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IAS® Standard 19 Employee Benefits

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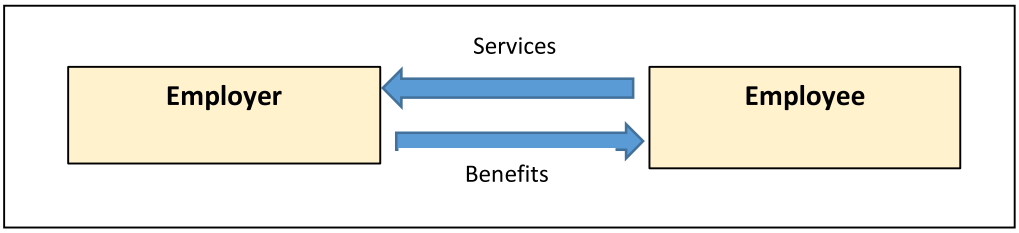
IAS® Standard 19 Employee Benefits

SCOPE AND DEFINITIONS

The objective of IAS Standard 19 Employee Benefits is to prescribe the accounting and disclosure for employee benefits. IAS 19 should be applied by an employer in accounting for all employee benefits except those to which IFRS Standard 2 Share-based Payment applies. IAS 19 does not deal with reporting by employee benefit plans (which is addressed in IAS Standard 26 Accounting and Reporting by Retirement Benefit Plans).

Figure 1. Employee Benefits Allocation

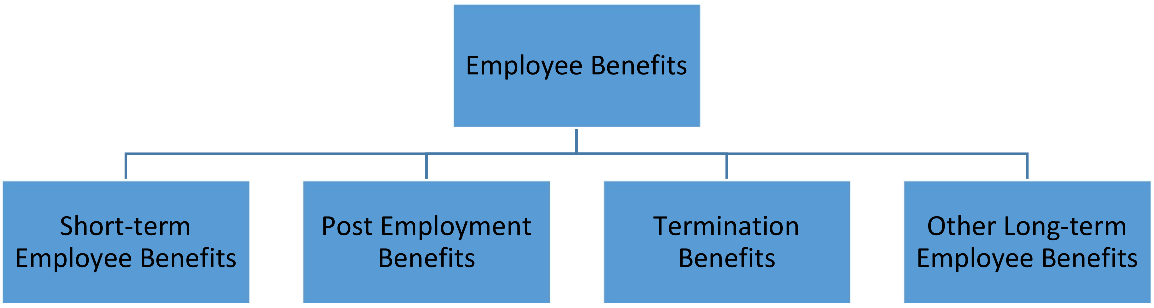


Employee Benefits: Employee benefits cover all forms of consideration given by an entity in exchange for services rendered by its employees or for the termination of employment (IAS19.8) (See Fig.1).

The main principle underlying all of the detailed requirements of IAS 19 is that the cost of providing employee benefits shall be recognized in the period when services are provided, rather than when employee benefits are paid or payable. The standard outlines how each category of employee benefits is measured, providing detailed guidance, in particular, about post-employment benefits.

Figure 2 presents the types of employee benefits addressed in IAS 19.

Figure 2. Types of Employee Benefits



SHORT-TERM EMPLOYEE BENEFITS

Short-term employee benefits are employee benefits that are expected to be settled wholly in maximum 12 months after the end of the annual reporting period in which the employees render the related service (IAS19.8).

An entity shall recognize the undiscounted amount of short-term employee benefits expected to be paid in exchange for employee services during the accounting period:

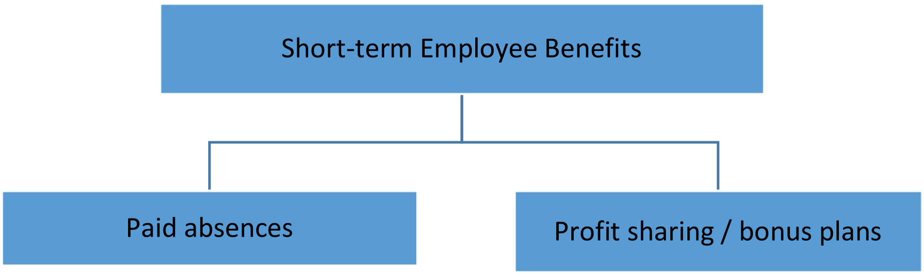
- As a liability (accrued expense), after deducting any amount already paid; and

- As an expense, unless another IFRS requires or permits its inclusion in the cost of an asset (eg. IAS 16 Property, Plant and Equipment)

However, if the amount paid exceeds the undiscounted amount of the benefits, the entity shall recognize such excess as an asset (prepaid expense) to the extent that the prepayment will lead to, for example, a reduction in future payments or cash refund.

As shown in Figure 3, IAS 19 provides the recognition and measurement requirements for short-term employee benefits in the form of **paid absences** and **profit sharing or bonus plans**.

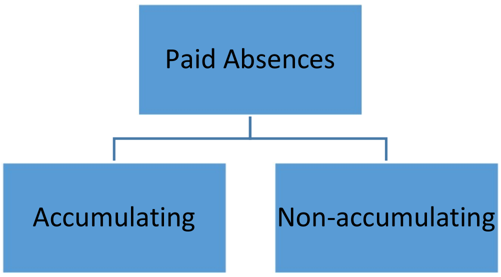
Figure 3. Short-term Employee Benefits



- **Paid Absences**

An entity may compensate its employees for absences for various reasons (eg. Vacation, sickness, military service, maternity). As shown in Figure 4 entitlement to paid absences can be accumulating or non-accumulating.

Figure 4. Paid Absences



Accumulating paid absences can be carried forward by an employee and used in future periods, if the current period's entitlement is not used in full (eg. legal paid vacation).

An entity should recognize the expected cost of such absences when the employees render a service that increases their entitlement to future paid absences. The expected cost is the additional amount that the entity expects to pay due to the accumulated entitlement at the end of the reporting period.

If employees are not entitled to a cash payment for unused entitlement on leaving the entity, the possibility that they may leave affects the measurement of the obligation.

Non-accumulating paid absences cannot be carried forward by an employee (eg. maternity leave or sick pay if unused past entitlement does not increase future entitlement). Any unused entitlement is lost at the end of the current period or when the employee leaves the entity.

An entity should recognize the expected cost of such absences when the absences occur because employee service does not increase the amount of the benefit.

Example: As of December 31, 2021 number of the total employees was 30. Average unused entitlement annual leave at December 31, 2021 was 5 days per employee. Average amount of annual leave taken during 2022 was 12 days per employee.

Entity policy for annual leave: In addition to all general holidays, employees will be allowed 15 days of paid annual leave each year. Annual leave cannot be accrued. Any outstanding balance will be forfeited on 31 December each year.

How many days of paid leave should the entity recognize as a liability as of December 31, 2022?

According to the entity's policy for annual leave, annual leave cannot be accrued. So total liability as of December 31, 2022 will be 0.

Example: As of December 31, 2020 and December 31, 2021 total number of the office employees was 50. At December 31, 2020, the average amount of unused leave was 5 days per employee. At December 31, 2020 the entity had a related liability of CU 20,000.

Entity's policy regarding annual leave is as follows:

"In addition to all general holidays, you will be allowed 15 days of paid annual leave each year in accordance with the policy below. Annual leave is accrued after the completion of one month's service. Accrual of annual leave is limited to your annual leave entitlement. Annual leaves not used by the employees in the current year can be carried over to the next year (only 1 year)."

The average salary increase on January 1, 2021 was 2%. During the year 2021, the average amount of annual leave taken was 14 days (5 days from 2020 and 9 days from 2021) per employee, which included all leaves carried forward from 2020.

The total liability to be recognized for the annual leave in the office in the financial statements at December 31, 2021 should be CU 24,480.

$$\text{CU } 24{,}480 = \text{CU } 20{,}000 * (100\% + 2\%) * 6^{*}/5$$

(*6 days (for the year 2021) = 15 days – 9 days)

The expense to be recognized for annual leave is the increase in the liability during the year.

So the total expense to be recognized for annual leave during the year 2021 is CU 4,480.

$$\text{CU } 4{,}480 = \text{CU } 24{,}480 - \text{CU } 20{,}000$$

- **Profit Sharing and Bonus Plans**

An entity shall recognize 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 (IAS19.19).

POST EMPLOYEE BENEFITS

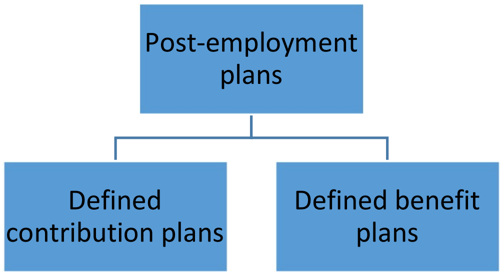
Post employee benefits are employee benefits (other than termination benefits and short-term employee benefits) which are payable after the completion of employment (IAS19.8).

Some examples of post-employee benefits are:

- Retirement benefits, such as pensions;
- Post-employment life insurance; and
- Post-employment medical care.

IAS 19 specifies two types of post-employment benefit plans. Classification depends on the economic substance of the plan. Figure 5 presents the types of post-employment plans.

Figure 5. Post-employment Plans



Defined Contribution Plans

Defined contribution plans are those under which:

- An entity pays fixed contributions into a separate entity (a fund); and
- Has 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 or prior periods.

Defined contribution plans have terms that specify how contributions to the individual's accounts are to be determined, rather than the amount of post-employment benefits the individual is to receive. For example, the employer may contribute 3 percent of pre-tax income into the plan.

Under defined contribution plans:

- The entity's legal or constructive obligation is limited to the amount that it agrees to contribute;
- The amount of the post-employment benefits received by the employee is determined by the amount of contributions paid together with investment returns; and
- 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.

Under a defined contribution plan, an entity's obligation is determined by the amount to be contributed to the plan for the period. When an employee has rendered services during a period, the entity recognizes the contribution payable in exchange for that service:

- In profit or loss as an expense, unless another IFRS requires or permits its inclusion in the cost of asset e.g. IAS 2 Inventories or IAS 16 Property, Plant and Equipment ….

- In the statement of a financial position as a liability (accrued expense) after deducting any contributions paid
- In the statement of financial position as an asset (prepaid expense), if the payment exceeds the contributions due, to the extent that the prepayment will be recoverable, eg. by reduced future payments or a cash refund, in accordance with the terms and conditions of the plan and any statutory requirements in the jurisdiction of the plan.

Example: Under a defined contribution plan, Entity A is obligated to pay a contribution equal to 5% of gross earnings. Once the contributions have been paid, Entity A has no further payment obligations.

Gross earnings during 2021 is CU 20,000,000

Cash payment during 2021 is CU 1,200,000

Prepaid expense as of December 31, 2020 was CU 200,000.

Entity A makes the below journal entry to record the entity's contributions made in 2021.

Dr. Employee Benefit Expense	1,000,000	
Dr. Prepaid Expense	200,000	
Cr. Cash		1,200,000

Example: The employing entity is required to pay a contribution equal to 5% of salaries into a plan. Once the contributions have been paid, the entity has no further payment obligations.

Total salaries of all employees under the benefit plan in 2021 is CU 900,000. Total payments into the plan in 2021 is CU 40,000.

There were no assets or liabilities for prepaid/outstanding contributions at December 31, 2021.

Under a defined contribution plan, an entity's obligation is limited to the amount it agrees to contribute to the fund. Hence, the obligation for each period is determined by the amount to be contributed for that period. The contribution for the year is equal to 5% of the salaries.

CU 900,000 * 5% = CU 45,000

Dr. Employee Benefit Expense	45,000
Cr. Cash	40,000
Cr. Accrued Expense	5,000

Defined Benefit Plans

Defined benefit plans are post-employment benefit plans other than those that meet the definition of defined contribution plans.

Defined benefit plans indicate the amount of post-employment benefits that an employee will receive after employment, usually as a function of factors such as age or years of service. For example, participants in such a plan may receive annual benefit payments of 2 percent of the final year's pay for each year of service, payable for the remainder of the participant's life.

Under defined benefit plans:

- It is the entity's obligation to provide the agreed benefits to current and former employees; and
- Actuarial risk (that benefits will cost more than expected) and investment risk (that assets invested will be insufficient to meet expected benefits) fall on the entity.

We can use the following steps in accounting for defined benefit plans. The accounting treatment described by steps is complex since the final benefits will depend on future events that are incorporated in the plan's benefit formula (eg. the employee's expected life).

Step 1: Attributing benefits

Actuarial techniques are used to make a reliable estimate of the benefit that employees have earned in return for their service in the current period and in prior periods (employer's obligation). This requires an entity to attribute (allocate) benefit to periods of service and to make estimates (actuarial assumptions) about variables that will influence the cost of the benefit.

An entity should normally attribute benefit to periods of service under the plan's benefit formula. However, if an employee's service in later years will lead to a materially higher level of benefit than in earlier years, an entity should attribute benefit on a straight-line basis from the date when service first leads to benefits under the plan, until the date when further service will lead to no further material benefits other than from salary increases.

After the benefits have been estimated, the next steps deal with measurement, including the discounting of benefits and measurement of the plan assets at fair value.

Step 2: Discount the benefits

The "projected unit credit method" is required to discount the benefits in order to determine the present value of the entity's defined benefit obligations and the related current service cost. This actuarial valuation method sees each period of service as giving rise to an additional unit of benefit entitlement, and measures each unit separately to build up the final obligation.

Ordinarily, the current service cost shall be determined using the assumptions at the start of the annual period. When a significant event, such as a plan amendment, curtailment, or settlement occurs; the current service cost for the period following the significant event should be determined using the assumptions used in remeasuring the net defined benefit liability (asset).

Step 3: Fair value of any plan assets

Plan assets are usually investments in shares, bonds, other securities, and real estate that a company holds to earn a reasonable rate of return. Plan assets are reported at fair value. The fair value of any plan assets is deducted from the present value of the defined benefit obligation in determining the deficit or surplus. The deficit or surplus is often referred to as the funded status of the plan. If the defined benefit obligation is greater than the plan assets, then the pension plan has a deficit. If the defined benefit obligation is less than the plan assets, the pension plan has a surplus.

The next two steps deal with the recognition requirements on the statement of financial position and the statement of profit or loss and comprehensive income.

Step 4: Amount recognized in statement of financial position – net defined benefit liability (asset)

Net defined benefit liability (asset) is determined by deducting the fair value of any plan assets from the present value of the defined benefit obligation, adjusted for any effect of limiting a net defined benefit asset to the asset ceiling. An entity shall recognize the net defined benefit liability (asset) in the statement of financial position.

If a plan amendment, curtailment, or settlement occurs, the past service cost or gain or loss on settlement, would be measured and recognized in profit or loss while the effects of the asset ceiling is not considered. Changes in the effect of the asset ceiling would be recognized separately in other comprehensive income, as a result of the effect of the asset ceiling on the updated surplus.

Step 5: Amount recognized profit or loss

The amount to be recognized in profit or loss comprises three main components:

1- ***Current Service Cost:*** An entity shall attribute benefits to periods of service under the defined benefit plan's benefit formula. Current service cost is the increase in the present value of the defined benefit obligation resulting from employee service in the current period. It is the expected cost of providing the benefits allocated to that period.

2- ***Past Service Cost and Gain or Loss on Settlement:*** An entity shall recognize a gain or loss on the settlement of a defined benefit plan when the settlement occurs. Past service cost is the change in the present value of the defined benefit obligation for employee service for prior periods (generally resulting from a plan amendment). An entity shall recognize past service cost (including both vested and unvested, together with gains and losses from curtailments) as an expense at the earlier of:
   - When the plan amendment or curtailment occurs; and
   - When the entity recognizes related restructuring costs in accordance with IAS 37 Provisions, Contingent Liabilities and Contingent Assets termination benefits.

   The gain or loss on a settlement is the difference between:

   - The present value of the defined benefit obligation being settled, as determined on the date of settlement; and
   - The settlement price, including any plan assets transferred and any payments made directly by the entity in connection with the settlement.

3- Net Interest on Net Defined Benefit Liability (Asset): Net interest on the net defined benefit liability (asset) is the change during the period in the net defined benefit liability (asset) that arises from the passage of time. Under a defined benefit plan, the net interest cost for a period needs to be computed.

   *Net Interest = (Defined Benefit Obligation * Discount Rate) – (Plan Assets * Discount Rate)*

   The rate used to discount post-employment benefit obligations (both funded and unfunded) shall be determined by reference to market yields on high quality corporate bonds at the end of the reporting period. In countries where there is no deep market in such bonds, the market yields on government bonds shall be used.

   The discount rate reflects the:
   - Time value of money, but not the actuarial or investment risk; and
   - Estimated timing of benefit payments.

   In practice, entities often apply a single weighted average discount rate to reflect the estimated timing, amount, and the currency of the benefit payments.

   It can be viewed as comprising interest income on plan assets, interest cost on the defined benefit obligation, and interest on the effect of the asset ceiling. When a significant event, such as a plan amendment, curtailment, or settlement occurs; the net interest for the period following the significant event should be determined using the assumptions used in remeasuring the net defined benefit liability (asset).

Step 6: Amount recognized in other comprehensive income – remeasurement of the net defined benefit liability (asset)

The amount to be recognized in other comprehensive income comprises three main components:

1- ***Actuarial gains and losses:*** Changes in the present value of the defined benefit obligation resulting from experience adjustment and the effects of changes in actuarial assumptions.
2- ***Return on plan assets, excluding amounts included in net interest on the net defined benefit liability (asset):*** The actual return on plan assets, net of the interest on plan assets included in the net interest component.
The return on plan assets comprises:
    - Interest, dividends, and other revenue derived from the plan assets together with realised and unrealised gains or losses on the plan assets
    - Less any cost of managing the plan assets and any tax payable by the plan itself, other than tax included in the actuarial assumptions used to measure the present value of the defined benefit obligation.
3- ***Any change in the effect of the asset ceiling, excluding amounts included in net interest on the net defined benefit liability (asset):*** Remeasurements are never reclassified as profit or loss in the subsequent period but may be transferred within equity (eg. to retained earnings).

Contributions paid into the plan and benefits paid out

Contributions paid by an entity into a plan increase the fair value of the plan assets. Contributions have no impact on the obligation as the effects of transactions are recognized when the employee provides the service (and not when cash or its equivalent is paid).

Example: Entity A operates a defined benefit plan for its employees. The balances of defined benefit plan assets and liabilities as of December 31, 2020 were CU 30,000,000 and CU 32,000,000 respectively.

Current service cost	CU 5,000,000
Past service cost	CU 3,000,000
Contributions paid in	CU 2,000,000
Benefits paid out	CU 4,000,000
Fair value of plan assets	CU 32,000,000
Fair value of plan liabilities	CU 34,000,000
Yield on high quality corporate bonds	3%

- The accounts and the balances to be reported in the profit and loss statement are as follows:

Total Service Cost	= CU 5,000,000 + CU 3,000,000	= CU 8,000,000
Interest Expense	= CU 32,000,000 * 3%	= CU 960,000
Return on Plan Assets	= CU 30,000,000 * 3%	= CU 900,000

- Gain to be reported in the other comprehensive income is as follows:

Defined Benefit Plan Assets = CU 30,000,000 + CU 900,000 + CU 2,000,000 – CU 4,000,000

Defined Benefit Plan Assets = CU 28,900,000

Gain = Fair Value of Plan Assets – Defined Benefit Plan Assets (December 31, 2021)

CU 32,000,000 – CU 28,900,000 = CU 3,100,000

Defined Benefit Plan Liability = CU 32,000,000 + CU 960,000 + CU 8,000,000 – CU 4,000,000

Defined Benefit Plan Liability = CU 36,960,000

Gain = Fair Value of Plan Liability – Defined Benefit Plan Liability (December 31, 2021)

CU 34,000,000 – CU 36,960,000 = CU 2,960,000

Gain (reported in the other comprehensive income) CU 3,100,000 + CU 2,960,000 = CU 6,060,000

Deficit of the Plan = CU 34,000,000 – CU 32,000,000 = (CU 2,000,000)

Example: If an entity makes annual cash contributions of CU 150,000 into a defined benefit plan, the following journal entry is recorded:

Dr. Plan assets 150,000

Cr. Cash 150,000

Benefits paid to employees

A payment of benefits is made out of plan assets in settlement of part of the entity's obligation to pay such benefits. The effects of the transactions are recognized at the time cash or its equivalent is paid.

Example: If an entity makes benefit payments of CU 600,000 out of a defined benefit plan, the following journal entry is recorded:

Dr. Defined Benefit Obligation 600,000

Cr. Cash 600,000

Actuarial assumptions and actuarial gains and losses

Actuarial gains and losses result from increases or decreases in the present value of the defined benefit obligation because of changes in actuarial assumptions and experience adjustments.

All actuarial gains and losses are to be recognized immediately through ***other comprehensive income*** in order for the net pension asset or liability recognized in the statement of financial position to reflect the full value of the plan deficit or surplus.

Actuarial assumptions are an entity's best estimate of the variables that will determine the ultimate cost of providing post-employment benefits. They comprise:

- Demographic assumptions (about the future characteristics of current and former employees and their dependents who are eligible for benefits). Demographic assumptions deal with matters such as mortality, rates of employee turnover, disability, and claim rates under medical plans.

- Financial assumptions. Financial assumptions deal with matters such as the discount rate, future salary and benefit levels, future medical costs, and taxes payable by the plan relating to the benefits.

Causes of actuarial gains and losses include, for example;

- Unexpected high or low rates of employee turnover, early retirement or mortality or of increases in salaries, benefits (if the formal or constructive terms of a plan provide for inflationary benefit increases) or medical costs;
- 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 increases in salaries, benefits (if the formal or constructive terms of a plan provide for inflationary benefit increases) or medical costs; and
- The effect of changes in the discount rate.

Contributions from employees or third parties to defined benefit plans

Some defined benefit plans require employees or third parties to contribute to the cost of the plan. In general, such contributions are treated as part of the post-employment benefits, which effectively reduce the cost to the entity.

IAS 19 provides specific guidance in accounting for contributions by employees or third parties, depending on whether those contributions are either set out in the formal terms of the plan (or arise from a constructive obligation that goes beyond those terms), or are discretionary. Where such contributions are non-discretionary, the accounting also differs depending on whether they are linked to service or not.

If the amount of the contributions is dependent on the number of years of employee service, an entity shall attribute the contributions to periods of service using an attribution method for the gross benefit (ie. either using the plan’s contribution formula or on a straight-line basis).

If the amount of the contributions by employees or third parties is independent of the number of years of employee service, the entity is permitted to recognize such contributions as a reduction of the service cost in the period in which the related service is rendered. Examples of contributions that are independent of the number of years of service include those that are a fixed percentage of the employee’s salary, a fixed amount throughout the service period or that are dependent on the employee’s age.

If the amount of the contributions by employees or third parties is not linked to service, it affects remeasurements of the net defined benefit liability (asset).

If the amount of the contributions by employees or third parties is discretionary, it reduces service cost upon payment of these contributions to the plan.

TERMINATION BENEFITS

Termination benefits are employee benefits payable as a result of either an entity’s 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.

The form of the employee benefit does not determine whether it is provided in exchange for service or in exchange for termination of the employee's employment. Termination benefits are typically lump sum payments, but sometimes also include:

- Enhancement of post-employee benefits, either indirectly through an employee benefit plan or directly; and/or
- Salary until the end of a specified notice period if the employee renders no further service.

IAS 19 deals with termination benefits separately from other employee benefits because an obligation arises from the termination rather than from employee service.

OTHER LONG-TERM EMPLOYEE BENEFITS

Other long-term employee benefits are all employee benefits other than short-term employee benefits, post-employment benefits, and termination benefits (IAS19.8).

Some examples of other long-term employee benefits are:

- Sabbatical leave;
- Jubilee (eg. a bonus payable for 15 years of service);
- Long service bonuses;
- Long-term disability benefits; and
- Profit sharing, bonuses, or deferred compensation payable 12 months or more after the end of the period in which the employee renders the related service.

DISCLOSURES

An entity shall disclose the amount recognised as an expense for defined contribution plans. Where required by IAS 24 Related Party Disclosures an entity discloses information about contributions to defined contribution plans for key management personnel.

An entity shall disclose information that:

- Explains the characteristics of its defined benefit plans and risks associated with them,
- Identifies and explains the amounts in its financial statements arising from its defined benefit plans,
- Describes how its defined benefit plans may affect the amount, timing and uncertainty of the entity's future cash flows,
- A description of any plan amendments, curtailments and settlements.

An entity shall assess whether all or some disclosures should be disaggregated to distinguish plans or groups of plans with materially different risks.

An entity shall disclose a description of any asset-liability matching strategies used by the plan or the entity, including the use of annuities and other techniques.