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

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

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 Retirn on plan assests

LIABILITY RECOGNISED IN THE FINANCIAL STATEMENTS

Item	**Increase/decrease in liability resulting from**
Current service cost	Employee service during the period
Past service cost	Plan amendments
Net interest	Interest on opening deficit/surplus
Actuarial gains/loss	Changes in assumptions/Experience
Return on plan assets	Total investment return, less investment costs and less the interest included above

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)