

IFRS IC POTENTIAL AGENDA ITEM REQUEST

I. The issue

Accounting for Early Retirement Programs in the form of Old-age-part-time-work

On 16 June 2011 the IASB published the amended version of IAS 19 *Employee Benefits* (IAS 19 (2011)) to be applied for annual periods beginning on or after 1 January 2013. Earlier application of the Standard is permitted. Under the requirements of the amended standard significantly divergent interpretations are expected to emerge in accounting for Early Retirement Programs in the form of Old-age-part-time-work arrangements.

The specific issue in question is described as follows: To account for the feature 'additional compensation' in the context of Old-age-part-time-work arrangements (for further technical explanations please refer to the below description of such arrangements), i.e. whether one of the following three views is required to be applied or whether there is any other more appropriate accounting in order to account for such arrangements in line with the requirements of IAS 19 (2011):

View 1 ó additional compensation is to be categorised as *termination benefits*,

View 2 ó additional compensation does not fall into the category of *termination benefits*, or

View 3 ó considering individual facts and circumstances either View 1 or View 2 needs to be followed.

In order to further detail the issue, this *Potential Agenda Item Request* (PAIR) is structured as follows:

- A. Description of Old-age-part-time-work arrangements
- B. Possible views of the accounting for Old-age-part-time-work arrangements in accordance with IAS 19 (2011)

A. Description of Old-age-part-time-work arrangements

Old-age-part-time-work arrangements are early retirement programs designed to create an incentive for employees within a certain age group to smooth the transition from (full or part time) employment into retirement before the employees' legal retirement age. Old-age-part-time-work arrangements are provided for certain age groups in connection with voluntary workforce reduction programs, as part of a variety of measures intended to address the needs and preferences of different age groups. These arrangements are also provided in connection with larger restructuring measures.

Old-Age-part-time-work programs or similar programs are applied in a few European countries and in countries outside Europe. The following description is referring to typical arrangements as agreed in Germany, since in this country Old-age-part-time work is much more widely used as compared with other jurisdictions.

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Employees taking advantage of an Old-age-part-time-work arrangement must sign a contract with the employer. The employer may offer such contracts

- since they are committed by collective labor agreement,
- in the course of a company-agreement, or
- individually for selected employees.

The employer typically offers two alternative arrangements for participating employees:

- Type I: participant works 50 percent of the regular time during each year of the entire Old-age-part-time-work period, and receives 50 percent of his / her salary each year.
- Type II: participant works full-time for half (the "service period") of the Old-age-part-time-work period, and then does not work for the remaining half (the "inactive period"), and receives 50 percent of his / her salary each year during the entire Old-age-part-time-work period.

Under both alternatives, participants also receive an additional compensation comprised of so called uplift payments and additional contributions are made by the employer into the national government pension scheme.

The uplift payments vary by employer, but will often equal 20 percent of the participants most recent regular pay prior to the start of the Old-age-part-time-work period; thus, the regular combined paid compensation will normally equal about 70 percent of the participants most recent regular pay prior to the start of the Old-age-part-time-work period.

The employer further has to make additional contributions into the national government pension scheme for participants (to compensate for the fact that the employee has not been working at his / her previous level during the Old-age-part-time-work period) during the entire Old-age-part-time-work period. Contributions into the national government pension scheme (as well as length of service) determine the amount of pension benefits the employee will receive from the national government pension scheme upon retirement. Therefore, by making additional contributions into the national government pension scheme during the entire Old-age-part-time-work period, the pension benefits paid to the employees will be higher than they would have been had the contributions been based solely on the employees' active service during the Old-age-part-time-work period.

The majority of participants in Old-age-part-time-work arrangements select the Type II arrangement.

The following illustrates the relationship between the work performed and the uplift-payment received by a participant under a Type II arrangement, during the Old-age-part-time-work period, assuming an Old-age-part-time-work period of four years:

<i>Year</i>	<i>% worked</i>	<i>% salary paid</i>	<i>uplift paid (as % of full-time salary)</i>	<i>Total</i>
1	100%	50%	10%	60%
2	100%	50%	10%	60%
3	0%	50%	10%	60%
4	0%	50%	10%	60%

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Employees must fulfill their obligation to provide service to an employer for the required portion of the Old-age-part-time-work period in order to receive the full additional compensation. If a participant dies, voluntarily leaves the company, or is otherwise terminated prior to fulfilling the service period requirement, the Old-age-part-time-work arrangement will be unwound and the total compensation received by the participant will be adjusted to the amount that the participant would have received if he / she had not participated in the Old-age-part-time-work arrangement (salary is contractually set at the amount the employee earned just prior to signing the contract with the employer). For example, if an employee signs up for a 4-year Type II Old-age-part-time-work arrangement and leaves the company after 1 year, the employee will receive (for the 1 year worked) 100 percent of his / her most recent pre - Old-age-part-time-work agreement annual salary and will not receive any Old-age-part-time-work additional compensation.

During the inactive period under the Type II - Old-age-part-time-work arrangement, participants are legally under a work contract with the employer (thus, they are considered employees); however, an employee is not permitted to return to any active work.

The detailed terms of Old-age-part-time-work arrangements in various industries may differ because of negotiations and / or agreements between employers and the respective workers' council / union, or employees. Typical additional features of the framework within an Old-age-part-time-work arrangement include the following:

- The individual contract starts for an employee at the later of when (1) he / she reaches a minimum age (which is usually determined in accordance with the requirements outlined in the specific terms within an individual company's Old-age-part-time-work arrangement), and (2) he / she signs an individual Old-age-part-time-work contract with the employer.
- The employee can sign the Old-age-part-time-work contract before he / she is eligible to begin working under the Old-age-part-time-work arrangement. An employee is eligible to begin working under the Old-age-part-time-work arrangement upon attaining the age such that upon completion of the Old-age-part-time-work period, he / she will be eligible for the normal government retirement benefits (differing for the various countries - e.g. 65 years for men and 63 years for women).
- The arrangement requires that an employer allows participation in the Old-age-part-time-work arrangement without restriction until participation reaches e.g. 5 percent of the total work force. After 5 percent participation is achieved, an employer has, at its discretion, the right to determine whether employees are accepted into the Old-age-part-time-work arrangement.
- In most cases, an employee is required to work for a minimum period of time with the present employer before being eligible for the Old-age-part-time-work arrangement; prior employment required with the present employer in some instances amounts to 12 years of service before becoming eligible.

B. Possible views of the accounting for Old-age-part-time-work arrangements in accordance with IAS 19 (2011)

The amendments of IAS 19 as issued by the IASB in June 2011 and as far as they relate to the improvements in the accounting for termination benefits ó among other things ó were expected

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by many constituents to reduce differences between IFRSs and US GAAP¹ (i.e. that the additional compensation under IFRSs no longer needs to be treated as a *termination benefit*). However, the discussions started subsequent to the issuance of IAS 19 (2011) indicate the existence of three fundamentally different views on how to account for Old-age-part-time-work arrangements in line with IAS 19 (2011).

The three different views as lined out below mainly arose because on the one hand the definition of *termination benefits* in IAS 19.8 (2011) did not change ^ó as far as it relates to content and disregarding some minor wording changes ^ó as compared to the definition in IAS 19.7 (1998)². On the other hand, IAS 19 (2011) introduces in paragraph 162 two indicators that an employee benefit is not provided in exchange for termination of employment. According to the first of the two indicators (IAS 19.162 (a) (2011)), that is the case if ~~the~~ benefit is conditional on future service being provided^ø. By purpose the following discussion excludes further analysis of the second indicator in IAS 19.162 (b) (2011), according to which benefits are provided in exchange for services, when ~~the~~ employee benefit plan is provided in accordance with the terms of an employee benefit plan.^ö This is because Old-age-part-time-work arrangements provided in accordance with the terms of an employee benefit plan will according to IAS 19.163 ^ó sentence 4 (2011) only be categorised as termination benefits, ~~if~~ they both result from an entity^øs decision to terminate an employee^øs employment and are not conditional on future service being provided.^ø Therefore, even if Old-age-part-time-work arrangements are provided in accordance with the terms of an employee benefit plan, it needs to be clarified whether or not they are conditional on future service being provided. This question, however, shall be the focus of the issue.

The supposed ~~contradiction~~^ø between definition and indicator arose from the issuance of IAS 19 (2011), which is considered to be a new situation as compared with the requirements of IAS 19 (1998).

The three views can be characterised as follows:

¹ Please note that in the FASB^øs Accounting Standards Codification **Topic 715-30-55: No. 81-86** (formerly: EITF Abstract No. 05-5) the issue is being dealt with referring to a specific Old-age-part-time-work arrangement. In accordance with that guidance and in contrast to the view displayed in section B of this PAIR, additional compensation should be recognised over the period from the point at which the employee signs the Old-age-part-time-work contract until the end of the active service period.

² In this context it should be noted that at least in Germany additional compensation in the context of Old-age-part-time-work in accordance with IAS 19 (1998) is categorised as termination benefit as promulgated by the HFA (Auditing and Accounting Board of the Institute of Public Auditors in Germany) in their guidance on the corresponding IFRS accounting treatment (Statement on Accounting No. 3 (**IDW RS HFA 3**) as issued in 1998). This view has also been confirmed by the German Accounting Interpretations Committee (AIC) in its **AIC Position Paper** issued in January 2006 (~~IFRS Accounting for Additional Compensation under German *Alters-zeit* Partial and Early Retirement Arrangements in the Light of EITF Issue No. 05-5~~^ø). The main reason to categorise additional compensation as termination benefits under IAS 19 (1998) in these two documents is based on the predominant argument that from an economical point of view the additional compensation is clearly provided in order to get the employees to accept the (early) termination of their employment, and therefore, does not represent a compensation for employee services received or to be received. This view needs to be seen in light of the fact that in IAS 19 (1998) the definition of the *termination benefits*^ø had not been accompanied by indicators as now included in IAS 19 (2011). Whether or not a benefit has to be categorized as *termination benefit*^ø in line with IAS 19 (1998) has to be determined based on the definition in paragraph 7 of the standard only.

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View 1 ó additional compensation in the context of Old-age-part-time-work arrangements from an economic perspective remains to be classified as termination benefits (since they are provided to the employee for the (early) termination of the employee's employment) and, therefore, needs to be accounted for as *termination benefits* as defined in IAS 19 (2011) since the definition of *termination benefits* with regards to its content did not change as compared to IAS 19 (1998).

View 2 ó due to the changed guidance for termination benefits (please refer to the new guidance in IAS 19.159-164 (2011)) additional compensation in the context of Old-age-part-time-work arrangements does not fall into the category of *termination benefits* anymore.

View 3 ó considering individual facts and circumstances either View 1 or View 2 needs to be followed.

The arguments supporting each of the three views are further detailed and discussed in the following.

View 1 ó Additional compensations (Old-age-part-time-work arrangements) are *termination benefits* (IAS 19 (2011))

This view is based on the economical substance of Old-age-part-time-work arrangements, i.e. the additional compensation provided under this scheme. According to the proponents of this view the additional compensation is provided to the employees if they accept the (early) termination of their employment and therefore additional compensation is termination benefit. In other words: the additional compensation does not represent a benefit (an increased pay) for future services.

Although the wording used to define the term *termination benefit* in IAS 19 (2011) has slightly changed as compared to IAS 19 (1998), the content did not change. On that basis, the proponents of view 1 see no reason to question the current interpretation of additional compensation within Old-age-part-time-work arrangements as *termination benefits* in line with IAS 19 (please refer to footnote 2 of this document). This viewpoint is further underpinned by the observation that neither the basis for conclusions nor any other part of the revised standard as issued in June 2011 provides evidence that it is the IASB's intention to pursue any such change (as an example please refer to page 19 of the 'Project Summary and Feedback Statement' where reference is made only to the recognition of *termination benefits*). Under both, IAS 19 (1998) and IAS 19 (2011) the predominant objective of Old-age-part-time-work arrangements is to terminate older employees at an earlier date than it would be possible without recourse to Old-age-part-time-work arrangements (and possibly to replace them by younger employees).

The new guidance in IAS 19.162 f. (2011) is considered to be a clarification of the above basic principle and according to which benefits are considered to be *termination benefits* in the meaning of IAS 19 if the benefit is provided for the termination of employment and not for future service to be provided. Thus, the existing understanding of *termination benefits* is not changed by IAS 19.162 f. (2011).

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Proponents of View 1 also make reference to the illustrating example in IAS 19.170 (2011) and compare it to a scenario under the Old-age-part-time-work arrangements. The incremental benefits that employees according to the example in IAS 19.170 (2011) will receive if they provide services for the full ten-months period are in exchange for additional future services provided over that period when compared to the other employees terminated immediately. Not treating these incremental benefits as *termination benefits* is in line with IAS 19 (2011) since these incremental benefits are truly paid for future services being provided. The example also perfectly illustrates the meaning of the indicator in IAS 19 162 (a) (2011) although a slightly different wording is used, i.e. "... conditional on future services ...".

In contrast, in line with an Old-age-part-time-work arrangement the employee receives higher payments (due to the additional compensation in addition to the regular pay) although the service provided is less than the employee would need to provide if the Old-age-part-time-work arrangement had not been agreed. This supports again the view, that the additional compensation is not for future (additional) services but for the fact that the employee accepts to leave the company earlier than without an Old-age-part-time-work agreement, thus it represents a *termination benefit*. Or, expressed another way, it makes clear that the additional compensation is not provided for the employee's future services and are therefore in substance not "stay bonuses" as is the case in the afore-mentioned example).

View 2 – Additional compensations (Old-age-part-time-work arrangements) are not termination benefits (IAS 19 (2011))

According to this view the additional compensation in the context of Old-age-part-time-work arrangements does not fall into the category *termination benefits*, but is normally considered to be *other long-term employee benefits* or if the given requirements are met, which in exceptional instances may be the case – *short-term employee benefits*.

This view is mainly supported as follows:

- IAS 19.162 (2011) lists two indicators according to which an employee benefit is provided in exchange for services (in contrast to: "for the termination of the employment"), and thus, the additional compensation is not a termination benefit.
- According to the first indicator (IAS 19.162 (a) (2011)) the additional compensation within an Old-age-part-time-work program is not a termination benefit, since the benefit (the additional compensation) is conditional on future service to be provided by the employee during the active service period. In this context the indicator is understood in a way, that the additional compensation must not be provided for these future services, but it is required that the employee has to provide future services, for which the employer "locks in" the employee, i.e. the payment must be independent from any future service.
- This view also gives consideration to the IASB's intention with respect to the changes in the amended IAS 19 (2011). The changes were initiated by the short-term project to converge IFRSs with US GAAP as mentioned already in the *ED Amendments to IAS 37 Provisions, Contingent Liabilities and Contingent Assets and IAS 19 Employee Benefits* issued in June 2005 (please refer to the BC with respect to the proposed changes to IAS 19).

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View 3 ó The treatment of additional compensation (Old-age-part-time-work arrangements) depends on the individual facts and circumstances

According to the third view it is argued that based on individual (pertinent) facts and circumstances either View 1 or View 2 should be followed.

Individual facts and circumstances supporting View 1 ó as examples ó could be:

- from an employment law perspective, in a specific country it may hardly be possible to lay-off employees at the age of 57 or above; therefore Old-age-part-time-work arrangements are used as a means to facilitate personnel layoffs with seniority not being a requirement to qualify for it,
- an entity internally plans to close a factory in six years and, according to the plan, at that time the employment of all of the remaining employees working at the factory shall be terminated. Simply due to cost considerations it is favorable for the entity to get older employees immediately into Old-age-part-time-work agreements, which are scheduled to be completed at the time of the factory's closure, rather than providing termination payments to them at the end of the six year's period.

Individual facts and circumstances supporting View 2 ó as examples ó could be:

- Old-age-part-time-work is offered as part of a union agreement or a company agreement and is available for more than a short period and there is more than a short period between the offer and the expected date of actual termination (please note that Old-age-part-time-work in practice normally is agreed for a period of four to six years (consisting of 2 or 3 years service period and 2 or 3 years inactive period, respectively),
- in order for an employee to qualify for the Old-age-part-time-work program, he or she must meet certain seniority requirements ó or in other words ó must be with the company for a given period of time (e.g.: before signing an Old-age-part-time-work contract ó according to a company employee benefit plan ó, the employee must be with the company for at least 10 years).

II. Current practice: diversity in practice

Based on controversial discussions observed in jurisdictions, in which Old-age-part-time-work arrangements are in use, there appear to be strong indications that significantly divergent interpretations will emerge once IAS 19 (2011) will be applied.

III. Reasons for the IFRS IC to address the issue:

a) Is the issue widespread and has it practical relevance?

Based on investigations and inquiries made, it was confirmed that the issue as described in this document is widespread and of practical relevance. Based on our investigations several European countries and a few countries in other areas will be subject to the issue.

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- b) **Does the issue involve significantly divergent interpretations (either emerging or already existing in practice)?**

As outlined above ó there are currently three views in discussion, which lead to the expectation that significantly divergent interpretations will emerge.

- c) **Would financial reporting be improved through elimination of the diversity?**

Financial reporting would greatly be improved by clarifying this issue since the magnitude of Old-age-part-time-work arrangements ó specifically if based on union agreements with far reaching impacts ó can be significant for single prepares. If divergent interpretations and practices will not be prevented, information about a reporting entity may not be compared with similar information about other entities. Therefore, an appropriate clarification would enhance comparability among companiesø financial reporting.

- d) **Is the issue sufficiently narrow in scope to be capable of interpretation within the confines of IFRSs and *Framework for the Preparation and Presentation of Financial Statements*, but not so narrow that it is inefficient to apply the interpretation process?**

We are of the opinion that the issue is sufficiently narrow in order to be addressed by the IFRS IC.

- e) **If the issue relates to current or planned IASB project, is there a pressing need for guidance sooner than would be expected from the IASB project? (The IFRS IC will not add an item to its agenda if an IASB project is expected to resolve the issue in a shorter period than the IFRS IC would require to complete its due process).**

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