IAS 19-Employee Benefits

1-Introduction

In April 2001 the International Accounting Standards Board (Board) adopted IAS 19 Employee Benefits, which had originally been issued by the International Accounting Standards Committee in February 1998. IAS 19 Employee Benefits replaced IAS 19 Accounting for Retirement Benefits in the Financial Statements of Employers (issued in January 1983). IAS 19 was further amended in 1993 and renamed as IAS 19 Retirement Benefit Costs.

The Board amended the accounting for multi-employer plans and group plans in December 2004. In June 2011 the Board revised IAS 19; this included eliminating an option that allowed an entity to defer the recognition of changes in net defined benefit liability and amending some of the disclosure requirements for defined benefit plans and multi-employer plans.

In November 2013 IAS 19 was amended by Defined Benefit Plans: Employee Contributions (Amendments to IAS 19). The amendments simplified the requirements for contributions from employees or third parties to a defined benefit plan, when those contributions are applied to a simple contributory plan that is linked to service.

2-Objective :

The objective of IAS 19 is to prescribe the accounting and disclosure for employee benefits, requiring an entity to recognise a liability where an employee has provided service and an expense when the entity consumes the economic benefits of employee service.

3-Scope:

IAS 19 applies to (among other kinds of employee benefits):

-wages and salaries
-compensated absences (paid vacation and sick leave)
-profit sharing and bonuses
-medical and life insurance benefits during employment
non-monetary benefits such as houses, cars, and free or subsidised goods or services
-retirement benefits, including pensions and lump sum payments
-post-employment medical and life insurance benefits

-long-service or sabbatical leave
'jubilee' benefits
-deferred compensation programmes
-termination benefits.

4-Definitions

Multiemployer plan. Either a defined contribution or a defined benefit plan that pools the assets contributed by various companies that are not under common control and uses those assets to provide benefits to employees of more than one entity.
Present value of a defined benefit obligation. The present value before deducting any plan assets or any expected payments required to settle the obligation that has occurred as a result of the service of employees in the current and previous periods.
Current service cost. The increase in the present value of the defined benefit obligation that occurs as a result of employee service in the current period.
Interest cost. The increase in the period in the present value of the defined benefit obligation that arises because the benefits payable are one year closer to the settlement of the scheme.
Plan assets. Those assets held by the employee benefit fund, including any qualifying insurance policies.
Return on plan assets. The interest, dividends, and any other income that is derived from the plan assets together with any realized or unrealized gains or losses on those assets less the cost of administering the plan and any tax payable by the plan.
Actuarial gains and losses. Experience adjustments and the effects of any changes in actuarial assumptions. Experience adjustments are differences between the previous actuarial assumptions and what has actually happened.
Past service cost. The increased present value of a defined benefit obligation for employee service in previous periods that has arisen because of the introduction of changes to the benefits payable to employees. Past service costs may be positive or negative depending on whether the benefits are improved or reduced.

5-Short- term Employee Benefits

Short-term employee benefits are those expected to be settled wholly before twelve months after the end of the annual reporting period during which employee services are rendered, but do not include termination benefits.[IAS 19(2011).8] .

Examples include wages, salaries, profit-sharing and bonuses and non-monetary benefits paid to current employees.
The undiscounted amount of the benefits expected to be paid in respect of service rendered by employees in an accounting period is recognised in that period.

The expected cost of short-term compensated absences is recognised as the employees render service that increases their entitlement or, in the case of non-ac-cumulating absences, when the absences occur, and includes any additional amounts an entity expects to pay as a result of unused entitlements at the end of the period.

5.1-Recognition and measurement

5.2-Disclosure

6-Post-employment benefits classification:

In defined contribution plans, an entity pays a fixed contribution into a separate entity (fund) and will have no legal or constructive obligation to pay further contributions if the fund does not have sufficient assets to pay employee benefits relating to employee service in the current and prior periods. An entity should recognize contributions to a defined contribution plan where an employee has rendered service in exchange for those contributions.

All other postemployment benefit plans are classified as defined benefit plans. Defined benefit plans can be unfunded, partly funded, or wholly funded.

6.**1 –Accounting for Defined Contribution plans:**

The accounting for a defined-contribution scheme is relatively straightforward, as the employer's obligation for each period is determined by the amount that has to be contributed to the scheme for that period. There are no actuarial assumptions required to measure the obligation or expense and there are no actuarial expenses or losses

Moreover, the obligations are measured on an undiscounted basis, except where they are not expected to be settled wholly before twelve months after the end of the annual reporting period in which the employees render the related service.

EX1-According to the pension plan of an entity, the employees and entity contribute 5% of the employee's salary to the plan, and the employee is guaranteed a return of the contributions plus 3% a year by the employer.

Required

What classification would be given to the above pension scheme?

Solution

It is a defined benefit plan, as the employer has guaranteed a fixed rate of return and therefore carries the
risk.

1-Recognition and measurement: When an employee has rendered service to an entity during a period, the entity shall recognise the contribution payable to a defined contribution plan in exchange for that service:

(a) as a liability (accrued expense), after deducting any contribution already paid. If the contribution already paid exceeds the contribution due for service before the end of the reporting period, an entity shall recognise that excess as an asset (prepaid expense) to the extent that the prepayment will lead to, for example, a reduction in future payments or a cash refund.

(**b**) as an expense, unless another IFRS requires or permits the inclusion of the contribution in the cost of an asset (see, for example, IAS 2 and IAS 16).

When contributions to a defined contribution plan are not expected to be settled wholly before twelve months after the end of the annual reporting period in which the employees render the related service, they shall be discounted using the discount rate.

2-Disclosure: An entity shall disclose the amount recognised as an expense for defined contribution plans. Where required by IAS 24 an entity discloses information about contributions to defined contribution plans for key management personnel.

6.2- Accounting for Defined benefit plans:

Accounting for defined benefit plans is complex because actuarial assumptions are required to measure the obligation and the expense and there is a possibility of actuarial gains and losses. Moreover, the obligations are measured on a discounted basis because they may be settled many years after the employees render the related service.

-The obligation of an employer under a defined benefit plan is to provide an agreed amount of benefits to current and former employees in the future. Benefits may be in the form of cash payments or could be in-kind in terms of medical or other benefits.
-Normally benefits will be based on age, length of service, and wage and salary levels. Pensions and other long-term benefits plans are basically measured in the same way. Actuarial gains and losses of long-term benefits plans other than pensions are reported immediately in net income.
- The defined benefit plan can be unfunded, partially funded, or wholly funded by the employer. The employer contributes to a separate entity or fund that is legally separate from the reporting entity.
- This fund then pays the benefits. The payment of benefits depends on the fund's financial position and the performance of its investments.
- However, the payment of benefits will also depend on the employer's ability to pay and to make good any shortfall in the fund. The employer is essentially guaranteeing the fund's investment and actuarial risk.
- Accounting for defined benefit plans is more complex because actuarial assumptions are needed to determine the obligation and the expenses. Often the actual results differ from those determined under the actuarial valuation method. The difference between these results creates actuarial gains and losses.
- Discounting is used because the obligations often will be settled several years after the employee gives the service. Usually actuaries are employed to calculate the defined benefit obligation and also the current and past service costs.
1-Recognition and Measurement: Accounting by an entity for defined benefit plans involves the following steps:

(a) determining the deficit or surplus. This involves:

(i) using an actuarial technique, the projected unit credit method, to make a reliable estimate of the ultimate cost to the entity of the benefit that employees have earned in return for their service in the current and prior periods (see paragraphs 67–69). This requires an entity to determine how much benefit is attributable to the current and prior periods (see paragraphs 70–74) and to make estimates (actuarial assumptions) about demographic variables (such as employee turnover and mortality) and financial variables (such as future increases in salaries and medical costs) that will affect the cost of the benefit (see paragraphs 75–98).

(ii) discounting that benefit in order to determine the present value of the defined benefit obligation and the current service cost (see paragraphs 67–69 and 83–86).

(iii) deducting the fair value of any plan assets (see paragraphs 113–115) from the present value of the defined benefit obligation.

(b) determining the amount of the net defined benefit liability (asset) as the amount of the deficit or surplus determined in (a), adjusted for any effect of limiting a net defined benefit asset to the asset ceiling (see paragraph 64).

(c) determining amounts to be recognised in profit or loss:

(i) current service cost .

(ii) any past service cost and gain or loss on settlement.

(iii) net interest on the net defined benefit liability (asset) .

(d) determining the remeasurements of the net defined benefit liability (asset), to be recognised in other comprehensive income, comprising:

(i) actuarial gains and losses (see paragraphs 128 and 129);

(ii) return on plan assets, excluding amounts included in net interest on the net defined benefit liability (asset) (see paragraph 130); and

(iii) any change in the effect of the asset ceiling (see paragraph 64), excluding amounts included in net interest on the net defined benefit liability (asset).

Where an entity has more than one defined benefit plan, the entity applies these procedures for each material plan separately.

An entity shall determine the net defined benefit liability (asset) with sufficient regularity that the amounts recognised in the financial statements do not differ materially from the amounts that would be determined at the end of the reporting period.

2-Accounting for the constructive obligation :An entity shall account not only for its legal obligation under the formal terms of a defined benefit plan, but also for any constructive obligation that arises from the entity's informal practices. Informal practices give rise to a constructive obligation where the entity has no realistic alternative but to pay employee benefits. An example of a constructive obligation is where a change in the entity's informal practices would cause unacceptable damage to its relationship with employees.

EX2-A director of an entity receives a retirement benefit of 10% of his final salary per annum for his contractual period of three years. The director does not contribute to the scheme. His anticipated salary over the three years is Year 1 $100,000, Year 2 $120,000, and Year 3 $144,000. Assume a discount rate of 5%.

Required

Calculate the current service cost, the pension liability, and the interest cost for the three years.

Solution

Year	**Salary**	**Current Service Cost**	**Discounted Current Service Cost**	**Interest Cost 5% Liability**	**Liability Brought Forward**	**Liability at year-end**
1	**100000**	**14400**	**13061**	**-**	**-**	**13061**
2	**120000**	**14400**	**13714**	**653**	**13061**	**27428**
3	**144000**	**14400**	**14400**	**1372**	**27428**	**43200**
Total		**43200**	**41175**	**2025**		

3-Statement of financial position : An entity shall recognise the net defined benefit liability (asset) in the statement of financial position. When an entity has a surplus in a defined benefit plan, it shall measure the net defined benefit asset at the lower of:

(a) the surplus in the defined benefit plan; and

(b) the asset ceiling, determined using the discount rate specified

The amount recognized in the balance sheet could be either an asset or a liability calculated at the balance sheet date.

The amount recognized will be

(a) The present value of the defined benefit obligation, plus

(b) Any actuarial gains less losses not yet recognized because the gains and losses fall outside the limits of the corridor, minus

(c) Any past service cost not yet recognized, and minus

(d) The fair value of the plan assets at the balance sheet date.

-If the result of the preceding calculation is a positive amount, then a liability is incurred, and it is recorded in full in the balance sheet.

- Any negative amount is an asset that is subject to a recoverability test. The asset recognized is the lesser of the negative amount calculated above or the net total of

• Any unrecognized net actuarial losses and past service costs, and

• The present value of any benefits available in the form of refunds or reductions in future employer contributions to the plan.

EX3-

An entity has these balances relating to its defined benefit plan:

• Present value of the obligation: $33 million

• Fair value of plan assets: $37 million

• Actuarial losses: $3 million unrecognized

• Past service cost: $2 million unrecognized

• Present value of available future refunds and reduction in future contributions: $1 million.

Required

Calculate the value that will be given to the net plan asset under IAS 19.

Solution

The negative amount (asset) determined under the Standard will be $33 million minus $37 million, minus $3 million, minus $2 million, which equals $9 million. The limit under IAS 19 is computed in this way: unrecognized actuarial losses of $3 million plus unrecognized past service cost of $2 million, plus the present value of available future refunds and reductions in future contributions of $1 million, which equals $6 million. The entity recognizes an asset of $6 million and discloses the fact that the limit has reduced the carrying amount of the asset by $3 million.

4-Recognition and measurement: present value of defined benefit obligations and current service cost:

The ultimate cost of a defined benefit plan may be influenced by many variables, such as final salaries, employee turnover and mortality, employee contributions and medical cost trends. The ultimate cost of the plan is uncertain and this uncertainty is likely to persist over a long period of time. In order to measure the present value of the post-employment benefit obligations and the related current service cost, it is necessary:

(a) to apply an actuarial valuation method;

(b) to attribute benefit to periods of service; and

(c) to make actuarial assumptions .

-Actuarial valuation method : An entity shall use the projected unit credit method to determine the present value of its defined benefit obligations and the related current service cost and, where applicable, past service cost.

Attributing benefit to periods of service: In determining the present value of its defined benefit obligations and the related current service cost and, where applicable, past service cost, an entity shall attribute benefit to periods of service under the plan's benefit formula. However, if an employee's service in later years will lead to a materially higher level of benefit than in earlier years, an entity shall attribute benefit on a straight-line basis from:

(**a**) the date when service by the employee first leads to benefits under the plan (whether or not the benefits are conditional on further service) until

(**b)** the date when further service by the employee will lead to no material amount of further benefits under the plan, other than from further salary increases.

EX- Projected Unit Credit Method (PUC)

IAS 19 requires for the accounting for the Defined Benefit Plan to use Projected Unit Credit Method to measure :

-PV of the Defined Benefit Obligation (DBO)

-Current Service Costs

An employee has 7 years of employment from 20X1 to 20X7 and will receive a bonus f 300000 CU(ultimate cost of benefit) at the end of 20X7.Discount rate is 2 %.

Require

How to recognize the cost each year

Solution

We apply the PUC method as follow (ignoring other actuarial assumptions)

1-Attrributing Benefit to the periods of service

	1	2	3	4	5	6	7
Previous years	**0**	**42857**	**85714**	**128571**	**171429**	**214286**	**257143**
Current year(300000/7)	**42857**	**42857**	**42857**	**42857**	**42857**	**42857**	**42857**
Total	**42587**	**85714**	**128571**	**171429**	**214286**	**257143**	**300000**

2-Measurement

	1	2	3	4	5	6	7
Opening Obligation	**0**	**38057**	**77635**	**118779**	**161539**	**205964**	**252100**
Interest at 2%	**0**	**761**	**1553**	**2376**	**3231**	**4119**	**5042**
Discount [1]factor at 2 %	**0,8880[2]**	**0,9057**	**09238**	**0,9423**	**0,9612**	**0,9804**	**[o]1,0000**
Current service cost	**38057**	**38817**	**39591**	**40384**	**41194**	**42017**	**42857**
Closing Obligation (total)	**38057**	**77635**	**118779**	**161539**	**205964**	**252100**	**300000**

[1]1/(1+2%)^year

[2] 1/1+2%)^ 6..... [o] 1/(1+2%)^o

3- Illustrative journal entries

	1	2	3	4	5	6	7
Dr expense Employee Benefit	**38056**						
Cr Liability-Provision for Employee Benefit	**38056**						

	38056	**38056**

Actuarial assumptions

- Actuarial assumptions shall be unbiased and mutually compatible.

- Actuarial assumptions are an entity's best estimates of the variables that will determine the ultimate cost of providing post-employment benefits. Actuarial assumptions comprise:

(**a**) demographic assumptions about the future characteristics of current and former employees (and their dependants) who are eligible for benefits. **Demographic assumptions** deal with matters such as:

(i) mortality An entity shall determine its mortality assumptions by reference to its best estimate of the mortality of plan members both during and after employment.

(ii) rates of employee turnover, disability and early retirement;

(iii) the proportion of plan members with dependants who will be eligible for benefits;

(iv) the proportion of plan members who will select each form of payment option available under the plan terms; and

(v) claim rates under medical plans.

(b) financial assumptions, dealing with items such as:

(i) **the discount rate** The rate used to discount post-employment benefit obligations (both funded and unfunded) shall be determined by reference to market yields at the end of the reporting period on high quality corporate bonds. For currencies for which there is no deep market in such high quality corporate bonds, the market yields (at the end of the reporting period) on government bonds denominated in that currency shall be used. The currency and term of the corporate bonds or government bonds shall be consistent with the currency and estimated term of the post-employment benefit obligations.

(ii) benefit levels, excluding any cost of the benefits to be met by employees, and future salary ;

(iii) in the case of medical benefits, future medical costs, including claim handling costs (ie the costs that will be incurred in processing and resolving claims, including legal and adjuster’s fees) ; and

(iv) taxes payable by the plan on contributions relating to service before the reporting date or on benefits resulting from that service.

Past service cost and gains and losses on settlement

When determining past service cost, or a gain or loss on settlement, an entity shall remeasure the net defined benefit liability (asset) using the current fair value of plan assets and current actuarial assumptions, including current market interest rates and other current market prices, reflecting:

(**a**) the benefits offered under the plan and the plan assets before the plan amendment, curtailment or settlement; and

(**b**) the benefits offered under the plan and the plan assets after the plan amendment, curtailment or settlement.

Past service cost : An entity shall recognise past service cost as an expense at the earlier of the following dates:

(**a)** when the plan amendment or curtailment occurs; and

(**b**) when the entity recognises related restructuring costs (see IAS 37) or termination benefits.

Gains and losses on settlement :The gain or loss on a settlement is the difference between:

(**a**) the present value of the defined benefit obligation being settled, as determined on the date of settlement; and

(**b**) the settlement price, including any plan assets transferred and any payments made directly by the entity in connection with the settlement.

An entity shall recognise a gain or loss on the settlement of a defined benefit plan when the settlement occurs.

Recognition and measurement: plan assets

Fair value of plan assets: The fair value of any plan assets is deducted from the present value of the defined benefit obligation in determining the deficit or surplus.

Reimbursements: When, and only when, it is virtually certain that another party will reimburse some or all of the expenditure required to settle a defined benefit obligation, an entity shall:

(a) recognise its right to reimbursement as a separate asset. The entity shall measure the asset at fair value.

(b) disaggregate and recognise changes in the fair value of its right to reimbursement in the same way as for changes in the fair value of plan assets The components of defined benefit cost recognised may be recognised net of amounts relating to changes in the carrying amount of the right to reimbursement.