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LKAS 19 - Employee Benefits

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What will you learn?

1) Describe objective, scope and main principles of LKAS 19
2) Classify different types of post-employment benefits
3) Describe a DC post-employment plan and its accounting treatment
4) Describe a DB post-employment plan and its accounting treatment
5) Describe the calculation of DB obligations and current service cost
6) Classify different types of "other" employee benefits
7) Evaluate the quality of disclosures

DC = defined contribution
DB = defined benefit

Agenda

- The basics
- Post-employment benefits
  - Defined contribution
  - Defined benefit
- Other employee benefits
- Disclosure
- Check?
- Amendments

Objective and scope

In scope of LKAS 19	♦ **Covers all kinds of employee benefits**
Out of scope of LKAS 19	♦ **Share-based payment made to employees** ♦ **Reporting by employee retirement benefit plans (see LKAS 26)**

Overview of employee benefits

- **Short-term benefits** (LKAS 19.8-23)
- **Post-employment benefits** (LKAS 19.24-125)
- **Other long-term benefits** (LKAS 19.126-131)
- **Termination benefits** (LKAS 19.132-143)

SLFRS 2 for all share-based payment transactions

Main principles of LKAS 19

Recognise employee benefits when service rendered in exchange for those benefits

Post-employment benefit plans are classified as:

DC plans	**DB plans**
Cost of benefits = contribution paid / payable to the plan	- Cost of benefit = present value of entitlement earned - Many variable factors, such as final or average pay levels - Involves complex calculations - Plan assets measured at fair value

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Post-employment benefit plans

DC plans

Obligation limited to amount of contributions paid to fund

Plans under which entity has ***no*** further obligation, legal or constructive, to pay amounts in addition to contributions as set out in plan documentation

DB plans

- **All other plans**
- **Recognise legal and constructive obligations**

Plans for which the entity ***has*** a legal or constructive obligation to make good any shortfall in benefits levels as set out in plan documentation

DC plans

- **Expense recognised = contributions paid and payable**
- **Accrue cost as service is rendered**

- **Any shortfall / excess of contributions payable over amounts paid is recognised as liability / asset**
- **Disclose amount recognised as expense**

DB plans

Accounting complexity in DB plans

Demographic assumptions; mainly based on past experience, such as:

- Mortality
- Rate of employee turnover, disability, early retirement

Financial assumptions; based on market expectation, such as:

- Discount rate and expected rate of return on assets
- Future salary and benefit levels

Determining net DB pension obligation / asset

Step 1	**Determine defined benefit obligation (DBO) using actuarial techniques, including discounting**
Step 2	**Determine value of plan assets at fair value**
Step 3	**Calculate past service costs (if any)**
Step 4	**Determine actuarial gains/losses to be recognised (if any)**

Usually requires involvement of an actuary

Step 1: Determine the DBO

1. Determine gross DBO

- Estimate of benefits earned by employees for services in current and prior periods
- Use unbiased and mutually compatible assumptions
- Assumptions reflect best long-term estimates

2. Discount gross DBO: *Projected Unit Credit method*

- Use market yield of high quality corporate bonds or of government bonds when there is an insufficiently deep corporate bond market
- Currency and term of bond should be consistent with those of obligation

Step 2: Determine fair value of plan assets (1)

Plan assets are assets held by a long-term employee benefit fund and qualifying insurance policies

Other insurance policies recognised as reimbursement rights

Measure plan assets at fair value at end of reporting period

Step 2: Determine fair value of plan assets (2)

Meets definition of plan asset?

yes	no
Plan asset	**Reimbursement right**
♦ Measured at fair value ♦ Netted against pension liability	♦ Recognised as separate asset when recovery virtually certain ♦ Measured at fair value ♦ Treated in same way as plan assets

Step 3: Determine past service cost

Additional benefits related to services in prior periods

Employee receives pension of 1% of final salary for each year of services

Change: in Year 3 employer increases retrospectively the pension of 1% to 2%

	Year 1	Year 2	Year 3	
			1% for Yr 1	Past service cost
			1% for Yr 2	
			2%	
		1%	1%	
	1%	1%	1%	
Total pension	**1%**	**2%**	**6%**	

Step 4: Determine actuarial gains / losses

What causes actuarial gains and losses to arise?

- **Actual is different from expected**
- **Revision to estimates**
  - Salary
  - Turnover
  - Mortality
  - Early retirement
  - Return on assets

Actuarial gains and losses

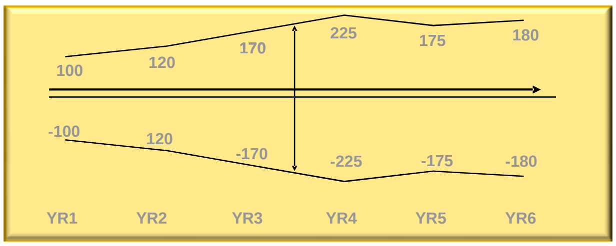
Accounting policy choice	♦ **Corridor method** ♦ **Recognise immediately**
Corridor method	♦ **Recognise amount outside “corridor” in profit or loss over average remaining working life** ♦ **Or faster method, e.g. all amounts outside corridor immediately in profit or loss**
Immediate recognition in OCI	♦ **Presented in statement of comprehensive income, and** ♦ **Recognised immediately in retained earnings**

OCI = other comprehensive income

Determining the corridor

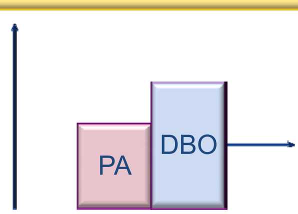
Greater of 10% of present value of DBO & 10% of fair value of plan assets

Reporting period	Liability at 1.1	Assets at 1.1	Corridor: 10%
31.12.YR1	1,000,000	900,000	100,000
31.12.YR2	1,200,000	1,100,000	120,000
31.12.YR3	1,300,000	1,700,000	170,000
31.12.YR4	1,500,000	2,250,000	225,000
31.12.YR5	1,700,000	1,750,000	175,000
31.12.YR6	1,800,000	1,700,000	180,000

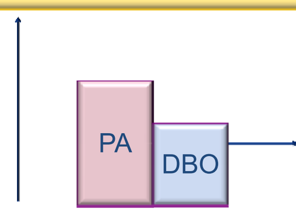


Net accounting and the corridor

Condition to apply net accounting:
Plan assets or qualifying insurance policies



=> Net liability / obligation



=> Net asset?

Net accounting and corridor method
Net asset/obligation not equal to amount recorded in statement of financial position

Amount in statement of financial position

	DBO:
-	Plan assets
- / +	Unrecognised past service cost
- / (+)	Unrecognised actuarial losses/(gains)
=	**Net liability / asset**

Corridor method only

Determination of DBO movement

DBO: Amount 01.01.YR1	
+ Service costs	**Present value of "newly generated liability"**
+ Interest costs	**Unwinding discounting effect**
+/- Past service costs	**Retroactively effective plan change**
+/- Actuarial losses/gains	**Residual change in obligation**
- Benefits paid	**Liability settled**
DBO: Amount 31.12.YR1	

Changes in DBO vs plan assets

Defined benefit obligation	Plan assets
Amount 01.01.YR1	Fair value at 01.01.YR1
+ Service costs	+ Expected return
+ Interest costs	+ Contributions
+/- Past service costs	
+/- Actuarial losses/gains	+/- Actuarial losses/gains
- Benefits paid	- Benefits paid
Amount 31.12.YR1	Fair value at 31.12.YR1

Profit or loss

Profit or loss

+ Current service costs
+ Interest costs
- Expected return on assets

+/- Past service costs

+/- Actuarial losses/gains

= Net pension cost

Minimum funding requirements: 3 issues

When a refund or reduction in future contributions is available

How that is affected by an MFR

When an MFR might give rise to a liability

PV of DBO | MFR
FV of Plan Assets

PV of DBO | MFR
FV of Plan Assets

PV of DBO | MFR
FV of Plan Assets

Prepayments to a plan when there is an MFR are an asset not expense

MFR = minimum funding requirement

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Short-term employee benefits

Benefits due within 12 months, such as:

- Wages, salaries, social security contributions
- Vacation, sick leave
- Profit-sharing, bonuses and deferred compensation to which employee becomes entitled within 12 months after reporting period in which services rendered

Short-term employee benefits: Recognition

- **Recognition criteria similar to those of LKAS 37 apply**
- **Undiscounted expected costs recognised as expense**
- **Difference between expected costs and amount paid in reporting period recognised as asset or liability**
- **No specific disclosure requirements**

Other long-term employee benefits

Benefits due in more than 12 months such as

Compensated absences (e.g. sabbatical leave)

Long-service awards and disability benefits

Profit-sharing, bonuses and deferred compensation to which employee becomes entitled > 12 months after reporting period in which services were rendered

Immediate recognition of
actuarial gains and losses and past service cost

Termination benefits

Recognition criteria similar to those of LKAS 37 apply

Obligation event is termination, not service

Only recognise when demonstrably committed to:
- Terminate specific individual(s)/group(s) of individuals; or
- Provide termination benefits to encourage voluntary redundancy

Discount if due in more than 12 months

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Disclosure

- DB plans:
- ♦ Accounting policy
- ♦ Description
- ♦ Reconciliation of opening to closing DBO and Plan assets
- ♦ Principal actuarial assumptions
- ♦ Current and comparative disclosures for DBO, plan assets, surplus or deficit and experience adjustments
- ♦ Total expense with break up

- Short term benefits-para 23
- DC plans – para46-47
- Other long term benefits –para 131
- Termination benefits – para 141-143

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Which benefits are in the scope of LKAS 19?

CA-Health pays employee income taxes related to share-based payments granted to its employees. The payment is not based on the price or value of CA-Tech's shares

CA-Health employees will receive a R$ 1,000 bonus payment if CA-Tech's share price remains above R$ 8 during Year 2

CA-Health employees will receive a bonus of 200% of CA-Tech's share price on 31 December Year 2 if the share price remains above R$ 8 during Year 2

CA-Health operates an annual bonus scheme for senior managers. Under the scheme senior managers receive a bonus based on CA-Health's performance for the year

Which of the following are correct?

Under a DC plan the employer has an obligation to pay fixed contributions into a fund

Under a DB plan the employer has a legal or constructive obligation to provide post-employment benefits to employees

Which of the following are plan assets?

Equities held by the CA-Health employee DB plan, Galaxy-Pension (i.e. separately from CA-Health)

Cash held by the CA-Health employee DB plan, Galaxy-Pension (i.e. separately from CA-Health)

CA-Health outsources 10 employees who are members of its DB plan. Under the agreement CA-Health is reimbursed for the cost of providing DB plan benefits to these employees. It is virtually certain that CA-Health will receive the reimbursement of these costs

CA-Health holds an insurance policy that was not issued by a related party, the proceeds of the policy are only available to the DB plan, are not available to CA-Health's creditors in the event of bankruptcy, and cannot be returned to CA-Health except as reimbursement for employee benefits paid

Which statements are true?

The MFR may reduce the net pension asset recognised in the statement of financial position

The MFR may change the net pension asset recognised in the statement of financial position to a net pension liability

The MFR may increase the net pension liability recognised in the statement of financial position

The MFR has no impact on the net pension asset recognised in the statement of financial position

MFR = minimum funding requirement

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In 2012.... Changes to Para 57

- This Standard encourages, but does not require, an entity to involve a qualified actuary in the measurement of all material post-employment benefit obligations. For practical reasons, an entity may request a qualified actuary to carry out a detailed valuation of the obligation before the end of the reporting period. Nevertheless, the results of that valuation are updated for any material transactions and other material changes in circumstances (including changes in market prices and interest rates) up to the end of the reporting period.
- Gratuity formula/basis of valuation -Appendix D & E deleted

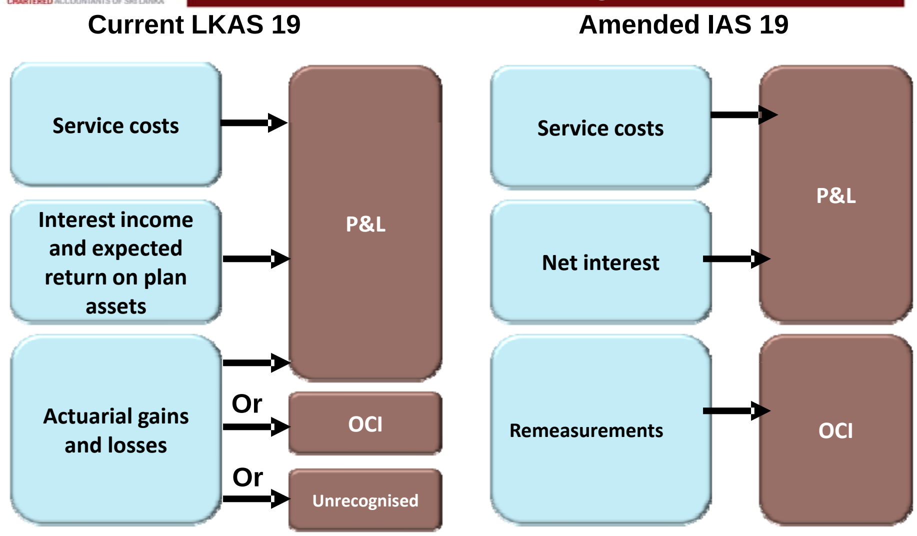
Amendments to IAS 19 Employee Benefits:

- Amended version of IAS 19 published 16 June 2011
- IASB planned a comprehensive review, but deferred
  Amendment result of restricted scope project
  Makes no change to:
  - Fundamental measurement method under which benefits are attributed to periods of service, though changes of detail
  - Requirement to recognise expense on a straight-line basis when employee service in later years will lead to a materially higher level of benefit than in earlier years

Major Differences from Current Requirements

IAS 19 Highlights	Difference
All actuarial gains and losses are recognised immediately in other comprehensive income	The option to apply the corridor method for AGLs is removed
Revised basis of calculation for finance costs	The nature of plan assets held will have no impact on the net finance charge
Amended definitions of short-term and other long-term employee benefits	More benefits may now be classified as other long-term

Summary of Change in Presentation of Changes



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Key Changes and Potential Impacts

- The amendments will make more volatile the statement of financial position of entities currently applying the corridor method
- The nature of the plan assets held will have no impact on the net finance charge or credit
- More benefits may now be other long-term than was previously the case
- Entities may wish to reconsider how their covenant tests will be affected by the amended standard
- Entities may need to discuss with their lenders revising the definitions of any relevant covenants included in their lending agreements
- Entities will need to plan the way that they assess the need for and how best to aggregate the disclosures to be made

1) LKAS 19 covers all benefits except share-based payments (SLFRS 2)
2) Main principle: Recognise cost as service is rendered
3) Post-employment plans classified as DC or DB
4) DC = obligation to provide contributions only
5) DB = obligation to provide benefits
6) Actuarial gains/losses: Immediate recognition or corridor method – accounting policy choice
7) Short-term benefits due within 12 months

CA

Thank you.