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International Public Sector Accounting Standards (IPSAS) Workshop

Central Rift Branch, Nakuru

# IPSAS 39 – Employee Benefits

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# Learning Outcome

- IPSAS 39 Background
- Scope and classification of employee benefits
- Recognition and measurement of short-term, long-term, post-employment and termination employee benefits
- Defined contribution versus defined benefit pension plans
- Example
- Key disclosure requirements

# IPSAS 39 in Summary

- The International Public Sector Accounting Standards Board (IPSASB) published IPSAS 39, *Employee Benefits*, which will replaced IPSAS 25, *Employee Benefits*, on January 1, 2018, with earlier adoption encouraged.

- This limited-scope project was part of the IPSASB's strategy to maintain its existing standards, including updating them for relevant changes made to the equivalent International Financial Reporting Standards (IFRS).

# IPSAS 39 in Summary

The main differences between IPSAS 39 and IPSAS 25 are:

- Removal of an option that allowed an entity to defer the recognition of changes in the net defined benefit liability (the "corridor approach");
- Introduction of the net interest approach for defined benefit plans;
- Amendment of certain disclosure requirements for defined benefit plans and multi-employer plans;
- Simplification of 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; and

# IPSAS 39 in Summary

- Removal of the requirements for Composite Social Security Programs.

-The **first four** changes above reflect those made by the International Accounting Standards Board to its equivalent standard, International Accounting Standard (IAS) 19, *Employee Benefits,* up to December 2015.

- The **fifth** change, removal of the Composite Social Security Programs section, reflects the IPSASB's conclusion that the section was unnecessary in practice.

# IPSAS 39 in Summary

- *Exposure Draft (ED) 59, Amendments to IPSAS 25, Employee Benefits*, proposed significant changes to IPSAS 25 to converge with IAS 19. After considering constituents' responses and a revised version of IPSAS 25, the IPSASB decided to issue a new standard, IPSAS 39, which reflects the revisions proposed in ED 59 in a more user-friendly format.
- "IPSAS 39, *Employee Benefits*, ensures that financial statements provide faithfully representative and relevant information about the financial impact of employee benefits, particularly defined benefit pension plans, while maintaining convergence with IFRS," said IPSASB Chair Ian Carruthers. "The issuance of a new standard is intended to present the new accounting requirements more clearly."

# Objectives of IPSAS 39

The main objective of IPSAS 39 is to prescribe the Accounting and disclosure requirements for employee benefits.

The Standard requires an entity to recognize:

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

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

# Objectives of IPSAS 39 ( Cont..)

- IPSAS 39 - *outlines the accounting requirements for employee benefits, including* ***short-term benefits*** *(e.g. wages and salaries, annual leave),* ***post-employment*** *benefits such as retirement benefits,* ***other long-term benefits*** *(e.g. long service leave) and termination benefits.*

- The **main principle** is that the cost of providing employee benefits should be **recognised in the period in which the benefit is earned** by the employee, **rather than when it is paid or payable**, and outlines how each category of employee benefits are measured, providing detailed guidance in particular about post-employment benefits.

# Scope of IPSAS 39

- ***Short-term 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 subsidized goods or services) for current employees;*

- ***Post-employment benefits:*** *such as pensions, other retirement benefits, post-employment life insurance and post-employment medical care;*

- ***Termination benefits:****-obligating event is termination, not service*

- ***Other long-term 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*

# Scope of IPSAS 39

Accounting for short-term employee benefits is generally straight forward because no actuarial assumptions are required to measure the obligation or the cost and there is no possibility of any actuarial gain or loss.

# IPSAS 39 – Recognition & Measurement criteria

- **Profit-sharing and bonus plans.** An entity shall recognise the expected cost of profit-sharing and bonus payments when, and only when:
- The entity has **a present legal or constructive obligation** to make such payments as a result of past events; and
- **A reliable estimate** of the obligation can be made. A present obligation exists when, and only when, the entity has no realistic alternative but to make the payments.

# IPSAS 39 – Recognition & Measurement criteria ( Cont…)

- Under some profit sharing plans, employees receive a share of the profit only if they remain with the entity for a specified period. Such plans create a constructive obligation as employees render service that increases the amount to be paid if they remain in service until the end of the specified period. *(ifrs 2)*

- The measurement of such constructive obligations reflects the possibility that some employees may leave without receiving profit-sharing payments.

# IPSAS 39 – Recognition & Measurement criteria ( Cont…)

- **Post-employment benefits, these include:**

(a) retirement benefits, such as pensions; and
(b) Other post-employment benefits, such as post employment life insurance and post-employment medical care.

- Arrangements whereby an entity provides post employment benefits are post-employment benefit plans. An entity applies this Standard to all such arrangements whether or not they involve the establishment of a separate entity to receive contributions and to pay benefits.

# IPSAS 39 – Benefits Definitions

- **Defined contribution plans -** are post employment benefit plans under which an entity pays **fixed contributions** into a separate entity (a fund) and will have no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods.

- **Defined benefit plans** are post employment benefit plans other than defined contribution plans.

# IPSAS 39 – Post Employment Benefits

- IPSAS 39 covers 2 types of post-employment (pension) scheme:

**Defined contribution schemes:**

The entity pays agreed contributions into a plan and has no further liability.

Accounted for on an accruals basis

**Defined benefit schemes:**

Any other type of scheme. Typically a pension is guaranteed based on final salary basis

Accounted for using the projected unit credit method.

# Defined Contribution Schemes

- **Contributions paid expensed straight line basis**

**Example:**

Kenya Ltd has payroll costs of 1.35 million for the year ended 31 December 2015. The company has a defined contribution scheme and pays pension contributions of 5% of salary costs each year. During the year, Kenya Ltd paid 5,000 per month and will pay over the balance in January 2016.

**Indicate amount to be charged in the following:**

i. *Statement of Comprehensive Income*
ii. *Statement of Financial Position*

# Defined Contribution Schemes ( Cont...)

- The entity's **legal or constructive obligation is limited** to the amount that it agrees to contribute to the fund. Thus, the amount of the post employment benefits received by the employee is determined by the amount of contributions paid by an entity (and perhaps also the employee)to a post-employment benefit plan or to an insurance company, together with investment returns arising from the contributions; and

- Inconsequence, actuarial risk (that benefits will be less than expected)and investment risk (that assets invested will be insufficient to meet expected benefits) fall on the employee.

# Defined Benefit schemes

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**DEFINED BENEFIT SCHEMES**

**SCHEME ASSETS**

**SCHEME LIABILITIES**

**MEASURED AT FAIR VALUE AS AT BALANCE SHEET DATE**

**MEASURED AT PRESENT VALUE OF FUTURE OBLIGATIONS**

**The pension surplus or deficit is presented in the balance sheet of the entity**

# Defined benefit schemes ( cont..)

- The pension payable on retirement normally depends on either the final salary or the average salary of the employees during their career. The employer undertakes to finance a pension income of a certain amount, e.g. = 1/4 ×expected final salary ×(years of service / 30 years).

- The employer has a continuing obligation to make sufficient contributions to the plan to fund the pensions.

- An actuary measures the present value of the defined benefit obligation at every end of the reporting period so as to ascertain the funding status of the plan and the amount to be contributed towards the plan by employer. The calculation or measurement is based on various estimates and assumptions including: ***Life expectancy: Investment returns: wage inflation.***

# Defined benefit schemes ( cont..)

**Defined benefit plans: the basic principle:**

- The entity recognises both the **liability** for future pension payments and the **scheme assets**.
- If the **liability exceeds the assets**, there is a deficit (the usual situation) and a liability is reported in the statement of financial position.
- If the **scheme assets exceed the liability**, there is a surplus and an asset is reported in the statement of financial position.
- The pension expense for the period is the difference between the deficit/surplus at the beginning of the period and the deficit/surplus at the end of the period.

# Defined benefit schemes ( cont..)

## Key Terms & Definitions:

- **Current service cost:-** is the increase in the actuarial liability (present value of the defined benefit obligation) resulting from employee service in the current period.
- **Past service cost:-** is the increase in the actuarial liability relating to employee service in the previous period but only arising in the current period. Past service costs usually arise because there has been an improvement in the benefits being provided under the plan.
- **Interest cost: -** is the increase in the pension liability arising from the unwinding of the discount as the liability is one period nearer to being settled.

# Defined benefit schemes ( cont..)

**Key Terms & Definitions:**

- **Return on assets : -** is the expected return earned from the pension scheme assets.
- **Curtailments and settlements: -** are the gains and losses arising when major reductions are made to the number of employees in the plan or the benefits promised to them.
- **Actuarial gains and losses:-** are increases and decreases in the pension asset or liability that occur either because the actuarial assumptions have changed or because of differences between the previous actuarial assumptions and what has actually happened (experience adjustments). For example, the investment income from the assets may have been greater than expected.

# Defined benefit schemes ( cont..)

- As per IPSAS 39, the **carrying amount** of the defined benefit liability is the net total of:

- The present value of the defined benefit obligation at the reporting date minus the fair value of the plan assets at the reporting date

# Defined benefit schemes ( cont..)

## Determining fair value of plan assets:

| | |
|---|---|
| **Fair value at start of period** (Market valuations should be carried out regularly) | XX |
| **Add:** | |
| **Increase/ (Decrease) in fair value of plan assets during period** | XX |
| **Contributions made:** | XX |
| **Benefits paid** | (XX) |
| Fair value at end of period | **XX** |

# Defined benefit schemes ( cont..)

- **Determining fair value of plan liabilities:**

| | |
|---|---|
| **Present value at start of period**<br>(Accumulated pension benefits earned by past and present employees in return for services to date, which will be payable in the future) | XX |
| **Current service cost**<br>(Extra pension benefits earned by employees in return for services in current period. Estimated by a qualified actuary -affected by mortality rates, future salaries, etc) | XX |
| **Interest cost**<br>(Increase in the present value of future obligations during the current period ('unwinding the discount'- Arises because the pension benefits for employees are now one year closer to being paid | XX |
| **Benefits paid:**<br>Amounts paid out from pension fund in current year, thus reducing future liability of the plan | (XX) |
| Present value at end of period | xx |

# Defined benefit schemes ( cont..)

**Actuarial gains and losses:**

Actuarial gains and losses can result from increases or decreases in the present value of plan liabilities or increases or decreases in the fair value of plan assets. Causes include:

- unexpectedly high or low rates of employee turnover;
- early retirement or mortality;
- salary increases;
- changes in discount rates;
- differences between actual and expected return on plan assets

# Defined benefit schemes ( cont..)

**Recognising actuarial gains and losses**

- Actuarial valuations are based on assumptions.
- Actuarial gains and losses arise because the actual outturn does not match the original estimates and 'experience adjustments' are needed.
- Actuarial assumptions may also be changed in the light of events, such as increasing life expectancy.
- Actuarial gains or losses are recognised directly in other comprehensive income.

# Defined benefit schemes ( cont..)

**The 'Asset Ceiling'**

- Sometimes the deduction of plan assets from the pension obligation results in an asset. IPSAS 39 states that pension plan assets surpluses are measured at the **lower of:**

(i) The amount calculated as per net plan asset

(ii) The present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan.

- Applying the ***'asset ceiling' means that a surplus can only be recognized to the extent that it will be recoverable in the form of refunds or reduced contributions in future.***

# Defined Benefits Plan-Presentation and Qualitative Disclosures

- Accounting policy for actuarial gain or loss
- General description of plan
- Reconciliation of opening and closing DBO and plan assets, including reconciliation to amounts in f/s
- Principal actuarial assumptions, in absolute terms
- Current and comparative disclosures for DBO, plan assets, surplus or deficit and experience adjustments
- Generally no offset of different plans in balance sheet; however, disclosures regarding different defined benefit plans may be aggregated.

# Other long-term employee benefits

- Other long-term employee benefits include items such as the following, if 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:
  (a) long-term paid absences such as long-service or sabbatical leave;
  (b) jubilee or other long-service benefits;
  (c) long-term disability benefits;
  (d) profit-sharing and bonuses; and
  (e) deferred remuneration.

- *The measurement of other long-term employee benefits is not usually subject to the same degree of uncertainty as the measurement of post-employment benefits. For this reason, this Standard requires a simplified method of accounting for other long-term employee benefits. Unlike the accounting required for post-employment benefits, this method does not recognise re-measurements in other comprehensive income*

# Termination benefits

**Termination benefits**

- The Standard deals with termination benefits separately from other employee benefits because the event that gives rise to an obligation is the termination of employment rather than employee service.

- Termination benefits result from either an entity's decision to terminate the employment or an employee's decision to accept an entity's offer of benefits in exchange for termination of employment.

# Termination benefits ( Cont...)

- Termination benefits do not include employee benefits resulting from termination of employment at the request of the employee without an entity's offer, or as a result of mandatory retirement requirements, because those benefits are post-employment benefits.
- Some entities provide a lower level of benefit for termination of employment at the request of the employee (in substance,a post-employment benefit) than for termination of employment at the request of the entity.
- The difference between the benefit provided for termination of employment at the request of the employee and a higher benefit provided at the request of the entity is a termination benefit.

# IPSAS 39 –DISCLOSURE

**An entity shall disclose information that:**

(a) Explains the characteristics of its defined benefit plans and risks associated with them.

(b) Identifies and explains the amounts in its financial statements arising from its defined benefit plans; and

(c) describes how its defined benefit plans may affect the amount, timing and uncertainty of the entity's future cash flows.

# IPSAS 39 –DISCLOSURE ( Cont..)

- A reconciliation of opening and closing balances of the present value of the defined benefit obligation showing separately, if applicable, the effects during the period attributable to each of the following:

  (i) Current service cost;
  (ii) Interest cost;
  (iii) Contributions by plan participants;

# IPSAS 39 –DISCLOSURE ( Cont..)

- (iv) Actuarial gains and losses;
- (v) Foreign currency exchange rate changes on plans measured in a currency different from the entity's presentation currency;
- (vi) Benefits paid;
- (vii) Past service cost;
- (viii) Entity combinations;
- (ix) Curtailments; and
- (x) Settlements.

# IPSAS 39 –DISCLOSURE ( Cont..)

The principal actuarial assumptions used as at the reporting date, including, when applicable:

(i) The discount rates;

(ii) The basis on which the discount rate has been determined;

(iii) The expected rates of return on any plan assets for the periods presented in the financial statements;

# IPSAS 39 –KEY TAKE AWAYS

- 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 Complex calculations.
- Plan assets at fair value

# IPSAS 39 –KEY ENTRIES ( DB)

| Changes in PA/DBO | Accounting Treatment ( Recognition) | Double Entry |
|---|---|---|
| Current service cost | Operating cost | Dr. Income<br>Cr. Liability( DBO) |
| Interest Cost | Financial cost | Dr. Income<br>Cr. Liability( DBO) |
| Return on plan assets | Financial income | Dr. Asset ( PA)<br>Cr. Income |
| Past Service costs ( if any) | Operating cost | Dr. Income<br>Cr. Liability (DBO) |
| Curtailments and settlements if any | Operating cost | Dr. Income<br>Cr. Liability ( DBO) |
| | | |

# Interactive Session

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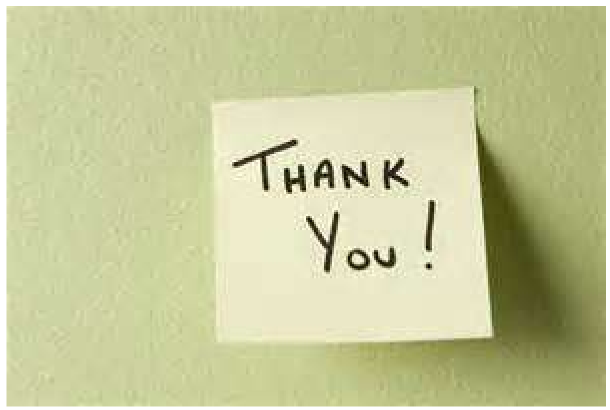

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