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cutting through complexity

# Employee contributions

## A practical approach

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**IN THE HEADLINES**

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> “The introduction of this practical expedient will provide welcome relief for many companies from the complex accounting otherwise required.”
>
> – Lynn Pearcy
> KPMG’s global IFRS employee benefits leader

## Simpler accounting for more plans

Amendments to pension accounting finalised by the IASB on 21 November 2013 will provide some welcome relief from the potentially burdensome requirements that many companies would be applying for the first time in 2013.

However, not all companies will see the benefits of this practical expedient. The amendments are relevant only to defined benefit plans[1] that involve contributions from employees or third parties meeting certain criteria.

## What’s the issue?

The practical expedient addresses an issue that arose when amendments were made in 2011 to the previous pension accounting requirements.

Some defined benefit plans require contributions not only from the employer, but also from employees or third parties. Under previous pension accounting, contributions from employees or third parties that were linked to service were generally deducted from the service cost in the period in which they were received. They were not included in calculating the defined benefit obligation.

IAS 19 *Employee Benefits* (2011), which has been effective since 1 January 2013, required the company to:

- forecast future contributions from employees or third parties; and
- attribute those contributions to periods of service as negative benefits under the plan’s benefit formula or on a straight-line basis.

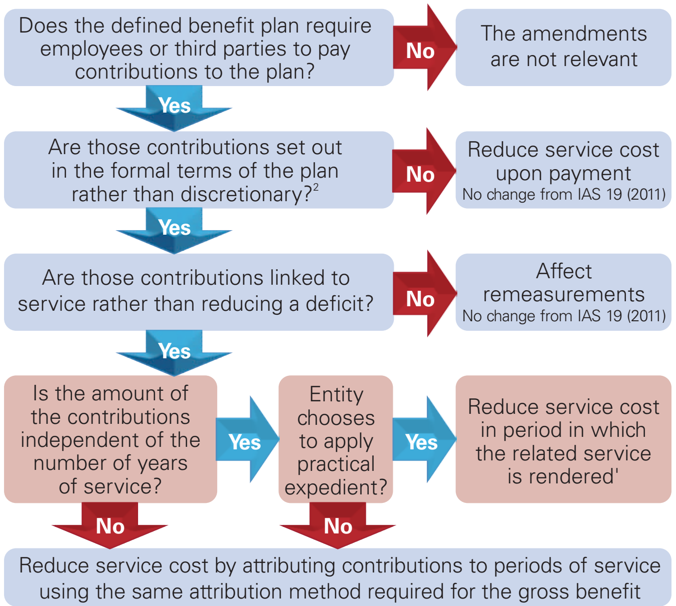
As a result, such contributions would be included when calculating net current service cost and the defined benefit obligation. For many, this would have been a significant change from previous practice, and could have required complex actuarial calculations.

## How does the practical expedient work?

The amendments introduce a relief that will reduce the complexity and burden of accounting for certain contributions from employees or third parties. Such contributions are eligible for the practical expedient if they are:

- set out in the formal terms of the plan;
- linked to service; and
- independent of the number of years of service.

When contributions are eligible for the practical expedient, a company is permitted (but not required) to recognise them as a reduction of the service cost in the period in which the related service is rendered.




Examples of contributions independent of the number of years of service include:

- contributions that are a fixed percentage of the employee’s salary;
- a fixed amount of contributions throughout the service period; and
- contributions that depend on the employee’s age.

## Clearer accounting for the rest

Companies that cannot (or decide not to) apply the practical expedient will benefit instead from a clarification. The amendments clarify how service-linked contributions from employees or third parties should be included in determining net current service cost and the defined benefit obligation. They are attributed to periods of service using the same attribution method required for the gross benefit either by using the plan’s *contribution* formula or on a straight line basis – i.e. rather than attributing them based on the net benefit.

## Effective date and transition

The amendments apply retrospectively for annual periods beginning on or after 1 July 2014. Earlier application is permitted.

## Find out more

For more information on the amendments, please speak to your usual KPMG contact or go to the IASB press release.

1 Post-employment defined benefit plans or other long-term employee defined benefit plans.

2 Or do contributions arise from a constructive obligation that goes beyond the terms of the plan?

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