Employee Benefits (IAS 19)

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Employee Benefits

- In 1983, IAS 19 was titled as "Accounting for Retirement Benefits in Financial Statements of Employers"
- In 1993, IAS 19 was titled as "Retirement Benefit Costs"
- In 1998, it was titled as "Employee Benefits"

Objectives of IAS 19

- IAS 19 *Employee Benefits* prescribes the accounting and disclosure by employers for employee benefits.

- The Standard requires an entity to recognize:

  (a) **A Liability:** A liability when an employee has provided service in exchange for employee benefits to be paid in the future; and

  (b) **An Expense:** An expense when the entity consumes the economic benefit arising from service provided by an employee in exchange for employee benefits.

Scope of IAS 19

The scope is broad and includes wages, vacation or holiday pay, bonus, termination benefits, etc. as well as retirement plans

Covers full-time, part-time, temporary staff and directors

Basic Principle of IAS 19

- The cost of providing employee benefits should be recognized in the period in which the benefit is earned by the employee, rather than when it is paid or payable.

IAS 19 – Employee Benefits -

- The Standard identifies following categories of employee benefits to be covered
  - Short term employee benefits
  - Post-employment benefits
  - Other long term employee benefits
  - Termination benefits
- It covers formal plans, state plans, constructive obligation (informal practices)

The Standard Does not apply to

- This standard does not apply to benefits which needs to cover under the IFRS2 share-based payment
- This Standard does not deal with reporting by employee benefit plans (covered under IAS 26) e.g. accounting and reporting by trust plans

Revised IAS 19

- The IASB had published a revised version of IAS 19 Employee Benefits on 16th June 2011.
- The revised standard will be applicable for reporting period starting on or after 1st January 2013

Highlights of Revised IAS 19

- Revised IAS 19 requires full recognition of deficit or surplus (actuarial gains and losses) to be fully recognized on the balance sheet date.
- Under the revised standard the net interest income is included is introduced as the equivalent of expected return on plan assets under IAS 19.
- The defined benefit cost under the revised standard comprises of service cost, net interest and remeasurements.
- A very extensive disclosure requirements are put forth under the revised standard especially those relating to characteristics, risk and the presented figures in the financial statements regarding defined benefit plans

The Revision impact on Companies

- The “corridor approach” being removed
- Assumption for the expected return on assets eliminated
- Immediate recognition of the plan based amendments in the Profit or Loss account
- Increased requirements on disclosure of information
- Removal of recognition of gains or losses in the profit or loss account
- Application of mark-to market approach and ‘ceiling tests’ on plan based assets

Revised Goal of Companies after Revision

- Multinational companies with multiple pension funds should definitely increase their efforts to manage the risk of their pension funds.
- Listing of the most important local pension funds and stakeholders
- Evaluating the impact of the changed IAS 19 for your pensions
- Looking at the possible IAS 19 proof solutions

Revised Goal of Companies after Revision

- Fix the corporate pension budget and redesign pension benefits within that budget
- Set up pension ambitions and acceptable levels of risk
- Fix a timeframe for derisking (if desired).
- Initiate communications programme to support the employer and employees
- Given that pension risks have become more obvious, companies are no longer rewarded with lower pension expenses resulting in increased risk

Type of Employee Benefit Plans

- **Defined Benefit** : Some formula/Monetary promise.
- **Defined Contribution** : Just contribution defined no promise of benefit.

Type of Employee Benefit Plans

- **Hybrid Plans** : Where employer's obligation is not limited to contributions to the fund but has legal or constructive obligation such as
  - Scheme having benefit formula that is not linked solely with accumulation (hybrid schemes)
  - Scheme providing guarantee, either indirectly through a plan or directly, of a specified return on contributions

Termination Benefits

- Termination benefits are employee benefits payable as a result of
  - Employer's decision to terminate an employee's employment
  - Employee's decision to accept voluntary redundancy in exchange for those benefits

Termination Benefits

- An entity is committed to a termination when, and only when, the entity has a detailed formal plan (with specified minimum contents) for the termination and is without realistic possibility of withdrawal.
- Where termination benefits fall due more than 12 months after the balance sheet date, they should be discounted.
- In the case of an offer made to encourage voluntary redundancy, the measurement of termination benefits should be based on the number of employees expected to accept the offer

Multi Employer Plans

- Where it is defined benefit plan and information is available, account and disclose proportionate share as though it were defined benefit plan of reporting entity
- If information is not available, account for it as though it were a defined contribution plan

Defined Contribution Plan - DCP

Defined Contribution Plan

- Employer pays fixed contribution to an external fund (usually % of salary).
- Employer's obligation is discharged upon payment of the contribution.
- Members benefits depend upon performance of the fund over time.
- Employees run the risk of investment

DCP – Financial Statement

- Income statement:
  - Record contribution as expense in Income Statement
- Balance sheet:
  - No impact on balance sheet other than outstanding contributions payable to the investment funds.

Example of Defined Contribution

- A Company agrees to pay 8% of an employee's salary into a third party fund.
- The company pays Rs10,000 pa for each employee into a third party fund following each year of service.
- Contribution is fixed
- The obligation on part of the employer ceases on payment of contribution

Defined Benefit Plan - DBP

Defined Benefit Plan

- Expected Future Payments are required to settle the benefits
- An Actuary calculates the Obligation
- The obligation can be arrived at
  - Based on the Service and current Salary levels
  - Based on the Service and future Salary levels
  - Based not on the future employee services

Defined Benefit Schemes

- It may be monthly pension or lump sum
- Calculated based on the salary and years of service
- Pay is Final Pay or Average Pay
- The actuary calculates the liability
- Company bears the risk of meeting the future obligation

Example of Defined Benefit

- The company agrees to pay 6% of their final salary for each year of service or
- The company agrees to provide a lump sum amount, amounting to 5 times of the final salary

Where any scheme does not fall within the rules of Defined Contribution it automatically falls under Defined Benefit

Arriving at DBP Liability

- The defined benefit obligation (DBO) recognized in the balance sheet is:
  - Present value of DBO
  - Plus actuarial gains not yet recognized
  - Less actuarial losses not yet recognized
  - Less past services costs not yest recognized
  - Less fair value of plan assets

Accounting for Defined Benefit Plan

Valuation of Benefits

- Actuarial mathematics is typically used and it is specified by IAS 19 (Para 50(a))
- It deals with – how liabilities should be apportioned in respect of “earned” and “unearned” service
- It also deals with calculation of cost pertaining to accrual of benefits in the plan over the most recent accounting period
- Actuarial funding method known as “projected unit method” is prescribed by IAS 19

Actuarial Gains & Losses Recognized Immediately under revised IAS 19

- Immediate Recognition of all Plans in the Statement of recognized income & expense.

Funding of Pension Plans

Funding of Pension Plans

- Contribution of Assets to a legal entity separate from that of the Employer
- The Legal Entity being a Trust
- Value of Assets < or> Value of Liability
- The scheme is funded in surplus if Assets are more
- The scheme is funded in deficit if Liabilities are more

Pension Plans with no Funding

- A very less secure Plan
- Company Funds are used to pay the Pension Plans
- There is no question setting aside of assets for payment of pension liabilities

Actuarial Assumptions

Actuarial Valuation Assumptions

- Financial Assumptions
- Demographic Assumptions

How assumptions are arrived at?

- Set by the Employer with advise from a actuary or auditor
- Estimate that are compatible
- Market expectation as at the balance sheet date

Financial Assumptions

- Discount Rate
- Salary Rate Hikes
- Expected Return on Assets (EROA)

Demographic Assumptions

- Mortality, Morbidity, Turnover, retirement rates
- Vary by age, seniority
- Turnover within first 5 years (Vesting) reduces gratuity liability
- Turnover after first 5 years (Vesting) may increase gratuity liability

Effects of changes in actuarial assumptions

Assumption	Increase	Decrease
Discount rate	Liab would decrease and leads to actuarial gain	Liab would increase and leads to actuarial loss
Salary Increase Rate	Liab would increase and leads to actuarial loss	Liab would decrease and will lead to actuarial gain
Expected long-term rate of return	High expected return results in low pension cost	Low expected return results in high pension cost

Asset Ceiling Test

Asset Ceiling Test (ACT)

- The amount of Net Asset (NA) is limited to the ACT
- The NA is limited to
  - Amt available in the form of refunds or reductions in contributions
  - + unrecognized actuarial losses
  - +unrecognized past service cost

Why ACT?

- To prevent gains to be recognized solely as a result of the deferred recognition of past service cost and actuarial losses
- Issue arises when an entity defers recognition of actuarial losses or past service cost. Results in the entity recognizing increased asset

Disclosure Requirements

Disclosure under IAS 19

IAS 19 requires company to disclose:

- Positions of liabilities and assets
- Key assumptions used to calculate these figures.
- Explanations for the movement in balances
- P&L expense recognized in the period
- Material "one-off" transactions
- Analysis of funded/ unfunded balances
- Sensitivity information about medical cost trend rates
- Five year history of experience adjustments on DBO and on plan assets

About the Author

- *CA. Rajkumar S Adukia is an eminent business consultant, academician, writer, and speaker. He is the senior partner of Adukia & Associates.*
- *In addition to being a Chartered Accountant, Company Secretary, Cost Accountant, MBA, Dip IFR (UK), Mr. Adukia also holds a Degree in Law and Diploma in Labor Laws and IPR.*
- *Mr. Adukia, a rank holder from Bombay University completed the Chartered Accountancy examination with 1st Rank in Inter CA & 6th Rank in Final CA, and 3rd Rank in Final Cost Accountancy Course in 1983.*
- *He started his practice as a Chartered Accountant on 1st July 1983, in the three decades following which he left no stone unturned, be it academic expertise or professional development.*

About the Author

- *He has been coordinating with various Professional Institutions, Associations, Universities, University Grants Commission and other Educational Institutions.*
- *Authored more than 50 books on a vast range of topics including Internal Audit, Bank Audit, SEZ, CARO, PMLA, Anti-dumping, Income Tax Search, Survey and Seizure, IFRS, LLP, Labour Laws, Real estate, ERM, Inbound and Outbound Investments, Green Audit etc.*
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