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What will you learn?

1. Describe the objective, scope and main principles of IAS19
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. Evaluate the quality of disclosures

Agenda

- Objective, Scope & main principles
- Post-employment benefits
- Defined contribution
- Defined benefit
- The closing

Objective

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

Scope

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

Overview of employee benefits

Short-term benefits
(IAS 19.9)

Post-employment benefits
(IAS 19.26)

Other long-term benefits
(IAS 19.153)

Termination benefits
(IAS 19.159)

Short-term employee benefits

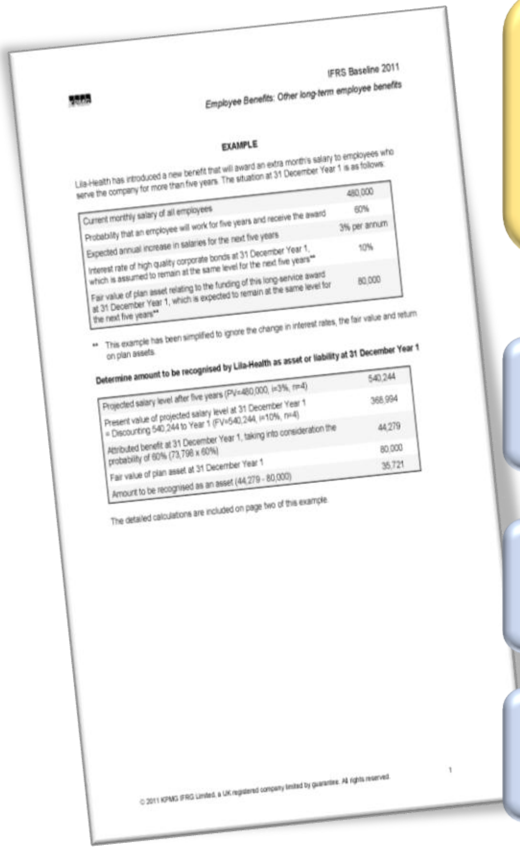
Benefits expected to be wholly settled before 12 months after the end of the annual reporting period, such as:

Wages, salaries, social security contributions

Vacation, sick leave

Profit-sharing and bonuses

Other long-term employee benefits



IFRS Baseline 2011

Employee Benefits: Other long-term employee benefits

EXAMPLE

Lila-Health has introduced a new benefit that will award an extra month's salary to employees who serve the company for more than five years. The situation at 31 December Year 1 is as follows:

Current monthly salary of all employees	480,000
Probability that an employee will work for five years and receive the award	60%
Expected annual increase in salaries for the next five years	3% per annum
Interest rate of high quality corporate bonds at 31 December Year 1, which is assumed to remain at the same level for the next five years**	10%
Fair value of plan asset relating to the funding of this long-service award at 31 December Year 1, which is expected to remain at the same level for the next five years**	80,000

** This example has been simplified to ignore the change in interest rates, the fair value and return on plan assets.

Determine amount to be recognised by Lila-Health as asset or liability at 31 December Year 1

Projected salary level after five years (PV=480,000, i=3%, n=4)	540,244
Present value of projected salary level at 31 December Year 1 = Discounting 540,244 to Year 1 (FV=540,244, i=10%, n=4)	368,994
Attributed benefit at 31 December Year 1, taking into consideration the probability of 60% (73,798 x 60%)	44,279
Fair value of plan asset at 31 December Year 1	80,000
Amount to be recognised as an asset (44,279 - 80,000)	35,721

The detailed calculations are included on page two of this example.

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 IAS 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 IAS 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

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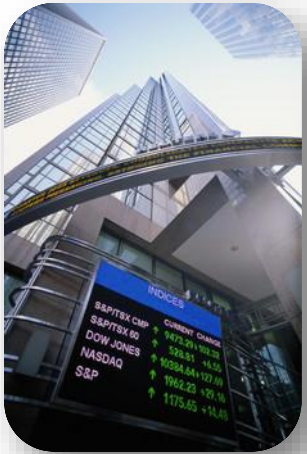
Classification of post-employment benefit plans

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

- Lila-Health operates two post-employment benefit plans:
  - Galaxy-Invest, the plan for certain employees of Lila-Health. Under this plan, Lila-Health is obliged to make monthly contributions of L$ 100 to a separate entity (fund), Lila-Health has no obligation to pay any further amounts
  - Galaxy-Pension, the plan for certain employees of Lila-Health. For this plan, Lila-Health makes monthly contributions of L$ 100 to a separate entity (fund), Lila-Health 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

State plans

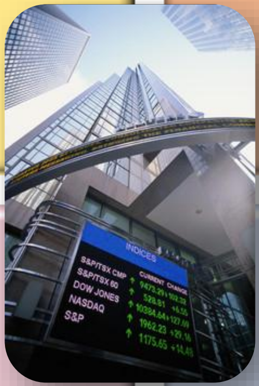
Group plans

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 defined contribution plan

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

What is the profit or 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

A question for you:
Accounting for a defined benefit plan

- Amy has worked for Lila-Health for 15 years
- Under the Galaxy-Pension plan, employees receive a pension of 0.2 per cent of final salary for each year of service

What information will Lila-Health need to calculate the liability for the pension payable to Amy in the future?

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 Amy will receive her pension is based on final salary
- Statement 1
  - Lila-Health is required to use the Projected Unit Credit method to estimate the DBO
- Statement 2
  - Lila-Health can choose between the Planet Lila 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	Funded
♦ No assets are set aside ♦ Benefits paid directly by employer	♦ 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
  - Planet Lila government bonds
  - Cash
  - Unpaid contributions from the employer

Which of these are *not* considered plan assets?

Surplus

Surplus

Plan Assets ***exceed*** **DBO**

Statement of financial position

Defined benefit obligation

-

Fair value of plan assets

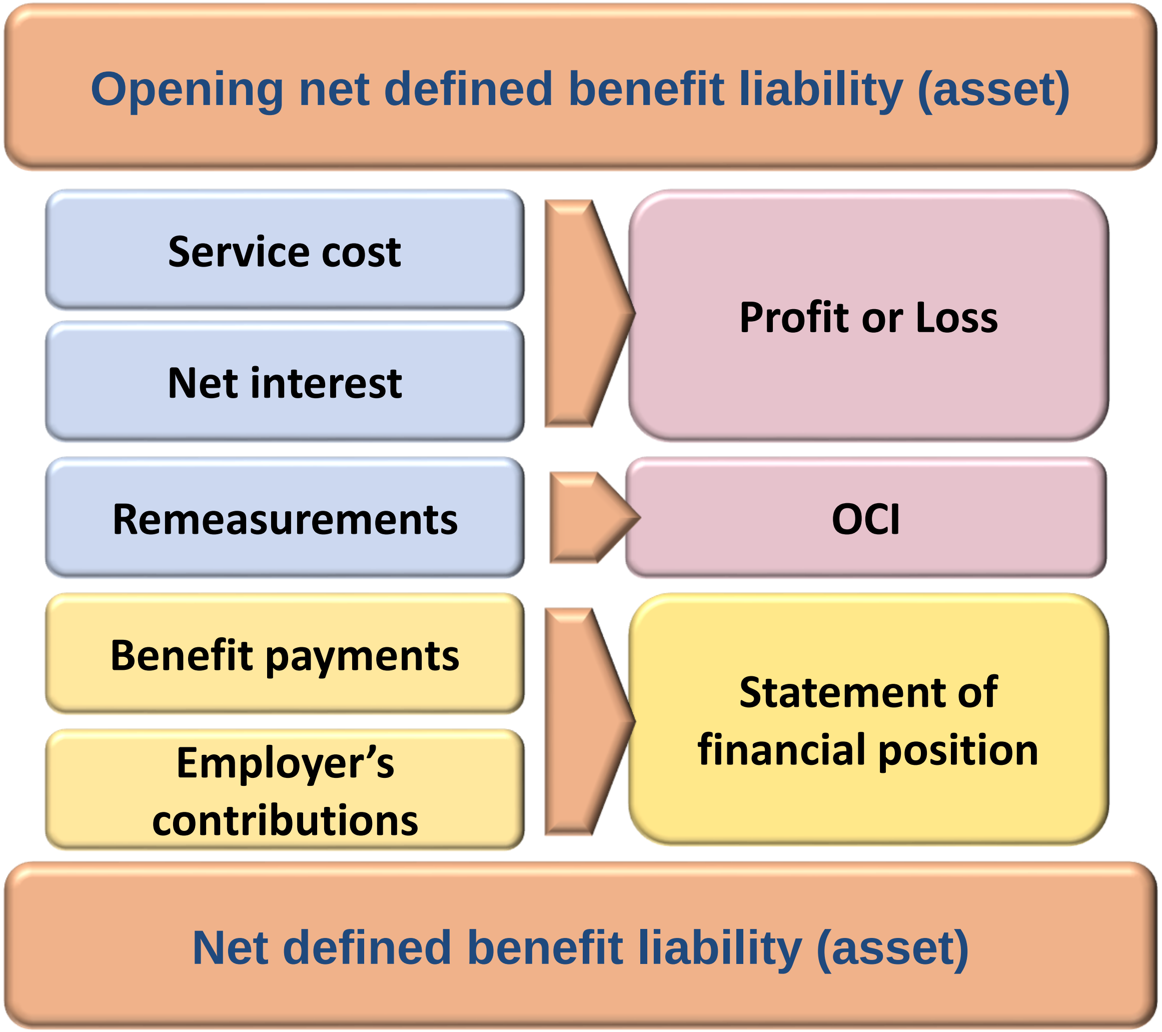
+

Effect of asset ceiling *(if any)*

=

Net defined benefit liability (asset)

Movements for the period in net defined benefit liability



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

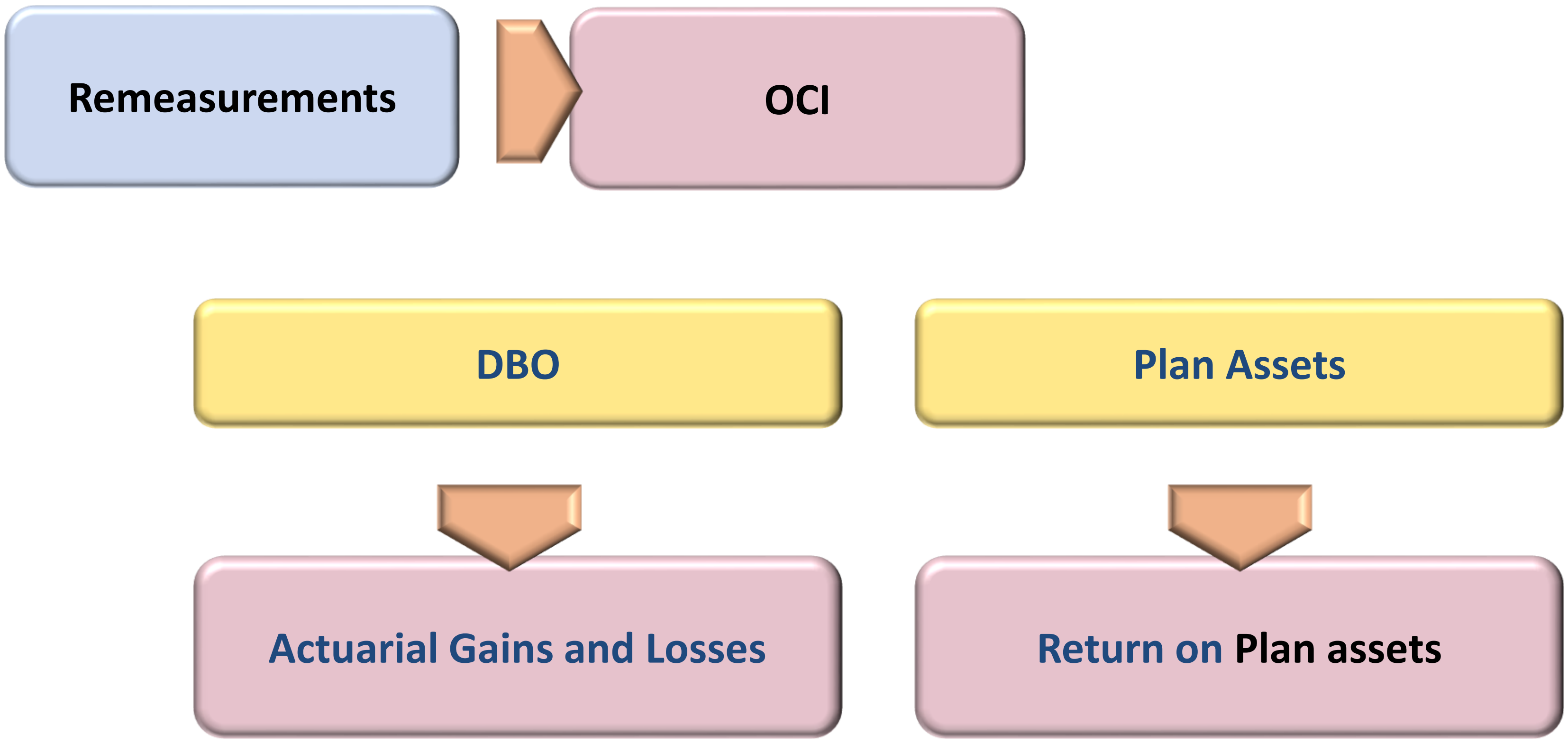
Net interest → **Profit or loss**

Net interest
Net Defined Benefit Liability (Asset)

DBO × Discount rate

Plan Assets × Discount rate

Remeasurements

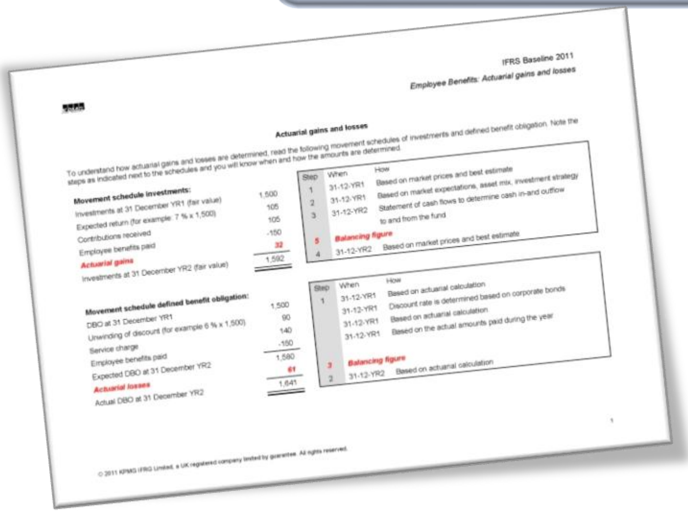


OCI = other comprehensive income, DBO = Defined Benefit Obligation

Remeasurements: Actuarial gains and losses

Remeasurements → **OCI**

What causes actuarial gains and losses to arise?



Actuarial gains and losses

To understand how actuarial gains and losses are determined, read the following movement schedules of investments and defined benefit obligation. Note the steps as indicated next to the schedules and you will know when and how the amounts are determined.

Movement schedule investments:	
Investments at 31 December YR1 (fair value)	1,500
Expected return (for example: 7 % x 1,500)	105
Contributions received	105
Employee benefits paid	-150
Actuarial gains	32
Investments at 31 December YR2 (fair value)	1,592

Step	When	How
1	31-12-YR1	Based on market prices and best estimate
2	31-12-YR1	Based on market expectations, asset mix, investment strategy
3	31-12-YR2	Statement of cash flows to determine cash in-and outflow to and from the fund
5	Balancing figure	
4	31-12-YR2	Based on market prices and best estimate

Movement schedule defined benefit obligation:	
DBO at 31 December YR1	1,500
Unwinding of discount (for example 6 % x 1,500)	90
Service charge	140
Employee benefits paid	-150
Expected DBO at 31 December YR2	1,580
Actuarial losses	61
Actual DBO at 31 December YR2	1,641

Step	When	How
1	31-12-YR1	Based on actuarial calculation
	31-12-YR1	Discount rate is determined based on corporate bonds
	31-12-YR1	Based on actuarial calculation
	31-12-YR1	Based on the actual amounts paid during the year
3	Balancing figure	
2	31-12-YR2	Based on actuarial calculation

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

A question for you: AGLs

- In 2016, Lila-Vitamins launched a multi-vitamin proven to help robots to live longer healthier lives
- Employee robots at Lila-Health, such as Amy, received a daily dose of this multi-vitamin tablet throughout 2016
- For the financial statements for the year-ended 31 December 2016, Galaxy-Pension changes the actuarial assumption for the mortality rates to recognise that life expectancy has increased

As a result of this change in actuarial assumption, do you expect an actuarial gain or loss to be recognised?

AGLs = Actuarial Gains and Losses

A question for you: AGLs

- The yield on high quality corporate bonds increased from 9.5% to 10% and_Lila-Health 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 Milky Way a publically traded entity
- The share price at 31 Dec 2016 was L$22, compared to L$21 at 31 December 2015
- Equity assets are managed by a stock broker, who charges a flat annual fee of L$10 for managing this plan asset

What is the return on this plan 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


CHECK

Which benefits or transactions are in the scope of IAS 19?

Lila-Health is obliged to provide a pension to employees of 0.2 per cent of final salary for each year of service

Galaxy-Pension, a pension fund, which receives contributions from Lila-Health, invests plan assets and pays benefits to Lila-Health's (former) employees

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

Lila-Health operates an annual bonus scheme for senior managers. Under the scheme senior managers receive a bonus based on Lila-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 statements are true?

The present value of the defined benefit earned for the current year of service (current service cost) is estimated using the projected unit credit method

Past service cost is the change in the present value of the defined benefit obligation resulting from a plan amendment or curtailment

An example of a reduction of benefits is the switch from a final salary plan to a career average plan (when salary is increased as services are rendered)

An example of an improvement of benefits is changing the retirement age from 60 years to 65 years of age without any increase in benefits

Which of the following are causes of AGLs?

The effect of difference between the interest income and actual return on plan assets

The effect of changes in the discount rate

The effect of changes to assumptions concerning benefit payment options

The effect of changes in estimates of future employee turnover, early retirement or mortality or of increases in salaries, benefits or medical costs