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CHARTERED ACCOUNTANTS OF SRI LANKA

Employee Benefits

LKAS 19

Contents

1) Describe the objective, scope and main principles of LKAS19
2) Classify different types of "other" employee benefits
3) Classify different types of post-employment benefits
4) Describe a defined contribution post-employment plan and its accounting treatment
5) Describe a defined benefit post-employment plan and its accounting treatment
6) Describe the calculation of defined benefit obligations, current service cost and net interest and of OCI amount
7) Disclosure & Presentation

OCI = other comprehensive income

Objective & Scope

To recognise the employee benefit expense as the employee provides the service

In scope of LKAS 19	♦ **Covers all kinds of employee benefits, not just pensions**
Out of scope of LKAS 19	♦ **Share-based payment made to employees (SLFRS 2)** ♦ **Reporting by employee retirement benefit plans (see LKAS 26)**

Overview of employee benefits

Short-term benefits
(LKAS 19.9)

Post-employment benefits
(LKAS 19.26)

Other long-term benefits
(LKAS 19.153)

Termination benefits
(LKAS 19.159)

Short-term employee benefits

Benefits expected to be wholly settled before 12 months after the end of the annual reporting period, such as:

- Wages, salaries, social security contributions
- Vacation, sick leave
- Profit-sharing and bonuses

Other long-term employee benefits

Benefits not expected to be wholly settled before 12 months after the end of the annual reporting period, such as

- Paid absences (e.g. sabbatical leave)
- Long-service awards and disability benefits
- Profit-sharing, bonuses and deferred compensation

A question for you: Short-term vs long-term

- Lila-Energy awards a bonus to its employees in respect of their service in year one
- The employees are entitled to draw on the bonus payable to them in year two
- However, due to tax rules that apply on Planet-Lila, the employees will pay a lower level of tax on their bonus if they draw their bonus only after the end of year three
- Lila-Energy expects the majority of the bonus payable at the end of year one not to be drawn in year two

Will the bonus be classified as short-term or other long-term benefit?

Termination benefits

Recognition criteria similar to those of LKAS 37 apply

Obligation event is termination, not service

Recognise at the earlier of:
- When the entity recognises costs for a restructuring within the scope of LKAS 37; and
- When the entity can no longer withdraw the offer of those benefits

Subsequent changes in measurement are made in accordance with the nature of the benefit provided

Classification of post-employment benefit plans

Defined contribution

Obligation limited to amount of contributions paid

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

Defined benefit

- **All other plans**
- **Obligation to pay the agreed benefits**

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

A question for you:
Defined contribution or defined benefit

- Galaxy operates two post-employment benefit plans:
  - Galaxy-Invest, the plan for certain employees. Under this plan, Galaxy is obliged to make monthly contributions of Rs 100 to a separate entity (fund), Galaxy has no obligation to pay any further amounts
  - Galaxy-Pension, the plan for certain employees. For this plan, Galaxy makes monthly contributions of Rs 100 to a separate entity (fund), Galaxy is obliged to pay further contributions if the fund does not hold sufficient assets to provide a pension to employees of 0.2 per cent of final salary for each year of service

Which is DC? Which is DB?

DC = Defined Contribution, DB = Defined Benefit

Additional plan characteristics

Multi-employer plans

- Pool assets contributed by entities not under common control, and
- Use those assets to provide benefits.

State plans

State plans are established by legislation and are operated by national or local government or by another body

Group plans

DCP unless the entity has legal/constructive obligation to pay the employee benefit directly or to pay further amount

Insured benefits

Defined contribution 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

A question for you: Accounting for a DCP

- For the Galaxy-Invest DC plan, Galaxy paid monthly contributions in 2016 for the 200 employees
- The contribution due for service was Rs 0.5 (50 cents) per employee for each month of service rendered

What is the profit and loss expense to be recognised in 2016?

Defined benefit plans

Accounting complexity in DB plans

Demographic assumptions such as:
- Mortality
- Rate of employee turnover, disability, early retirement

Financial assumptions such as:
- Discount rate
- Future salary and benefit levels

Usually requires involvement of an actuary

Statement of financial position

Defined benefit obligation

-

Fair value of plan assets

+

Effect of asset ceiling *(if any)*

=

Net defined benefit liability (asset)

Defined benefit obligation

Actuarial technique
Projected unit credit method

Estimate of ultimate cost

Discounted using high quality corporate bonds *(principle)*

DBO = Defined Benefit Obligation

A question for you: Inputs used to determine the DBO

- The Galaxy-Pension DB plan, from which employee, Aruna will receive her pension is based on final salary
- Statement 1
  - Galaxy is required to use the Projected Unit Credit method to estimate the DBO
- Statement 2
  - Galaxy can choose between the government bond rate and the high quality corporate bond rate as the discount rate to use in the calculation of the DBO

Are the statements above True or False?

DBO = Defined Benefit Obligation

Unfunded or funded defined benefit plans

Unfunded

- No assets are set aside
- Benefits paid directly by employer

Funded

- Contributions are invested in a fund
- Typical assets are cash, bonds, stocks and property
- Assets are measured at fair value

Fair value of plan assets

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

Other insurance policies recognised as reimbursement rights

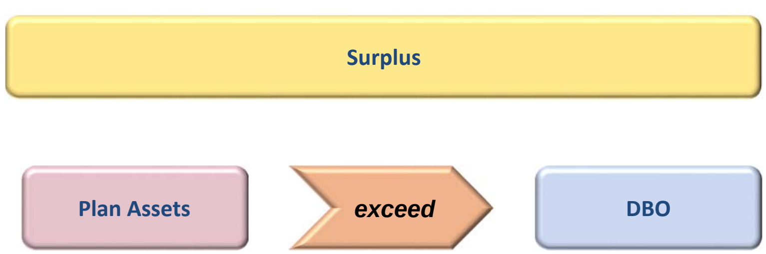
Measure plan assets at fair value at end of reporting period

A question for you: Plan assets

- Galaxy-Pension is a funded plan
- Assets held by the Galaxy-Pension plan include:
  - Equity/share/stocks
  - Government bonds
  - Cash
  - Unpaid contributions from the employer

Which of these are *not* considered plan assets?

Surplus



Statement of financial position

Defined benefit obligation

-

Fair value of plan assets

+

Effect of asset ceiling *(if any)*

=

Net defined benefit liability (asset)

Movements for the period in net defined benefit liability

Opening net defined benefit liability (asset)

Service cost Net interest	Profit or Loss
Remeasurements	OCI
Benefit payments Employer's contributions	Statement of financial position

Net defined benefit liability (asset)

OCI = other comprehensive income

Current service cost

Service costs → Profit or loss

Each year of employee service increases the agreed benefit

Present value of the benefit earned for the current year of service

Actuarial technique
Projected Unit Credit Method

Past service cost

Service costs → Profit or loss

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%**	

Net interest

Net interest → Profit or loss

Net interest
Net Defined Benefit Liability (Asset)

DBO × Discount rate

Plan Assets × Discount rate

Remeasurements

Remeasurements → OCI

DBO → **Actuarial Gains and Losses**

Plan Assets → **Return on Plan assets**

OCI = other comprehensive income, DBO = Defined Benefit Obligation

Remeasurements: Actuarial gains and losses

Remeasurements → OCI

What causes actuarial gains and losses to arise?

- Actual is different from expected
- Revision to estimates
  - Salary
  - Employee turnover
  - Mortality
  - Early retirement
  - Discount rate
  - Payment options

A question for you: AGLs

- The yield on high quality corporate bonds increased from 9.5% to 10% and_Galaxy changes the discount rate from 9.5% to 10% at the end of 2016

As a result of this change the discount rate, do you expect an actuarial gain or loss to be recognised?

AGLs = Actuarial Gains and Losses

Remeasurements: Return on plan assets

Return on plan assets

Deduct:

Costs of managing the plan assets

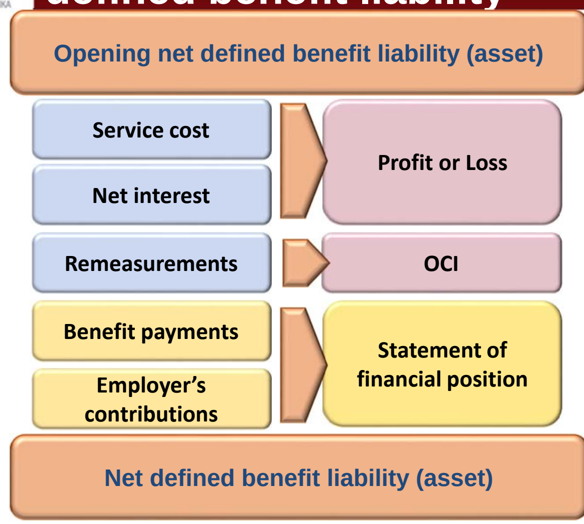
Any tax payable by the plan itself

A question for you: Return on plan assets

- Galaxy-Pension holds 100 shares in ABC a publicly traded entity
- The share price at 31 Dec 2016 was Rs22, compared to Rs21 at 31 December 2015
- Equity assets are managed by a stock broker, who charges a flat annual fee of Rs10 for managing this plan asset

What is the return on this plan asset?

Movements for the period in net defined benefit liability



OCI = other comprehensive income

Disclosures

- Explain characteristics of its defined benefit plans and associated risks
- Identify and explain amounts in its financial statements arising from its defined benefit plans; and
- Describe how its defined benefit plans may affect the amount, timing and uncertainty of the entity's future cash flows.

Characteristics of defined benefit plans and associated risks

- **Characteristics**
  - Nature of benefits provided (e.g. final salary defined benefit or contribution-based with guarantee)
  - Description of regulatory framework in which plan operates (e.g. minimum funding requirements)
  - Description of any other entity's responsibilities for plan governance (e.g. trustees of plan)
- **Risks**
  - Description of entity's risk exposure, focussing on unusual entity-specific or plan-specific risks and significant risk concentrations
- **Describe plan amendments, curtailments and settlements**

Explanation of amounts in the financial statements

- Separate reconciliations of opening to closing balance for net defined liability/asset for each of:
  - Plan assets, liabilities and effect of asset ceiling
- Show in reconciliations each of:
  - Current service cost, interest income or expense, remeasurement (split demographic & financial assumptions), past service cost and gains/losses from settlements, effect of changes in foreign exchange rates, contributions to the plan, payments from the plan, effect of business combinations and disposals
- Disaggregate fair value of plan assets into classes that distinguish their nature and risks
  - Subdivide each class into those with active market quoted prices (per SLFRS 13 *Fair Value Measurement*) and others

DBP assumptions

- Disclose the significant actuarial assumptions used to determine the defined benefit obligation
  - In absolute terms (e.g. as an absolute percentage)
  - Where provided in total for a grouping of plans, should be in form of weighted averages or relatively narrow ranges
- Amount, timing and uncertainty of future cash flows
  - Disclose sensitivity analysis for each significant actuarial assumption as of end of reporting period
    - Show how the defined benefit obligation would have been affected by reasonably possible changes in assumptions
  - Disclose methods and assumptions used in preparing the sensitivity analyses above and the limitations of those methods
  - Changes from the previous period in methods and assumptions

Sample disclosures

(i) Actuarial assumptions

The following were the principal actuarial assumptions at the reporting date (expressed as weighted averages).

	2013	2012
Discount rate	**5.1%**	4.8%
Future salary growth	**2.5%**	2.5%
Future pension growth	**3.0%**	2.0%
Medical cost trend rate	**4.5%**	4.0%

(ii) Sensitivity analysis

Reasonably possible changes at the reporting date to one of the relevant actuarial assumptions, holding other assumptions constant, would have affected the defined benefit obligation by the amounts shown below.

31 December 2013	**Defined benefit obligation**	
Effect in thousands of euro	**Increase**	**Decrease**
Discount rate (1% movement)	**(335)**	**350**
Future salary growth (1% movement)	**180**	**(172)**
Future pension growth (1% movement)	**175**	**(168)**
Medical cost trend rate (1% movement)	**380**	**(250)**
Future mortality (1% movement)	**(70)**	**67**

Although the analysis does not take account of the full distribution of cash flows expected under the plan, it does provide an approximation of the sensitivity of the assumptions shown.

Amount, timing and uncertainty of future cash flows

- Disclose any asset-liability matching strategies used to manage risk
- Disclose
  - Description of any funding arrangements and funding policy affecting future cash flows
  - Expected contributions to the plan for next annual reporting period
  - Information about maturity profile of defined benefit obligation
    - Weighted average duration of obligation
    - Other information about distribution of timing of benefit payments – e.g. maturity analysis of benefit payments

Disclosure requirements in other SLFRSs

- Where required by LKAS 24 an entity discloses information about:

  (a) related party transactions with post-employment benefit plans; and

  (b) post-employment benefits for key management personnel.

- Where required by LKAS 37 an entity discloses information about contingent liabilities arising from post-employment benefit obligations.

Presentation

- In profit or loss
  1. **Service cost – current service cost, past service cost, curtailments and gains and losses on settlements**
  2. **Net interest on the net defined benefit liability/asset**
     - Offset interest income on plan assets (at same rate as used to discount plan obligations) against interest cost on defined benefit obligation
- In other comprehensive income (and never reclassify to profit or loss)
  3. **Remeasurements – includes actuarial gains and losses on defined benefit obligation and the actual return on plan assets, net of interest income on plan assets included in 2 above**

Recap

1) Scope of LKAS 19 includes many types of employee benefits
2) Post-employment benefit plans are the main focus of the standard
3) Accounting for Defined Contribution is straightforward
4) Accounting for Defined Benefit plans is complex and involves actuarial valuations

Thank you