compare with IAS 8, p36-38).