EMPLOYEE BENEFITS
WITH SPECIAL REFERENCE TO RETIREMENT BENEFITS
OVERVIEW

• Two International Accounting Standards (IASs) apply
  
  • The primary one is *IAS 19: Employee Benefits*
  
  • The second is *IAS 26: Accounting and Reporting by Retirement Benefit Plans*
UNDERLYING PHILOSOPHY

• The effect of transactions will be recognized
  • when the transaction occurs
  • rather than when the effect materialises
SHORT-TERM BENEFITS

• Wages, Salaries and Social Security Contributions
  • including allowances settled in cash
• Short-term Compensated Absences
  • e.g., paid annual leave and sick leave
• Non-monetary Benefits
  • e.g., medical care, housing, equipment
LONG-TERM BENEFITS

- Long-service or Sabbatical Leave
- Jubilee or other Long-service Benefit payments
- Long-term Disability Benefits
- Liability will be actuarially assessed.
POST-EMPLOYMENT BENEFITS

• Retirement benefits

• Other post-employment benefits (e.g., medical care, housing)

• Standards are applicable whether or not there is a separate entity or trustees or whether the plan is operated by the entity itself
TYPES OF RETIREMENT BENEFIT PLAN

• Two types, depending on how the benefits are calculated:
  • If the benefit is paid according to the value of the fund – Defined Contribution Plan (DC)
  • If the benefit is independent of the value of the fund, but based on other parameters – Defined Benefit Plan (DB)
DC PLAN LIABILITIES

- Liability is limited to the agreed contributions
  - The actuarial risk and the investment risk fall on the employee

- Employers might incur additional liabilities
  - (even if inadvertently by a practice that creates an expectation by the employees)
DC PLAN LIABILITIES

- The employer recognizes the contributions due in the accounting period as the cost for the period
DB PLAN LIABILITIES

• Liability is to pay benefits at a defined level
  • The actuarial risk and the investment risk fall on the employer
  • The employer recognizes the liability to pay benefits based on the employees’ service already provided
FUNDING OF DB PLANS

• If the employer pays benefits out of current operations – Unfunded Plan

• If the employer pays into a separate fund, from which benefits are paid – Funded Plan
FUNDING OF DB PLANS

• A plan is said to be fully funded when the value of fund assets is sufficient to cover the present value of future benefits already earned

• This value is referred to in the standards as the actuarial present value (APV)
ACCOUNTING FOR DB PLAN LIABILITIES

• For an unfunded plan, the employer recognizes the APV as a liability

• For a funded plan, the employer recognizes the difference between the value of plan assets and the APV
CALCULATION OF APV

- Accounting Standard IAS 19 sets out how the APV is to be measured
- It encourages employers to engage the services of an actuary
CALCULATION OF APV

• In the pension plan itself the periodical use of an actuary is needed (*according to IAS 26*) to

  • assess the plan’s financial condition,

  • review the assumptions on which the liability is calculated and

  • recommend future contributions to the plan
CALCULATION OF APV

• In a pension plan the actuarial valuation is usually undertaken on a cycle (usually three years)

• In the employer’s annual financial statements this valuation must be updated.
CALCULATION OF APV

• IAS 19 refers to the method of calculation as the Projected Unit Credit Method
CALCULATION OF APV

• Calculate the payments to be made in future, by reference to the promise made to employees and their life expectancy
• Calculate the proportion of these benefits already earned by service to date
• Discount this liability to its present value
The liability is subject to many assumptions:

Demographic, for example:
- Mortality rates
- Employee turnover & early retirement
- Proportion of employees leaving service before vesting
- Claim rates under any medical benefit offered
CALCULATION OF APV

• Financial, for example:
  • The discount rate to be applied
  • Future salary increases
  • Future changes in contributions from third parties (e.g., state benefits)
  • Future increases in medical costs (where medical benefit is offered)

• Assumptions must be unbiased and mutually compatible
LIABILITY RECOGNISED IN THE FINANCIAL STATEMENTS

• In the Statement of Financial Position:
  • The surplus or deficit
    • (or the APV in the case of an unfunded plan)
LIABILITY RECOGNISED IN THE FINANCIAL STATEMENTS

• In the Statement of Financial Activity:
  • Current service cost
  • Past service cost
  • Net interest
  • Re-measurements
    • E.g., Actuarial gains and losses, and Return on plan assets
<table>
<thead>
<tr>
<th>Item</th>
<th>Increase/decrease in liability resulting from</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current service cost</td>
<td>Employee service during the period</td>
</tr>
<tr>
<td>Past service cost</td>
<td>Plan amendments</td>
</tr>
<tr>
<td>Net interest</td>
<td>Interest on opening deficit/surplus</td>
</tr>
<tr>
<td>Actuarial gains/loss</td>
<td>Changes in assumptions/Experience</td>
</tr>
<tr>
<td>Return on plan assets</td>
<td>Total investment return, less investment costs, less the interest included above</td>
</tr>
</tbody>
</table>
DISCLOSURES IN THE FINANCIAL STATEMENTS

• Classification of changes in Statement of Financial Position:
  
  • Current and past service cost are recognized “in profit or loss” – probably as employment cost in accordance with IAS 1
  
  • Net interest is also recognized “in profit or loss” – probably as cost of finance in accordance with IAS 1
  
  • Re-measurements are recognized in “other comprehensive income” – capital income/expense in the SDAAM model
DISCLOSURES IN THE FINANCIAL STATEMENTS

• Should identify and explain the amounts in the financial statements, and

• Describe how the plan might affect the future cash flows of the entity
DISCLOSURES IN THE FINANCIAL STATEMENTS

• Should include a narrative report disclosing the plan’s characteristics:
  • Nature of the benefits
  • Regulatory framework
  • Responsibilities of governing body
  • Risks to which the entity is exposed
  • Summary of plan amendments
DISCLOSURES IN THE FINANCIAL STATEMENTS

• Other disclosures:
  • Reconciliation of opening and closing surplus/deficit
  • Analysis of investments
  • Significant actuarial assumptions
  • A sensitivity analysis of the effect of changes in the assumptions
  • Description of funding arrangements, and expected contributions for the next period
TYPES OF DB PLAN

• Single-employer plans
• Group administration plans
• Multi-employer plans
• “Commonly-controlled entities” plans
TYPES OF DB PLAN

- Single-employer plans
  - One employer, one plan
  - No other employers involved
- Disclosures as already discussed
TYPES OF DB PLAN

• Group administration plans
  • The plan is an aggregate of single-employer plans to allow a pooling of resources for investment purposes

• Each employer recognizes and discloses its part of the plan as a single employer
TYPES OF DB PLAN

• Multi-employers plans
  • Plans in which two or more employers have pooled their resources
  • Contribution and benefit levels are not related to the identity of the employers

• State plans are multi-employer plans
TYPES OF DB PLAN

• Multi-employers plans
  • Each employer accounts for its proportionate share
  • Disclosures as for a single-employer plan
  • If sufficient information is not available
    • Account for the plan as though it were a DC plan, with additional disclosures
TYPES OF DB PLAN

• “Commonly-controlled entities” plans
  • Plans in which two or more employers have pooled their resources
  • Risk is shared between employers
  • Information for the whole plan is presumed to be available
TYPES OF DB PLAN

• “Commonly-controlled entities” plans
  
  • If there is a policy, or agreement, whereby the DB cost is charged to each employer:
  • each employer accounts for its allocated share as for a single-employer plan
  
  • If there is no policy or agreement: the sponsoring employer recognizes the whole plan, and other employers recognize a cost equal to its contributions
EMPLOYEE BENEFITS

• You decide:
  • How will you account for employee benefits
  • Whether your retirement plan is DC or DB
  • What type of plan are you operating
  • Who will do the work to prepare the disclosures
ACCOUNTING FOR EMPLOYEE BENEFITS

• The one who does what is right is righteous (1 John 3:7)