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*
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
CALCULATION OF APV

• 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

• 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

LIABILITY RECOGNISED IN THE FINANCIAL STATEMENTS

<table>
<thead>
<tr>
<th>Item</th>
<th>Increase/decrease in liability resulting from</th>
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<tbody>
<tr>
<td>Current service cost</td>
<td>Employee service during the period</td>
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<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>
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<tr>
<td>Return on plan assets</td>
<td>Total investment return, less investment costs and less the interest included above</td>
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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
<table>
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<td>• One employer, one plan</td>
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<td>• No other employers involved</td>
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<td>• The plan is an aggregate of single-employer plans to allow a pooling of resources for investment purposes</td>
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<tr>
<td>• Each employer recognizes and discloses its part of the plan as a single employer</td>
</tr>
</tbody>
</table>
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)