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# ICPAK IFRS WORKSHOP

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## **IAS 19:- Employee Benefits**

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Nairobi*

# Learning objectives

- By the end of the session participants should be better able to:
  - Describe the objective and scope of IAS 19
  - Classify different types of employees benefits
  - Differentiate between defined contribution and defined benefit plans
  - Calculate defined benefit obligations (DBO) and current service costs
  - Discuss disclosure requirements for the notes to financial statements.
  - Describe the main changes to the accounting for defined benefit plans and the impacts

# Agenda

Background

Recognition

Measurement

Presentation

Disclosure

# IAS 19: Employee benefits

- The objective of IAS 19 is to prescribe the accounting and disclosure for employee benefits.
- The standard requires an entity to recognize
  - **A liability** where an employee has **provided service** in exchange for employee benefits to be **paid in the future**; and
  - **An expense** when the entity **consumes the economic benefits** of employee service;
- **Employee benefits** are all forms of consideration given by an entity in exchange for services rendered or for the termination of employment.
- IAS 19 applies to all employee benefits except those to which IFRS 2 Share-based payment applies

# Employee benefits

## ■ Employee benefits

- Short-term benefits
  - Post-employment benefits
  - Other long-term benefits
  - Termination benefits
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- IFRS 2 *Share-based Payment* – accounting for all share-based payment transactions

# IAS 19 Main principles

- **Recognise employee benefits when service is rendered in exchange for those benefits**
- **Post-employment benefit plans are classified as defined contribution plans or defined benefit plans**
- **Defined contribution plans**
  - Cost of benefits = contribution paid or payable to the plan
- **Defined benefit plans:**
  - Cost of benefit = present value of entitlement earned
  - Many variable factors such as final or average pay levels
  - Involves relatively complex calculations
  - Plan assets measured at fair value

# Short term employee benefits

- Expected to be settled wholly within the 12 months after the reporting period end, in which the employee has rendered the related services.
- If the entity's expectations of the timing of settlement change temporarily, it need not reclassify a short-term employee benefit.
- Compensated absences
  - *Accumulating* – recognize expense when service that increases entitlement is rendered. e.g. leave pay
  - *Non-accumulating* – recognize expense when absence occurs.
- All short term benefits
  - Recognize the undiscounted amount as an expense / liability e.g. wages, salaries, bonuses, etc.

# Other long term employee benefits

- Employee benefits other than short-term employee benefits, post-employment benefits, and termination benefits.
- Statement of financial position
  - Carrying amount of liability = present value of obligation minus the fair value of any plan assets
  - Actuarial gains and losses are recognized immediately in OCI in full
  - past service costs are recognized immediately in profit or loss in full r
- **Statement of comprehensive income**
  - Recognize the net total of: Current service cost + Net interest on net defined benefit liability/(asset) + remeasurement of the net defined benefit liability/(asset).



# Profit sharing and bonus schemes

- Recognize the expense when entity has a present legal or constructive obligation to make payments; and a reliable estimate of the obligation can be made.

# Termination benefits

- Employee benefits provided in exchange for the termination of an employee's employment, as a result of either:
  - An entity's decision to terminate an employee's employment before the normal retirement date
  - An employee's decision to accept an offer of benefits in exchange for the termination of employment.
  
- Recognize liability and expense at the earlier of:
  - The date the entity can no longer withdraw the benefit or offer
  - The date the entity recognizes restructuring costs under IAS 37.

# Termination benefits

- If termination benefits settled wholly before 12 months from reporting date – apply requirements for short-term employee benefits
- If termination benefits are not settled wholly before 12 months from reporting date – apply requirements for other long term employee benefits.

# Post employment benefits

## ■ Defined contribution plans

- The entity pays fixed contributions into a fund and does not have an obligation to pay further contributions if the fund does not hold sufficient assets
- Recognize the contribution expense /liability when the employee has rendered the service.

# Post employment benefits

- Defined benefit plans

- These are post employment plans other than defined contribution plans.

# Post employment benefits - Definitions

- The net defined benefit liability (asset) is the deficit or surplus, adjusted for any effect of limiting a net defined benefit asset to the asset ceiling.
- The deficit or surplus is:
  - The present value of the defined benefit obligation less
  - The fair value of plan assets (if any).

# Post employment benefits - Definitions

- The **asset ceiling** is the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan.
- The **present value of a defined benefit obligation** is the present value, without deducting any plan assets, of expected future payments required to settle the obligation resulting from employee service in the current and prior periods.

# Post employment benefits - Definitions

## ■ **Service cost comprises:**

- **Current service cost**, which is the increase in the present value of the defined benefit obligation resulting from employee service in the current period;
- **Past service cost**, which is the change in the present value of the defined benefit obligation for employee service in prior periods, resulting from a plan amendment (the introduction or withdrawal of, or changes to, a defined benefit plan) or a curtailment (a significant reduction by the entity in the number of employees covered by a plan); and
- Any gain or loss on settlement.



# Post employment benefits - Definitions

- **Remeasurements** of the net defined benefit liability (asset) comprise:
  - Actuarial gains and losses (AGL);
  - The return on plan assets, excluding amounts included in net interest on the net defined benefit liability (asset); and
  - Any change in the effect of the asset ceiling, excluding amounts included in net interest on the net defined benefit liability (asset).

# Post employment benefits - Definitions

- **Actuarial gains and losses** are changes in the present value of the defined benefit obligation resulting from:
  - Experience adjustments (the effects of differences between the previous actuarial assumptions and what has actually occurred); and
  - The effects of changes in actuarial assumptions.
- A **settlement** is a transaction that eliminates all further legal or constructive obligations for part or all of the benefits provided under a defined benefit plan, other than a payment of benefits to, or on behalf of, employees that is set out in the terms of the plan and included in the actuarial assumptions.

# Post employment benefits

## ■ Statement of financial position

- When an entity has a surplus in a DBP, it measures the net defined benefit asset at the lower of:
  - The surplus in the defined benefit plan
  - The asset ceiling (being the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan), determined using the discount rate in reference to market yields at the end of the reporting period on high quality corporate bonds (IAS 19.83).

# Post employment benefits

## ■ Statement of comprehensive income

- Actuarial gains and losses are recognized in other comprehensive income in the period in which they occur.
- Past-service-costs are recognized in profit or loss in the period incurred.

## ■ The net interest on the net defined benefit liability/(asset) is recognized in profit or loss:

- Being equal to the change of the defined benefit liability/(asset) during the period that arises from passage of time.
- Determined by multiplying the net defined benefit liability/(asset) by the discount rate, taking into account actual contributions and benefits paid during the period.

# Post employment benefits

## ■ Presentation of the three components of 'defined benefit cost'

- Service cost (current, past, curtailment loss/(gain), and settlement loss/(gain) in profit or loss
- Net Interest (refer above) in profit or loss
- Remeasurements (actuarial gains, the return on plan assets (excl. net interest), change in the effect of the asset ceiling) in other comprehensive income (OCI).

# Post-employment benefits - recognition (1)

## Previous IAS 19

Defined benefit obligation

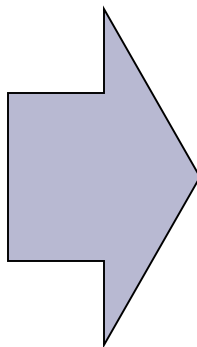
Less fair value of plan assets

Plus/less deferred actuarial gains and losses

Less deferred past service cost

Effect of asset ceiling

Defined benefit liability (asset)



## Amended IAS 19

Defined benefit obligation

Less fair value of plan assets

Plus/less deferred actuarial gains and losses

Less deferred past service cost

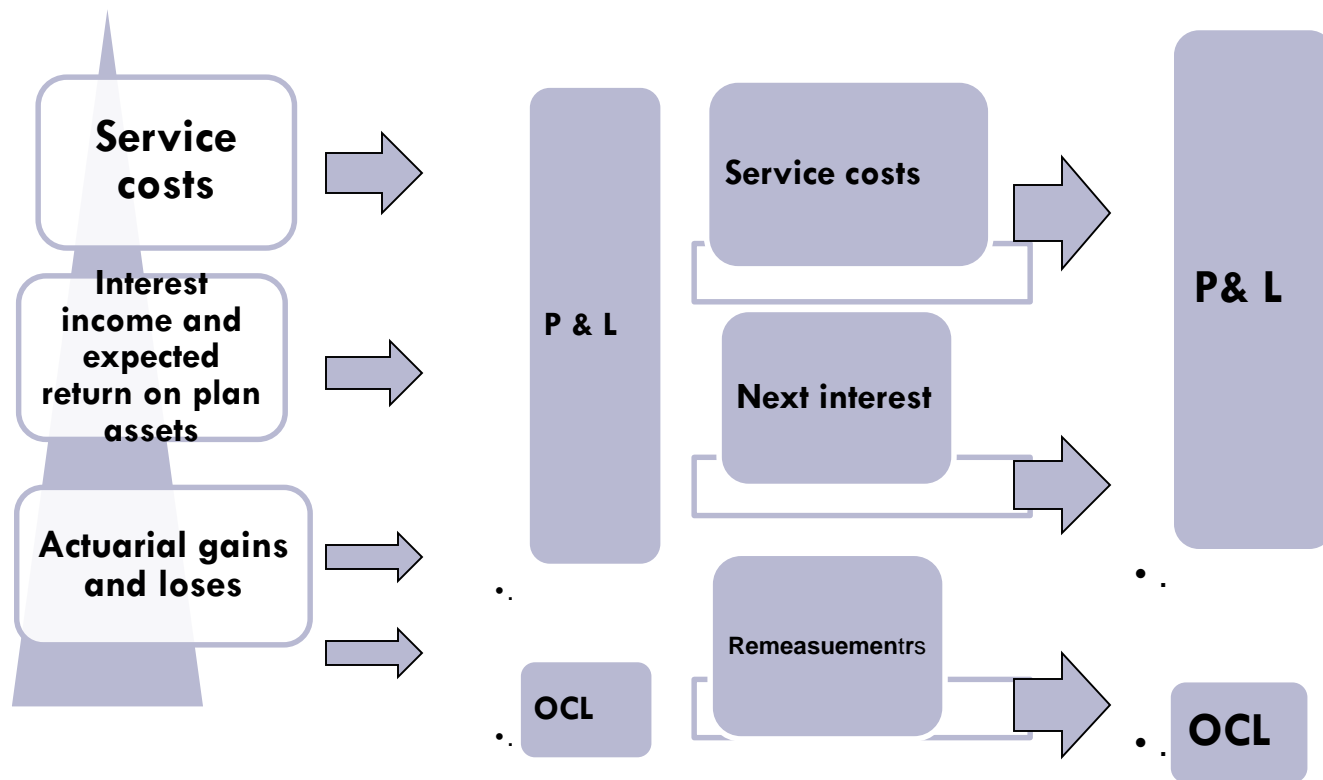
Effect of asset ceiling

Defined benefit liability (asset)



# Post-employment benefits – recognition (2)

## Previous IAS 19



# Post-employment benefits – recognition (3)

- The net defined benefit liability is recognized in the statement of financial position. This is:
  - The present value of the defined benefit obligation surplus/deficit
  - Less the fair value of plan assets
  - Adjusted for the asset ceiling
- Elimination of the corridor method for recognizing actuarial gains and losses
- Unvested past service cost is recognized immediately



## Post-employment benefit recognition - Illustrative example 1

Defined benefit obligation	Previous	Amended
Obligation at December 31, 2011	15,000	15,000
Interest cost (15,000 x 6%)	900	900
Current service costs	800	800
Benefits paid	(1,500)	(1,500)
Expected obligations at Dec. 31, 2012	15,200	15,200
Obligation (actual) at Dec 31 2012	17,410	17,410
<b>Cumulative (unrecognized) actuarial loss at 31.12.12</b>	<b>2,210</b>	<b>N/A</b>
<b>Remeasurements recognized in OCI</b>	<b>NA</b>	<b>2,210</b>

# Post-employment benefit recognition - example 2

Plan assets	Previous	Amended
Fair value at December 31, 2011	14,000	14,000
Expected return (14,000x 7%)	980	N/A
Calculated return on plan assets (14,000x 6%)	N/A	840
Contributions for the period	1,050	1,050
Benefits paid	(1,500)	(1,500)
Expected fair value of assets at Dec 31 2012	14,390	14,390
Actual fair value of assets at Dec. 31, 2012	14,920	14,920
Cumulative (unrecognized) actuarial gain on plan assets	390	N/A
Remeasurements recognized in OCI at Dec. 31, 2012	N/A	530

# Post-employment benefit recognition - Illustrative example 3

Statement of Financial Position – Previous IAS 19	2012	2011
Plan assets	14,920	14, 000
Defined benefit obligation	(17,410)	(15,000)
Plan deficit	(2,490)	(1,000)
Cumulative unrecognized actuarial loss	(1,820)	-
Balance sheet liability	(670)	(1,000)

# Post-employment benefit recognition - Illustrative example 3 (cont'd)

Statement of Financial Position – Amended IAS 19	2012	2011
Plan assets	14,920	14,000
Defined benefit obligation	(17,410)	(15,000)
<b>Plan deficit</b>	<b>(2,490)</b>	<b>(1,000)</b>
Cumulative unrecognized actuarial gains/losses	-	-
<b>Balance sheet liability</b>	<b>(2,490)</b>	<b>(1,000)</b>

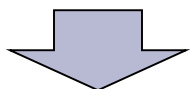
# Post-employment benefit recognition - Illustrative example 3 (cont'd)

Profit and loss account	Previous IAS 19	Amended IAS 19
Current service cost	800	800
Interest cost (on defined benefit obligation	900	900
Actual return on plan assets		(840)
<b>Net interest cost</b>	<b>-</b>	<b>60</b>
Expected return on plan asset	(980)	-
<b>Profit and loss charge</b>	<b>720</b>	<b>860</b>

# Post-employment benefits – recognition

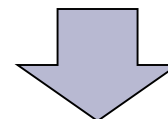
## PAST SERVICE COSTS

### PLAN AMENDMENTS



- Introduction of a plan
- Withdrawal of a plan
- Changes to a plan

### CURTAILMENTS



- Significant reduction in the number of employees covered by the plan

- Recognized at the earlier of the following:
  - If plan amendment/curtailment arises as part of restructuring, when the restructuring costs are recognized
  - If plan amendment/curtailment is linked to termination benefits, when the related termination benefits are recognized
  - When plan amendment/curtailment occurs

# Post-employment benefits – recognition

- Recognition of plan amendments:
  - Can no longer be deferred
  - Could be earlier than when the plan amendment occurs
- Recognition of curtailments:
  - Demonstrable commitment is no longer relevant
  - Could be recognized before related restructuring costs if occurs earlier
  - Could be recognized earlier than when curtailment occurs if related to termination benefits recognized

## Illustrative example 4 – past service cost (1)

Plan assets at January 1, 2012	95,000
Defined benefit obligation at January 1, 2012	100,000
Unrecognized net actuarial loss at January 1, 2012	20,000
Average remaining working life of employees at January 1, 2012	10 years
Discount rate at January 1, 2012	10%
Service cost for 2012	9,000
Expected return on plan assets at January 1, 2012	10,000
Re-measurement loss arising in 2012 (amended IAS 19)	1,500
Past service cost arising on January 1, 2012	3,000
Vesting period for past service cost	3 years



## Illustrative example 4 – past service cost (3)

Amended IAS 19	
Current service cost	9,000
Net interest cost (10% x 5,000)	500
Past service cost	3000
<b>Net cost for the year recognized in profit or loss</b>	<b>12500</b>
<b>Net cost for the year recognized in profit or loss</b>	<b>1,500</b>
<b>Net cost for the year recognized in total comprehensive income</b>	<b>14,000</b>

# Post-employment benefits – measurement (1)

Previous IAS 19	Amended IAS 19
Plan administration costs either reduce the return on plan assets, or are included in the actuarial assumptions used to measure the defined benefit obligation.	<ul style="list-style-type: none"><li>▪ Only costs of managing plan assets reduce the return on plan assets.</li><li>▪ Other plan administration costs are recognized when the administration services are provided but are not deducted from the return on plan assets.</li></ul>
The previous standard did not state specifically how to deal with optionality permitted by a plan.	Actuarial assumptions include an assumption about the proportion of plan members who will select each form of settlement option available under the plan terms.

## Post-employment benefits – measurement (2)

Previous IAS 19	Amended IAS 19
<p>The previous standard did not state specifically how to deal with employee and third party contributions.</p>	<ul style="list-style-type: none"><li>• The amended standard specifically requires an entity to consider whether third party contributions reduce the cost of benefits to the entity or are instead a reimbursement right.</li><li>• Discretionary contributions by employees or third parties reduce service cost upon payment of the contributions to the plan.</li></ul>

# Post-employment benefits – measurement (3)

## ■ Previous IAS 19

The previous standard did not state specifically how to deal with risk-sharing features.

## ■ Amended IAS 19

Actuarial assumptions include the best estimate of the effect of performance targets or other criteria.

For example, the terms of a plan may state that it will pay reduced benefits or require additional contributions from employees if the plan assets are insufficient. These kinds of criteria are reflected in the measurement of the defined benefit obligation.

# Post-employment benefits – presentation (1)

## **Interest costs under Amended IAS 19**

Net interest cost on the net defined  
benefit liability (asset)

calculated based on discount rate used  
to discount the obligation:

Interest cost on defined benefit obligation

Interest income on plan assets

Interest on the effect of the asset ceiling

# Post-employment benefits – presentation (2)

## Actuarial gains and losses under IAS 19, recognized in P&L or OCI

- AGL on the defined benefit obligation
- The difference between the return on plan assets and the expected return on plan assets
- Any change to the effect of the asset ceiling is recognized in P&L or OCI

## Remeasurements under Amended IAS 19 recognized in OCI

- AGL on the defined benefit obligation
- The difference between the return on plan assets and the amounts included in net interest
- Any change to the effect of the asset ceiling, excluding amounts included in net interest

# Post-employment benefits – presentation (3)

Interest costs and actuarial gains and losses under Previous IAS 19:

	Defined benefit obligation	Fair value of plan assets	The effect of the asset ceiling of 100	Defined benefit asset
31 Dec 2011	(1,000)	1,300	(200)	100
Service cost	(50)			(50)
Interest on defined benefit obligation 10%	(100)			(100)
Expected return on plan assets 15%		195		195
Actuarial gains and losses	(50)	5		(45) in P&L/OCI/deferred
31 Dec 2012	(1,200)	1,500	(200)	100

# Post-employment benefits – presentation (4)

Net interest and re-measurements under Amended IAS 19:

	Defined benefit obligation	Fair value of plan assets	The effect of the asset ceiling of 100	Defined benefit asset
31 Dec 2011	(1,000)	1,300	(200)	100
Service cost	(50)			(50)
Net interest on net defined benefit asset 10%	(100)	130	(20)	10
Remeasurements	( 50)	70	20	40 in OCI
31 Dec 2012	(1,200)	1500	(200)	100



# Post-employment benefits – Disclosures (1)

- Characteristics of and risks associated with defined benefit plans
  - Nature of benefits provided by the plan
  - Brief description of the regulatory framework in which the plan operates
  - Details of any other entity's responsibilities for the governance of the plan, e.g. responsibilities of trustees
  - Narrative description of the risks to which the plan exposes the entity
  - Narrative description of plan amendments, curtailments and settlements
- A detailed numerical reconciliation from the opening balance to the Closing balance of the net defined benefit liability/asset
- Separate reconciliation required for:
  - Plan assets
  - Present value of defined benefit obligation
  - The effect of the asset ceiling

# Post-employment benefits – Disclosures (2)

- Reconciliations should show:
  - Current service cost
  - Interest income/expense
  - Re-measurements of the net defined benefit liability/asset (show separately return on plan assets, actuarial gains/losses arising from changes in demographic and financial assumptions)
  - The effect of the asset ceiling limit on a defined benefit asset
  - Past service cost
  - Contributions to, and payments to the plan

# Post-employment benefits – Disclosures (3)

- Amounts in the financial statements arising from the defined benefit plans
  - Numerical disclosures disaggregating the fair value of the plan assets that distinguish the nature and risks of the assets
  - Fair value of plan assets used by the entity
  - Fair value of entity's own shares held by the plan
- How the defined benefit plans may affect the amount, timing and uncertainty of the entity's future cash flows
- Sensitivity analysis for the effect of a change to the defined benefit obligation for each significant actuarial assumption

## Post-employment benefits – Disclosures (4)

- The method and assumptions used in preparing the above analysis and limitations of those methods
- Details of any changes from previous period in the methods and assumptions used
- Narrative description of any asset-liability matching strategies used by the plan or the entity
- Narrative description of any funding arrangements and funding policy that affect future contributions
- Expected contributions to the plan for the next annual reporting period
- An entity shall assess whether all or some disclosures should be disaggregated to distinguish plans or groups of plans with materially different risks

# Other amendments (1)

## Short-term vs. other long-term employee benefits

- Short-term employee benefits are those employee benefits (other than termination benefits) that are expected to be settled wholly before 12 months after the end of the annual reporting period in which the employees render the related service.
- Other long-term employee benefits are all employee benefits other than short-term benefits, post-employment benefits and termination benefits.
- Reclassification of a short-term employee benefit as long-term need not occur if the entity's expectations of the timing of settlement change temporarily

# Other amendments (2)

## Termination benefits

- An employee benefit is provided in exchange for services (and not termination):
  - When the benefit is conditional on future service being provided, including when the benefit increases if further service is provided; and
  - When the benefit is provided in accordance with the terms of an employee benefit plan.
- Termination benefits are recognized at the earlier of the following dates:
  - When the entity recognizes costs for a restructuring within the scope of IAS 37 that includes the payment of termination benefits; and
  - When the entity can no longer withdraw the offer of those benefits.
- Termination benefits are measured on initial recognition, and accounted for subsequently, in accordance with the nature of the employee benefit provided.

# Summary of key areas of change

- New basis for recognizing actuarial gains and losses
- Finance costs – revised basis of calculation
- Additional disclosures for defined benefit plans
- Amended definitions of short-term and other long-term employee benefits
- Changes to timing of recognition of termination benefits

# Effective date and transition

- The effective date for the application of the amended standard is annual periods beginning on or after 1 January 2013. Earlier application is permitted, subject to making disclosure of this fact.
- The amendments are generally to be applied retrospectively, with two exceptions:
  - An entity need not adjust the carrying amount of assets outside the scope of IAS 19 (such as inventories and property, plant and equipment) for changes in employee benefit costs that were included in their carrying amount before the date of initial application.
  - In financial statements for periods beginning before 1 January 2014, an entity need not present comparative information for the disclosures required about the sensitivity of the defined benefit obligation.



# Key take always: Key potential impacts and considerations

The amendments make more volatile the statement of financial position of entities applying corridor method.

Entities need to plan carefully the way that they assess the need for and how best to aggregate the disclosures to be made

Entities may wish to reconsider how their covenant tests will be affected by the amended standard.

More benefits may now be long-term than was previously the case.

Entities may need to discuss with their lenders revising the definitions of any relevant covenants included in their lending agreements.

The nature of the plan assets held will have no impact on net finance charge or credit

# Questions & comments



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