FINANCIAL REPORTING WORKSHOP FOR COUNTY GOVERNMENTS AND PUBLIC-SECTOR ENTITIES

IPSAS 25: Employee Benefits

Laico Regency Hotel, Nairobi, 18th – 19th October, 2017

Session Objective

- To provide an overview of the requirements of IPSAS 25, Employee Benefits;
- To discuss which of the requirements are relevant to the Kenya Public Sector; and
- To give guidance on how to implement those requirements.

IPSAS 25: Employee Benefits - Agenda

ICPAK
Uphold Public Interest

- Scope of benefits included in the standard
- Recognition, measurement, disclosure and presentation
- Amendments to IPSAS 25 (IPSAS 39 – effective 1st January, 2018)
- Public sector pensions
- Links with HR systems and HR-generated information

The Scope of IPSAS 25

- Applied by an employer in accounting for all employee benefits, except Share-based Payment applies.

- An employee may provide services to an entity on a full time, part time, permanent, casual or temporary basis. For the purpose of this Standard, **employees include directors** and other management personnel.

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

IPSAS 25: Scope of benefits included

- IPSAS 25 deals with accounting by public sector entities for all employee benefits:
  - Short term
  - Long term
  - Termination
  - Post-employment – pensions

Note – Funding (for pensions) not required

Short term benefits

- Employee benefits, such as wages, salaries and social security contributions, paid annual leave and paid sick leave, profit-sharing and bonuses (if payable within twelve months of the end of the period) and non-monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees;

- Settled within 12 months of period end

- What types of benefit do you think are included in this category?

- Which of the examples you have given apply to the public service?

Accounting for short term benefits

- Recognise the undiscounted amount of short- term employee benefits expected to be paid as a liability
- Compensation for absences
  - Accumulating compensation increases with employee service –recognize liability for vesting; partial liability for non-vesting
  - Non-accumulating benefits recognized when absence occurs
- Bonuses – recognize when obligation to pay

Consider materiality when estimating liability for short-term benefits

Long term benefits

employee benefits, including long-service leave or sabbatical leave, jubilee or other long-service benefits, long-term disability benefits and, if they are not payable wholly within twelve months after the end of the period, profit-sharing, bonuses and deferred compensation; and

- Other benefits not settled within 12 months

- What types of benefit do you think are included
  - in this category?

- Which of the examples you have given apply to the public service?

Accounting for long term benefits

- Recognition and measurement similar to defined benefit plans
- Measurement not usually subject to same degree of uncertainty and changes rarely result in material past service costs
- Simplified method of accounting
  - Actuarial gains and losses are recognized immediately (no corridor and no amortization)
  - All past service costs are recognized immediately

Termination benefits

- Payable because of a decision to terminate an employee’s employment before the normal retirement date or an employee’s decision to accept voluntary redundancy in exchange for those benefits.

- Voluntary or compulsory redundancy

Accounting for termination benefits

- Recognise termination benefits when, it is demonstrably committed to either
  - Terminate the employment of an employee or group of employees before the normal retirement date or
  - Provide termination benefits as a result of an offer made in order to encourage voluntary redundancy; and is
- demonstrably committed – has formal plan and is without realistic possibility of withdrawal

Post-employment benefits

- Majority of benefits fall in this category
- Payable after completion of employment
  - Defined contribution plans
    - Liability limited to annual fixed contributions
    - Actuarial and investment risk borne by employee
  - Defined benefit plans
    - Entity’s obligation is to provide agreed benefits
    - Actuarial and investment risk borne by employer
  - Multi-Employer Plans

Defined contribution plans

- Paid in exchange for service rendered by employees
- Contributions payable recognised as a liability and an expense
- Contributions not due within twelve months of period end are discounted
- The amount recognised as an expense for the period must be disclosed

Defined benefit plans

- Complex
- Require actuarial assumptions -usually qualified actuary involved
- Maybe unfunded, partially funded or wholly funded
- Include most pension plans, post-employment life insurance and medical plans

Multi-employer plans

- Multi-employer plans should be classified as either defined contribution or defined benefit plans

- Defined benefit plans that share risks between various entities under common control are not multi-employer plans

- Such entities make relevant disclosures about the plan as a whole

- State plans are those that are established by legislation to cover a specific group of entities and are not covered by IPSAS 25

Accounting for multi-employer plans

- Entities account for their share of the assets/liabilities and costs – or, if these are not readily available entities account for the plan as if it were a defined contribution plan
- Entities under common control participating make relevant disclosures:
  - Information about the agreement or other policy for charging the net benefit cost, or a statement that there is no such policy
  - The policy for determining the contribution levels
  - Information about the plan as a whole where they account for a share in the assets/liabilities and costs
  - Where entities account for the contribution payable, certain disclosures as required

Accounting for defined benefit plans

- Assess liability to pay benefits and any assets set aside to meet liability
- Actuarial method and assumptions used to estimate liability and cost of the benefits earned
- Actuarial technique - Projected Unit Credit Method
- Actuarial assumptions - best estimates of the variables that determine the ultimate cost
- Done with sufficient regularity to ensure recognized and actual amounts not materially different
- Discount rate – risk free rate reflecting time value of money

Defined benefit plan liability

- Net total of
  - Present value of the defined benefit obligation
    - Discounted expected future payments
  - Plus unrecognised actuarial gains or losses
    - experience adjustments and changes in actuarial assumptions
  - Minus unrecognised past service cost
    - introduction of or changes to defined benefit plans
  - Minus fair value of plan assets (if any)
    - assets available to pay or fund employee benefits

Cost of benefits earned

- Recognise in surplus/deficit net total of:
  - Current service cost
  - Interest cost
  - Expected return on plan assets
  - Recognised actuarial gains and losses (or could be in net assets/equity)
  - Recognised past service cost
  - Effect of curtailments or settlements

Defined benefit obligation

- Expected future payments (undiscounted) required to settle the obligation resulting from employee service in the current and prior periods

Actuarial gains and losses

- Effects of differences between the previous actuarial assumptions and what has actually occurred
- Unrecognised balance affects net liability; amount recognised in period affects surplus/ deficit or net assets/equity
- Choose to
  - Recognise on deferred basis through surplus/deficit using corridor approach
  - Faster recognition by other systematic method through surplus/deficit or net assets/equity

Corridor approach

- The corridor is equal to the greater of:

– 10% of the present value of the obligation (before deducting plan assets); and

– 10% of the fair value of any plan assets

- Recognised actuarial gain/loss is:

$$\frac{\text{Cumulative unrecognized actuarial gain/loss} - \text{corridor}}{\text{Average remaining working life of employees}}$$

No longer an option in IFRS – hence IPSAS 39

Past service costs

- Changes to plan benefits in current periods may change benefits payable for past service
- Recognise immediately if benefits vested
- Amortize unvested amount straight-line over average remaining vesting period

Defined benefit plan assets

- Fair value of plan assets
- Pension plans more likely to be funded than other postemployment plans
- Expected return on plan assets part of expense calculation

Disclosures

- An entity should disclose information that enables users of financial statements to evaluate the nature of its defined benefit plans and the financial effects of changes in those plans during the period.

- The required disclosures related to defined benefit pension plans are extensive and IPSAS 25 should be referenced directly

- There is no substitute for the exercise of professional judgment in the determination of what disclosures an entity makes and it should be decided in the context of its specific circumstance and IPSAS 25

First time adoption

- Initial liability for defined benefit plans is
  - present value of the obligations at date of adoption less
  - fair value of plan assets at the date of adoption
  - past service cost to be recognized in later periods
- Opening accumulated surplus/deficit adjusted for
  - differences from amounts previously recognized
  - cumulative actuarial gains and losses
- Comparative information and certain disclosures not required

Amendments to IPSAS 25

- A ‘rules of the road’ project to align IPSAS 25 with IAS 19 as amended in 2011 and 2013
- Issues are:
  - Recognition of changes in the net defined benefit liability or asset
  - Plan amendments, curtailments and settlements
  - Disclosures
  - Accounting for termination benefits
  - Classification of short-term employee benefits
  - Current estimates of mortality rates
  - Tax and administration costs

Changes in the net defined benefit liability or asset (1)

- Immediate recognition of the changes in the net liability or asset means that the corridor approach allowed in IPSAS 25 will be removed

- Service cost will now exclude changes resulting from changes in demographic assumptions

- One discount rate will be applied to net assets or liabilities rather than applying a separate rate to gross assets and to gross liabilities

Changes in the net defined benefit liability or asset (2)

- Re-measurements now comprise:
  - Actuarial gains and losses on the defined benefit obligation
  - Return on plan assets excluding net interest
  - Any change in the effect of the asset ceiling (excluding net interest)
- The defined benefit liability (asset) is now measured at the lower of:
  - The surplus in the defined benefit plan; and
  - The asset ceiling
- The asset ceiling is the present value of any economic benefits available in the form of refunds from the plan

Changes in the net defined benefit liability or asset (3)

- Recognition of defined benefit cost components:
  - Service cost in surplus/deficit
  - Finance cost component in finance costs
  - Re-measurements in net assets/equity

Plan amendments, curtailments and settlements

- Both vested and unvested current service costs to be recognised immediately
- New definitions of:
  - Curtailment – significant reduction in number of employees covered by a plan
  - Service cost – current service and past service (a change arising from a plan amendment or curtailment and any gain or loss on settlement)
  - Settlement – a transaction that eliminates all further legal or constructive obligations other than paying benefits to or on behalf of employees consistent with the plan and actuarial assumptions

Disclosures

- State plan and group plan – disclosures to be consistent with disclosures for multi-employer plans and defined benefit plans
- Defined benefit plans:
  - Disclosure objectives
  - Characteristics of the plans and associated risks
  - Amounts in the financial statements relating to the plans
  - How the plans might affect the amount, timing and uncertainty of future cash flows
  - Multi-employer defined benefit plan

Accounting for termination benefits

- Clarification that an entity does not have a present obligation until it has communicated the plan of termination to each of the affected employees

- Measurement of the benefits should be consistent with the nature of the underlying benefits

Classification of short-term benefits

- Clarification that a short-term benefit will be settled wholly within 12 months after the end of the reporting period

Current estimates of mortality rates

- An amendment to require the mortality assumptions to reflect expected mortality rates of plan members, both during and after employment

Tax and administration costs

- The estimate of the defined benefit obligation should include the present value of taxes payable by the plan if they relate to service before the reporting date or are imposed on benefits resulting from that service. Other taxes should be included as a reduction to the return on plan assets
- Administration costs should be recognised when provided. Costs relating to the management of the plan assets should be deducted from the return on plan assets

Some questions

- What short term benefits are given to public service employees?
- What post-retirement benefits do public service employees get?
- What are the pension arrangements – how would you classify them?

Session Dialogue

Practical aspects

Links with HR

- How is leave recorded and how accurate are the records?
- Will existing systems capture the information required to account for the entity's employee benefits at each reporting period?
- Will the IT need to be customised for automating accrual of some employee benefits?
- What information is held about length of service?

Reliance on the work of actuaries

- IPSAS 25 does not require the use of an actuary
- What actuarial involvement is there currently in looking at pensions issues for the public services?
- What instructions does Treasury need to give to an actuary?
- What are the current linkages between the actuary and the pensions administrators?

Management verification of figures

- Understand the actuary’s report
- Putting the figures together in the financial statements
- Analytical review?

Thank you

- Discussion
- Questions?