- Employees benefits

IPSAS 25

Employee benefits

Employee benefits are all forms of consideration given in exchange for service rendered by employees.

Types:

- short-term employee benefits, due within twelve months after the employees render the service.
- post-employment benefits, that are payable after the completion of employment.

Employment benefits

- Other long-term employee benefits, that are not wholly due within twelve months after the end of the period in which the employees render the related service.
- Termination benefits, which are benefits payable as a result of employee's decision to accept voluntary redundancy in exchange for those benefits.

Accounting treatment

Short term benefits

- undiscounted amount of benefits expected to be paid in exchange for that service recognised as staff cost.
- recognise the expected cost of accumulating compensated absences when the employees render service.
- recognise the expected cost of profit-sharing and bonus payments when the entity has a present legal or constructive obligation and a reliable estimate of the obligation can be made.

Examples of S/TEBs include:

- wages, salaries & social security contrib;
- S/T compensated absences (paid annual leave & paid sick leave) for absences expected to occur within 12 month limitation;
- profit-sharing & bonuses payable within 12 month limitation; &
- non-monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees.

Examples S/TEBs

- An employee is entitled to 5 days paid sick leave a year. Unused sick leave is carried forward for 1 calendar year. It is allocated on a FIFO basis. No sick leave is expected to lapse.

  Employee 1 earns 400 per working day.   Sick leave record: 4.5 days accumulated at 1/7/2015; 2 days taken in 2016. Salary increase = 5% effective 1/1/2016.

30/6/2016 liability = 2,100

(ie 400 wage rate × 1.05 increase × 5 (max) days due at 30/6/2016 & expected to be taken in 2017.

Accounting treatment

Post employment benefits

- Include retirement benefits, such as
  - pensions,
  - provident,
  - post-employment life insurance
  - post-employment medical care.
- these arrangements may be imposed by law or by action of the entity
- may involve the establishment of a separate entity to receive contributions and to pay benefits (funding).

Classification of long term benefits

- Classified depending on their principal terms and conditions as either
  - defined contribution plans or
  - defined benefit plans,
- Multi-employer plans and state plans are classified on the basis of the terms of the plan, including any constructive obligation that goes beyond the formal terms.
- Entity may pay insurance premiums to fund a post-employment benefit plan, such plan are treated as a defined contribution plan.

Defined contribution plans

- an entity pays fixed contributions into a separate entity (a fund) and
- has no legal or constructive obligation to pay further contributions or to make direct benefit payments to employees.
- the benefits received by the employee is determined by the amount of contributions, together with investment returns arising from the contributions.

Defined contribution plan;

- contribution payable for a period are charged as an expense by creating a liability, after deducting any amount already paid.
- If contribution payments exceed the contribution due for service before the reporting date, recognise the excess as prepayments.

Defined benefit

Defined benefit plans where an entity has an obligation to provide the agreed benefits to employees, and actuarial risk and investment risk are borne, in substance, by the entity.

- Actuarial risk; that benefits will cost more or less than expected.
- Investment risk; that returns on assets set aside to fund the benefits will differ from expectations.

- If actuarial or investment experience is worse than expected, the entity's obligation may be increased, and vice versa if actuarial or investment experience is better than expected.

- Defined benefits plan
- obligations should reflect the estimated amount of benefit that employees have earned in return for their service in the current and prior periods, including benefits that are not yet vested and including the effects of benefit formulas that give employees greater benefits for later years of service.
- This requires estimation of benefit attributable to the current and prior periods on the basis of the plan’s benefit formula and to make actuarial assumptions that influence the cost of the benefit.

Employee benefits

- The actuarial assumptions are estimates of factors influencing the benefits such as:
  - demographic variables such as employee turnover and mortality, and
  - financial variables such as future increases in salaries and medical costs.
- The actuarial assumptions should be unbiased i.e neither imprudent nor excessively conservative, mutually compatible, and selected to lead to the best estimate of the future cash flows that will arise under the plan.

DBO actuarial assumptions

- **Actuarial assumptions comprise:**
  - Demographic assumptions, eg: (i) mortality during & after employment; (ii) employee turnover, disability & early retirement; (iii) proportion of plan members with dependants who will be eligible for benefits; & (iv) claim rates under medical plans;
  - Financial assumptions, eg: (i) discount rate; (ii) future salary & benefit levels; (iii) for medical benefits—future medical costs, including cost of administering claims and benefit payments.

Employee benefits

defined benefit obligation

- measure at discounted present value basis using market yields at the reporting date on high quality corporate bonds.
- use the projected unit credit method to measure defined benefit obligation and the related expense if possible without undue cost or effort.
    - If defined benefits are based on future salaries, the projected unit credit method requires an entity to measure its defined benefit obligations on a basis that reflects estimated future salary increases and applying actuarial assumptions.

Employee benefits

If projected credit unit method is not possible without undue cost or efforts the following simplifications are allowed:

- ignore estimated future salary increases (ie assume current salaries continue until current employees are expected to begin receiving post-employment benefits);
- ignore future service of current employees (ie assume closure of the plan for existing as well as any new employees); and
- ignore possible in-service mortality of current employees between the reporting date and the date employees are expected to begin receiving post-employment benefits (ie assume all current employees will receive the post-employment benefits). However, mortality after service (ie life expectancy) will still need to be considered.

DBO PUC valuation method

- Ex 30*: Lump sum benefit payable on retirement = 1% of final salary for each year of service. Salary in Y1 = 10,000 (increase at 7% pa). Discount rate = 10% pa. Employee expected to retire at end of Y5.
- Shows how the obligation builds up:
  - assuming that there are no changes in actuarial assumptions.
  - for simplicity, this example assumes employee will stay until end of Y5.

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DBO PUC valuation method

Year	*1*	*2*	*3*	*4*	***5***
Attributed to:					
– prior years	-	131	262	393	524
– current year (1% of final salary)	131	131	131	131	131
ï current and prior years	**131**	**262**	**393**	**524**	**655**
Opening obligation	**-**	**89**	**196**	**324**	**476**
Interest at 10%	-	9	20	33	48
Current service cost	89	98	108	119	131
Closing obligation	**89**	**196**	**324**	**476**	**655**

DBO simplified method

Year	*1*	*2*	*3*	*4*	*5*
1% of current salary (increase at 7% per year)	100	107	114	123	131
Years service at end of year	1	2	3	4	5
FV of obligation	**100**	**214**	**343**	**490**	**655**
Discount factor (10%)	0.6830	0.7513	0.8264	0.9091	1
PV of obligation	**68**	**161**	**284**	**445**	**655**
Opening obligation	ï	**68**	**161**	**284**	**445**
Interest (10%)	ï	7	16	28	45
Current service cost	68	80	95	111	131
Actuarial gain or loss (balancing figure)	ï	5	12	22	34
Closing obligation	**68**	**161**	**284**	**445**	**655**

Employee benefits

- independent actuary valuation not required
- If benefits are introduced or changed in the current period the entity should increase or decrease its defined benefit liability to reflect the change.
- plan has been curtailed (ie benefits or group of covered employees are reduced) or settled (the employer's obligation is completely discharged) in the current period, the defined benefit obligation should be decreased or eliminated.

Employee benefits

- Defined benefits plan assets
  - Fair value estimated
  - If defined benefit obligation is less than the fair value of plan assets at that date, the plan has a surplus. An entity should recognise a plan surplus as a defined benefit plan asset only to the extent that it is able to recover the surplus either through reduced contributions in the future or through refunds from the plan.

Employee benefits

- recognise the net change in its defined benefit liability during the period, other than a change attributable to benefits paid to employees during the period or to contributions from the employer as staff cost.
- recognise all actuarial gains and losses in the period in which they occur either;
  - in profit or loss, or
  - in other comprehensive income

Cost attributed to DBO

- The net charge comprises of:
  - the change attributable to employee service rendered during the reporting period (current service cost).
  - interest on the defined benefit obligation.
  - the returns on any plan assets and the net change in the fair value of recognised reimbursement rights.
  - actuarial gains and losses.
  - increases or decreases in the defined benefit liability resulting from introducing a new plan or changing an existing plan.
  - decreases in the defined benefit liability resulting from curtailing or settling an existing plan.

Other long term benefits

Other long-term employee benefits include;

- long-term compensated absences such as long-service or sabbatical leave.
- long-term disability benefits.
- profit-sharing and bonuses payable twelve months or more
- deferred compensation paid twelve months or more

Employee benefits

Termination benefits are created by legislation, contractual or other agreements with employees or their representatives or by a constructive obligation based on business practice, custom or a desire to act equitably, to make payments to employees when it terminates their employment.

Employee benefits

- recognise termination benefits as a liability and an expense only when the entity is committed either:
  - to terminate the employment of an employee or group of employees before the normal retirement date, or
  - to provide termination benefits as a result of an offer made in order to encourage voluntary redundancy.

Thank you

Interactive session