INTERNATIONAL FINANCIAL REPORTING STANDARDS EMPLOYEE BENEFITS – IAS 19

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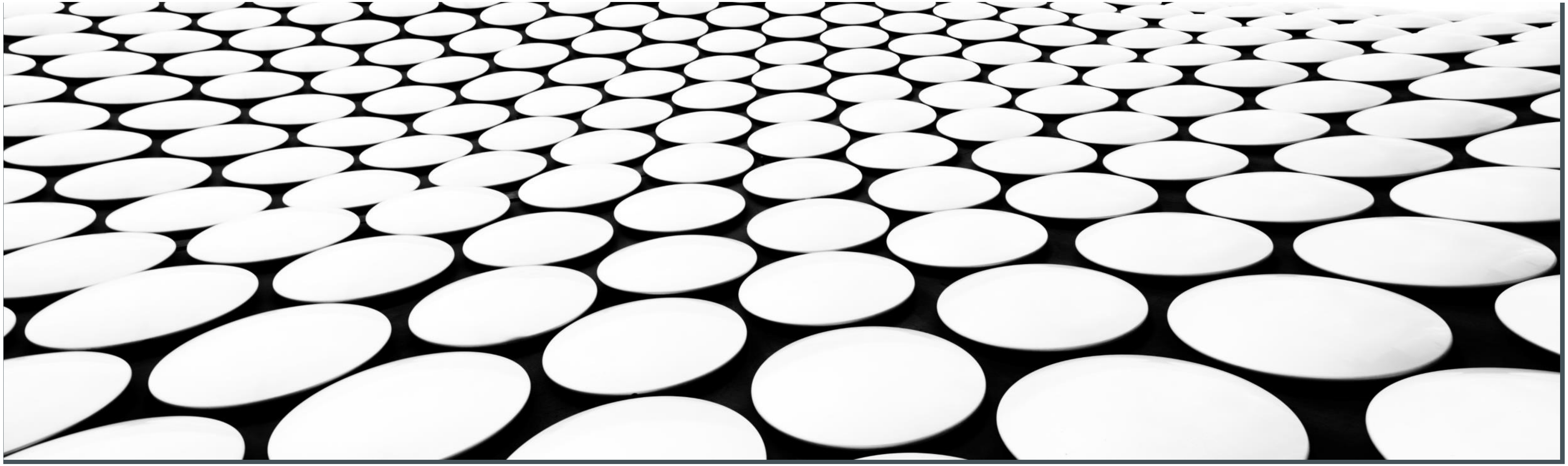


INTERNATIONAL FINANCIAL REPORTING STANDARDS
EMPLOYEE BENEFITS – IAS 19

EMPLOYEE BENEFITS – IAS 19

Learning outcomes :

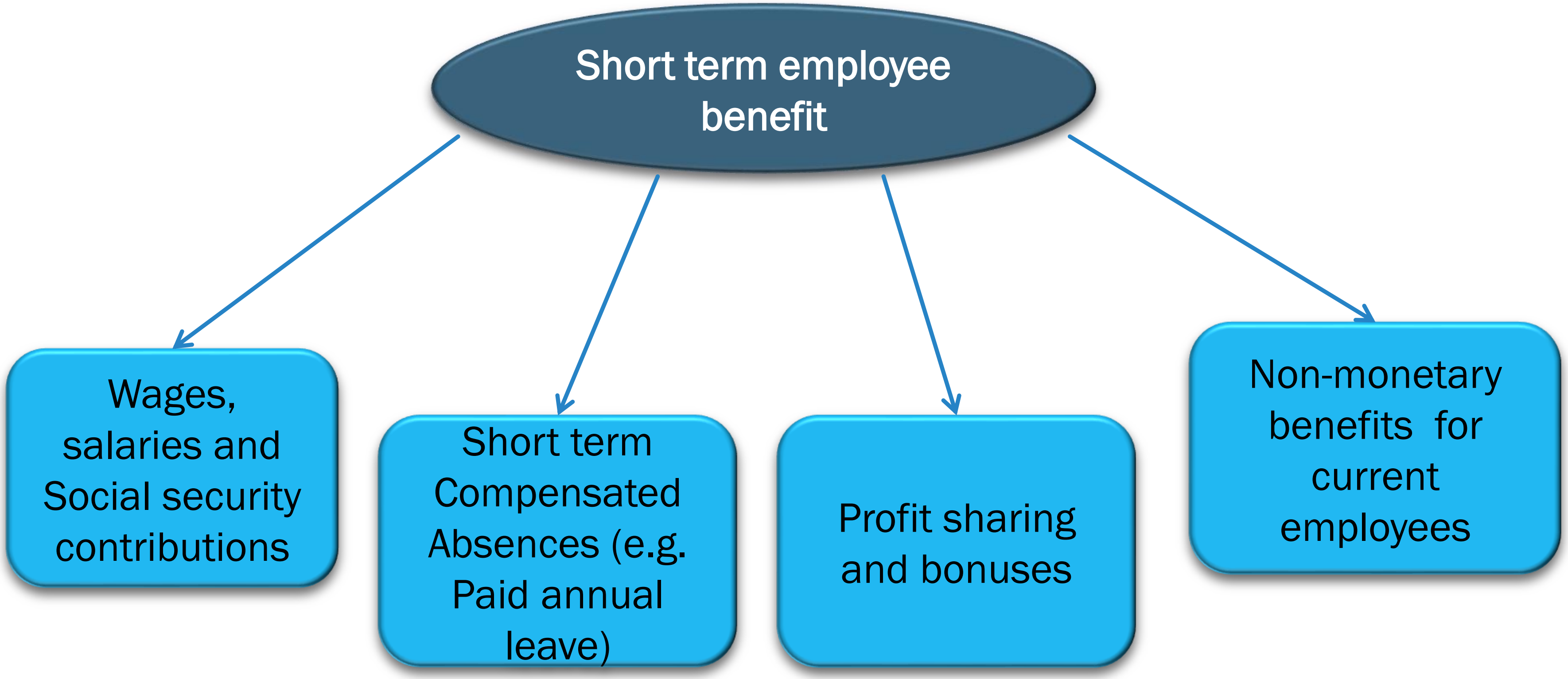
- Categories of employee benefits
- Multi employer plans
- Plan assets
- Assets held by a long term employee benefit fund
- Qualifying insurance policy

EMPLOYEE BENEFITS – IAS -19

Employee benefits are all forms of considerations given by an entity in exchange of service rendered by the employees. These are:

- ❑ Short term benefits :
- ❑ Post employment benefits:
- ❑ Other long term benefits:
- ❑ Termination benefits:

EMPLOYEE BENEFITS – IAS 19



Accounting for short-term employee benefits is generally straightforward because no actuarial assumptions are required to measure the obligation or the cost and there is no possibility of any actuarial gain or loss. Moreover, short-term employee benefit obligations are measured on an undiscounted basis.

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Short term benefits :

- Falling due within 12 months of rendering service (e.g. salaries. Bonuses, holiday pay, sick pay).

- Recongized as expenses in the period of rendering of services of the employee to the entity.

- The expected cost of compensated absences is recognized when
  - the absences occur for non-accumulating compensated absences and
  - the service is rendered increasing the employee's entitlement to benefits for accumulating compensated absence

- Profit sharing and bonus payments are recognized when the entity has a present legal or constructive obligation as a result of past events and a reliable estimate can be made of the obligation.

- Liability is recognized for unpaid short term benefits

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Post employment benefits:

- Payable after completion of employment (e.g. pension, life insurance, medical care etc)
- **Classified** into either
  - **defined contribution plans** or
  - **defined benefit plans**

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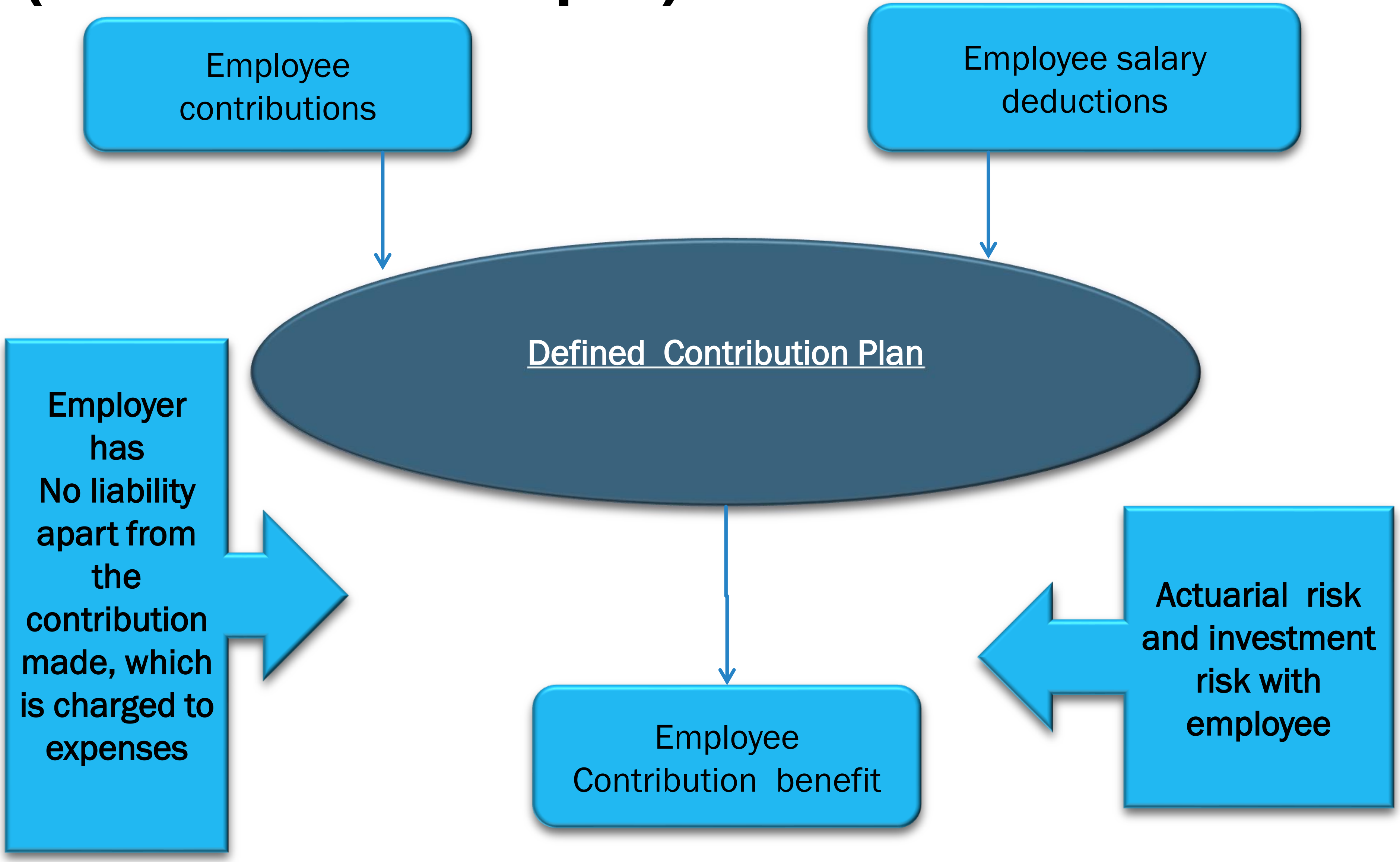
- **Defined contribution plan** are plans where an employer pays **fixed contributions** to a **separate entity** and will have no legal or constructive obligations to pay further contributions. **Contribution to defined contribution plan to be recognized as expense as the employee renders services to the entity**

- **Defined benefit plan** are plans where size of post-employment benefits is determined in advance, i.e. the benefits are defined. The employer pays contributions to the plan and the contributions are invested. The size of the contribution is set at an amount that is expected to earn enough investment returns to meet the obligation to pay the post – employment benefits.

- For a detailed benefit plan, an entity recognizes at the balance sheet date, a net defined benefit asset or liability considering the present value of the defined benefit obligations based on actuarial assumptions net of fair value of any plan assets at the balance sheet date.

EMPLOYEE BENEFITS - IAS 19 (Defined contribution plan)



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Defined Contribution Plan

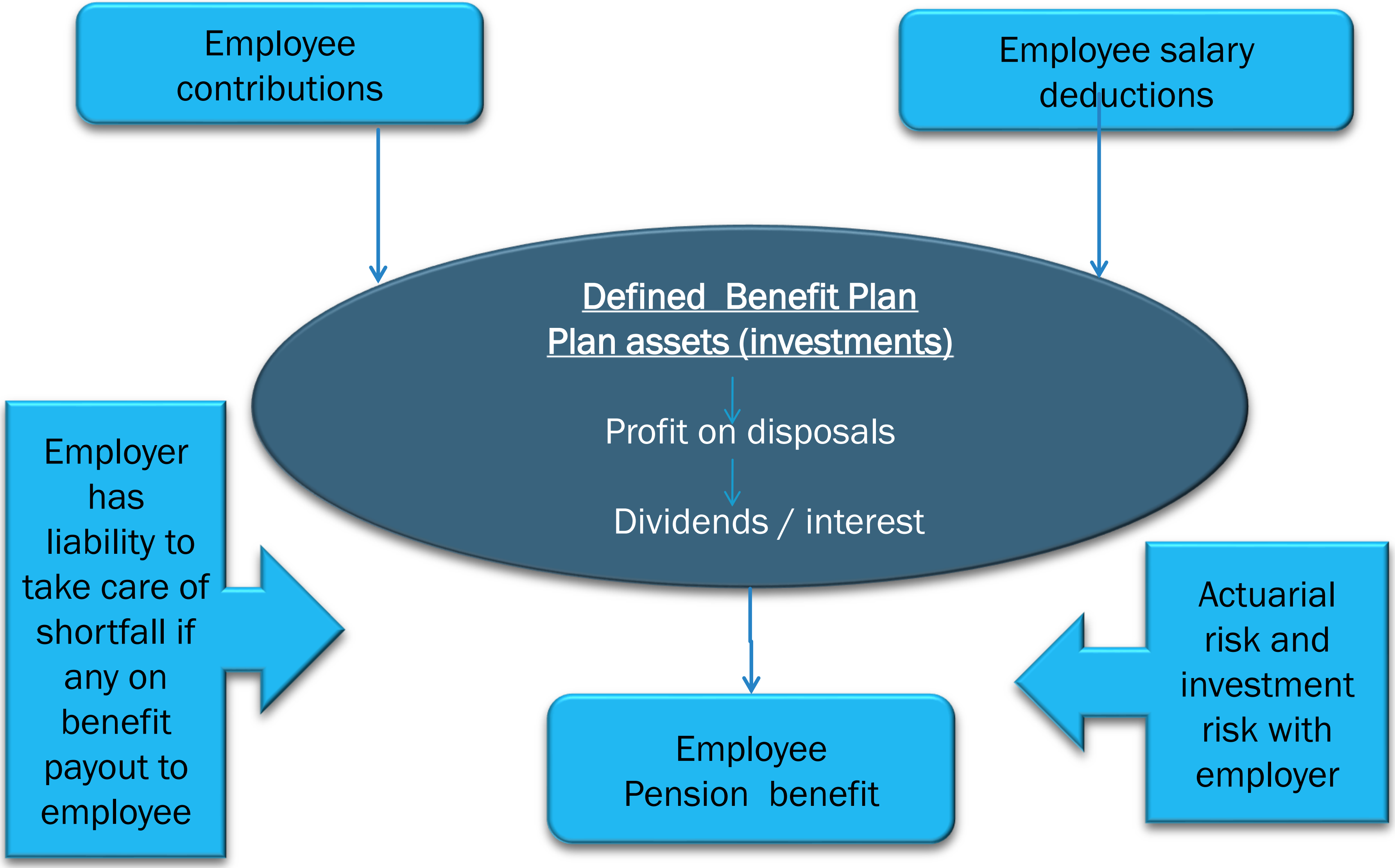
Recognition and measurement

- ❑ Contributions to a defined contribution plan should be recognized as an expense in the period they are payable (except to the extent that labour costs may be included wihin the cost of assets)
- ❑ Any liability for unpaid contributions that are due as at the end of the period should be recognized as a liability (accrued expense)
- ❑ Any excess contribution paid should be recognized as an asset (prepaid expense) but only to the extent that the prepayment will lead to e.g. a reduction in future payment of cash refund

Disclosure requirements

- A description of the plan
- The amount recognized as an expense in the period

EMPLOYEE BENEFITS – IAS 19
(Defined benefit plan)



EMPLOYEE BENEFIT – IAS 19 - Defined Benefit Plan

Recognition and measurement

a) The future benefits (arising from employee service in the current or prior years) cannot be estimated exactly, but whatever they are, the employer will have to pay them, and the liability therefore should be recognized now. To estimate these future obligations, it is necessary to use **Actuarial assumptions**

b) The obligations payable in future years should be valued, by discounting, on a present value basis. This is because the obligations may be settled in many years time.

c) If actuarial assumptions change, the amount of required contributions to the fund will change, and there may be actuarial gains or losses. Contribution to a fund in any period need to be adjusted accordingly

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Defined Benefit Plan : Six step method of accounting

Steps	Activities
Step I	Actuarial assumptions should be used to make a reliable estimate of The amount of future benefits employees have earned from service In current and previous years.
Step II	These future benefits should be attributed to service performed by Employees in the current period , and in prior periods , using Projected Unit Credit Method. This gives a total present value of Future benefit obligations arising from past and current periods of service
Step III	The fair value of any plan assets should be established
Step IV	The size of the actuarial gains or losses should be determined and The amount of these that will be recognized.
Step V	If the benefits payable under the plan have been improved, the Extra cost arising from past services should be determined
Step VI	If the benefits payable under the plan have been reduced or cancelled, the resulting gain should be determined.

EMPLOYEE BENEFITS – IAS 19: Defined Benefit Plan

Projected Unit Credit Method

a) With this method it is assumed that each period of service by an employee gives rise to an additional unit of future benefits. The present value of that unit of future benefits can be calculated and attributed to the period in which the service is given.
b) The units, each measured separately, builds up to the overall obligation.
c) The accumulated present value of (discounted) future benefits will incur interest over time and an interest expense should be recognized.

Please refer a simple example in the next slide.

EMPLOYEE BENEFITS – IAS 19 : Defined Benefit Plan

Projected Unit Credit Method – an example

An employer pays a lump sum to employees when they retire. The lump sum is equal to 1% of their salary in the final year of service , for every year of service they have given.

a) An employee is expected to work for 5 years (actuarial assumptions)
b) His salary is expected to rise by 8 % p.a. (actuarial assumption)
c) His salary in 20X1 is Rs. 10000
d) The discount rate applied is 10% p.a.

Required :

Calculate the amounts chargeable to each of the years 20X1 to 20X5 and the closing Obligation each year assuming no change in actuarial assumptions.

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Projected Unit Credit Method – an example

Since his salary in 20X1 is Rs.10,000, his salary in 20X5 is expected to be Rs.13,605 at 8%. His lumpsum entitlement is therefore expected to be Rs.136 (at 1%) for each year of service, i.e. Rs.680 in total.

Using the Projected Unit Credit Method and assuming that actuarial assumptions are unchanged between 20X1 to 20X5 , and employees do leave at the end of 20X5 the calculations are as follows:

Future benefits attributable to (Rs'000)	*20X1*	*20X2*	*20X3*	*20X4*	*20X5*
Prior years	0	136	272	408	544
Current year (1 % of salary)	136	136	136	136	136
Prior and current years total	136	272	408	544	680

The future benefit builds up to Rs.680 over five years at the end of which the employee
Is expected to leave and the benefit is payable.
This figures however are not discounted. For this please refer the next slide.

EMPLOYEES BENEFIT – IAS 19 : Defined Benefit Plan

Projected Unit Credit Method – an example

The benefit attributable to the current year should be discounted at 10% from the end
Of 20X5 :

Future benefits attributable to (Rs'000)	*20X1*	*20X2*	*20X3*	*20X4*	*20X5*
Opening obligation (note 1)	0	93	204	336	494
Interest (note 2)	0	9	20	34	50
Current service cost (note 3)	93	102	112	124	136
Closing obligation (note 4)	93	204	336	494	680

Note: To make the total add up to Rs.680 future benefit builds up to Rs.680, the interest of Rs.49.4 has been rounded off to Rs.50 in interest.

Note 1 : Opening obligation is the closing obligation of the previous period brought forward

Note 2 : Interest is charged on this opening obligation to the current year

Note 3 : The current service cost is the future obligation attributed to the current period(Rs.136)

Note 4 : The closing obligation is the total of the opening obligation brought forward, the interest charge on that amount and the current year service cost

Note 5 : The calculations above presupposes the actuarial forecasts are correct. If these are not then adjustments need to be made resulting in actuarial gain or loss.

EMPLOYEE BENEFITS – IAS 19 : Defined Benefit Plan

Re-measurement under the revised standard

- The concept of re-measurement is a new concept introduced in IAS 19 Revised which was issued in June 2011. Re-measurements of net defined liability (asset) comprise:
- Actuarial gains and losses on the defined benefit obligation
- Return on plan assets, excluding amounts included in net interest on the defined benefits liability (asset)
- Any change in the effect of the asset ceiling, excluding amounts included in net interest on the net defined benefit liability (asset).

- Asset ceiling is the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan.

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Methods of recognition of re-measurement under the revised standard

- According to IAS 19 R, actuarial gains or losses are now a part of re-measurements. Earlier IAS 19 provided three options to defer the actuarial gains or losses using the corridor method, either to SOPL or the OCI.

- The amended standard does not provide any option to recognise actuarial losses or gains in profit or loss. Effects of re-measurements are recognised in other comprehensive income and they cannot be recycled through profit or loss in the subsequent periods. Accordingly, the only treatment for re-measurements is to recognise them in other comprehensive income.

- Also in accordance with IAS 19R, the changes in the effect of the asset ceiling are presented both in profit or loss within net interest (for the interest effect on the asset ceiling) and in other comprehensive income as part of the re-measurements for the remainder.

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What is net benefit liability / asset under the revised standard

Net defined benefit liability /(asset)	Is the deficit or surplus, adjusted for any effect of limiting a net defined benefit asset to the asset ceiling. The deficit or surplus is: a) The present value of the defined benefit obligation less b) The fair value of plan assets (if any) ***IAS 19 para 8***
Treatment in SOFP	IAS 19 R stipulates that net defined benefit liability (asset) is to be recognised in the statement of financial position. The net defined benefit asset or liability is equal to the amount owed to or from a plan. This is similar to the conventional receivables or payables as we know of. The net defined benefit liability (asset) includes: a) The present value of defined benefit obligation b) Less, fair value of any plan assets (including the deficit or surplus in a defined benefit plan) adjusted for c) Any effect of limiting net defined benefit asset to the asset ceiling
Treatment in SOCI / OCI	IAS 19 R requires that entities should recognise all changes in the net defined benefit liability (asset) in the period in which those changes occur, and to disaggregate and recognise defined benefit cost as under: Service cost - SOCI Net interest on the net defined benefit liability (asset) - SOCI Re-measurements - OCI

EMPLOYEE BENEFITS – IAS 19 : Defined Benefit Plan

Recognition in Statement of Comprehensive Income

The expense that should be recognized in the income statement for post-employment benefits in a defined benefit plan is the total of the following :

A) The current service cost
B) Interest
C) Past service costs to the extent that it is recognized
D) The effect of any curtailments or settlements

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DEFINED CONTRIBUTION VS DEFINED BENEFITS

- **Defined contribution plans** are post-employment benefit plans under which an enterprise pays fixed contribution into a separate fund and will have no obligation to pay further contributions
- Under this plan actuarial risk (that benefits will be less than expected) and investment risk (that assets invested will be insufficient to meet expected benefits) fall on the employee.
- In defined contribution plans, the contribution is charged to income statement

- **Defined benefit plans** are post-employment benefit plans other than defined contribution plans
- In defined benefit plans , the actuarial and investment risk fall on the employer.
- In defined benefit plans the detailed actuarial calculation is performed to determine the charge
- The employer has the liability to make good the shortfall in employee benefit payout and also enjoy contribution holiday if there is any surplus

EMPLOYEE BENEFITS – IAS 19 : Defined Benefit Plan

Actuarial Assumptions

Demographic assumptions	Financial assumptions
• Mortality rates before and after retirement	• Discount rates to apply
• Rate of employee turnover	• Expected return on plan assets
• Early retirement	• Future salary levels (allowing for seniority and promotion as well as inflation)
• Claim rates under medical plans for former employees	• Future rate of increase in medical costs (not just inflationary cost rises but also cost specific to medical treatments - given the expectations of longer average life expectancy)

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- **Other long term benefits:** not payable wthin 12 months (long service leave etc)
  - An entity recognizes a liability for other long term benefits equal to the present value of the defined benefit obligation, minus the fair value of any plan assets at the balance sheet date.
  - Recognize immediately any actuarial gains or losses or past service costs as income or expense.

- **Termination benefits:** payable when an employee's contract is terminated either voluntarily or involuntarily (e.g. voluntary retirement, redundancy pay)
  - An entity recognizes the liability and an expense for termination benefits when it is explicitly committed to either
    a) provide termination benefits as a result of an offer made in order to encourage voluntary redundancy or
    b) terminate the employment of employees before the normal retirement date

IAS 19 provides certain disclosures on employee benefits

EMPLOYEE BENEFITS – IAS 19

Other Definitions

- *Multi-employer plans **are defined contribution plans (other than state plans) or defined benefit plans (other than state plans) that:***
  (a) pool the assets contributed by various entities that are not under common control; and
  (b) use those assets to provide benefits to employees of more than one entity, on the basis that contribution and benefit levels are determined without regard to the identity of the entity that employs the employees concerned.
- *Plan assets **comprise:***
  (a) assets held by a long-term employee benefit fund; and
  (b) qualifying insurance policies.
- *Fair value **is the amount for which an asset could be exchanged or a liability settled between knowledgeable, willing parties in an arm's length transaction***

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Other Definitions

- *Assets held by a long-term employee benefit fund* ***are assets (other than non-transferable financial instruments issued by the reporting entity) that:***

(a) are held by an entity (a fund) that is legally separate from the reporting entity and exists solely to pay or fund employee benefits; and

(b) are available to be used only to pay or fund employee benefits, are not available to the reporting entity's own creditors (even in bankruptcy), and cannot be returned to the reporting entity, unless either:

(i) the remaining assets of the fund are sufficient to meet all the related employee benefit obligations of the plan or the reporting entity; or

(ii) the assets are returned to the reporting entity to reimburse it for employee benefits already paid.

EMPLOYEE BENEFITS – IAS 19

Other Definitions

- *A qualifying insurance policy* ***is an insurance policy* issued by an insurer that is not a related party (as defined in Ind AS 24 Related Party Disclosures) of the reporting entity, if the proceeds of the policy:***

  (a) can be used only to pay or fund employee benefits under a defined benefit plan; and

  (b) are not available to the reporting entity's own creditors (even in bankruptcy) and cannot be paid to the reporting entity, unless either:

    (i)the proceeds represent surplus assets that are not needed for the policy to meet all the related employee benefit obligations; or

    (ii)the proceeds are returned to the reporting entity to reimburse it for employee benefits already paid.

Illustration I (Accumulated cost of compensated absence)

- An entity has 100 employees, who are each entitled to five working days of paid sick leave for each year. Unused sick leave may be carried forward for one calendar year. Sick leave is taken first out of the current year's entitlement and then out of any balance brought forward from the previous year (a LIFO basis). At 30 December 20X1, the average unused entitlement is two days per employee. The entity expects, based on past experience which is expected to continue, that 92 employees will take no more than five days of paid sick leave in 20X2 and that the remaining eight employees will take an average of six and a half days each.

- **Solution**

The entity expects that it will pay an additional 12 days of sick pay as a result of the unused entitlement that has accumulated at 31 December 20X1 (one and a half days each, for eight employees). Therefore, the entity recognises a liability equal to 12 days of sick pay.

Illustration II – Profit sharing and bonus plan

A profit-sharing plan requires an entity to pay a specified proportion of its profit for the year to employees who serve throughout the year. If no employees leave during the year, the total profit-sharing payments for the year will be 3% of profit. The entity estimates that staff turnover will reduce the payments to 2.5% of profit.

The entity recognises a liability and an expense of 2.5% of profit.

Illustration III – Multi employer plan

An entity participates in a multi-employer defined benefit plan that does not prepare plan valuations on an IAS 19 basis. It therefore accounts for the plan as if it were a defined contribution plan. A non-IAS 19 funding valuation shows a deficit of Rs100 million in the plan. The plan has agreed under contract a schedule of contributions with the participating employers in the plan that will eliminate the deficit over the next five years. The entity's total contributions under the contract are Rs 8 million.

The entity recognises a liability for the contributions adjusted for the time value of money and an equal expense in profit or loss.

THANK YOU!