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IAS® Standard 26 Accounting and Reporting by Retirement Benefit Plans

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IAS® Standard 26 Accounting and Reporting by Retirement Benefit Plans

SCOPE AND KEY DEFINITIONS

The IAS 26 aims to specify the content and format of financial statements for retirement benefit plans. This standard sets out the accounting practices for all participants of retirement benefit plans. It explains how to report periodically on topics such as investment portfolio, returns, and costs of investment in retirement benefit plans. It complements the "IAS Standard 19 Employee Benefits".

Retirement benefit plans provide for the establishment of a fund. Employees can make to various organisations such as a mutual aid institution or a solidarity fund during their working period payments in the form of monthly payments or as a lump sum after retirement. On the other hand, the organisation tries to create resources for the payments it will make to the employees after their working life by converting these payments into investments. This standard regulates the accounting and reporting of all participants' retirement benefit plans.

Within the scope of this standard, the definitions presented for a clearer understanding of the operation of the standard are as follows (IAS 26: 8):

Retirement Benefit Plans	"These are arrangements whereby an entity provides benefits for employees on or after termination of service when such benefits, or the contributions towards them, can be determined or estimated in advance of retirement from the provisions of a document or from the entity's
Defined Contribution Plans	"These are the plans in which the pension benefit amount to be obtained by the participants as a result of the contributions made to the pension fund and various investment earnings from these contributions is determined"
Defined Benefit Plans	"These plans are benefit plans in which retirement benefits are calculated mostly based on the current earnings or length of service of the employees"
Funding	"The transfer of assets to an entity other than the employer entity to meet obligations related to future payments of retirement benefits"

This standard does not cover other employee benefits such as severance pay or bonus plans. In addition, contracts in the form of state social security practices are outside the scope of this standard.

RECOGNITION

There are two types of retirement benefit plans, "defined benefit plans" and "defined contribution plans," which have different distinguishing features.

Defined Contribution Plans

The financial statements of a defined contribution plan shall contain a statement of net assets available for benefits and a description of the funding policy.

Example: Entity E plans contributions to its employees by calculating a percentage of their current annual salary, which varies according to seniority. The percentages applied are as follows:

Seniority	Percentage
5-10 Years	5 %
10-15 Years	7 %
15-20 Years	10 %
20 Years and above	12 %

All employees who have completed their 5-year working period in the entity are required to pay a 5% contribution. All contributions are invested in government bonds with an annual interest rate of 10%. Accordingly, the company with a total of 4 employees, can create the following contribution plan:

Seniority	Average Annual Wage	Employee Contribution	Employer Contribution	Total Contribution	Investment Return (10%)
5-10 Years	CU 100,000	CU 5,000	CU 5,000	CU 10,000	CU 1,000
10-15 Years	CU 150,000	CU 7,500	CU 10,500	CU 18,000	CU 1,800
15-20 Years	CU 300,000	CU 15,000	CU 30,000	CU 45,000	CU 4,500
20 Years >	CU 200,000	CU 10,000	CU 24,000	CU 34,000	CU 3,400
TOTAL	CU 750,000	CU 37,500	CU 69,500	CU 107,000	CU 10,700

The purpose of reporting for the defined contribution plan is to provide data on the performance of the investments included in and related to the plan. The amount of benefits to be obtained by the participants in the retirement period is determined within the framework of the defined contribution plans, the contributions invested in the fund by the employer or employees and the investment gains obtained through the operational efficiency of the fund. In this case, the employer's obligation is fulfilled thanks to the contributions transferred thereby to the fund. Depending on the need, an actuarial valuation may be applied for the benefits expected to be obtained as a result of changes in current and future contributions, and investment incomes.

The purpose of reporting for defined contribution plans is to provide periodic information about the plan's content and the performance of investments. To achieve this goal, the financial statements should include the following information:

- Disclosures on significant activities that took place during the period, terms and scope of the plan, and the impact of changes made on the participants.
- Investment performance, intra-period transactions, and the financial position of the plan at the end of the period.
- Explanation on investment policies

Defined Benefit Plans

Defined benefit plans are defined as benefits based on the active working time and the last earnings of the employees used in the calculation of the benefits to be paid to the employees during the retirement period. These are plans in which the amount of retirement benefits payable to participants at or after the end of their service is determined or estimated, often by a formula developed based on the employee's years of service or earnings. In this context, a certain salary is paid to the employees during the retirement period in return for regular deductions made from the salaries they receive during their active working period.

Example: Entity X has prepared a plan to ensure that an employee's annual retirement benefit is equal to 2% of years of service multiplied by the final average salary (FAS). FAS is determined by the average of the 3 highest consecutive salaries. Accordingly, the following formula was created:

$$BP = 2\% \times YS \times FAS$$

In this formula, BP is the Benefit plan, YS is the Year of Service and FAS is the final average salary.

For Mr Aras, who is a worker with 20 years of service and a final average salary of CU60,000, pre-retirement earnings are calculated as follows.

2% x 20 x CU60,000 = CU24,000

So, Mr. Aras would receive 40% of his pre-retirement earnings.

Under a defined benefit plan, businesses can finance their liabilities internally or externally. The employer can choose external resources by paying a contribution to a different business or fund to cover the risks that may arise in the future, or it can accumulate funds and goods in the portfolio of the business to meet the future risks. Financial statements for defined benefit plans include any of the following:

- Net assets that can be used for the benefits to be provided,
- The actuarial present value of promised retirement benefit rights (A distinction must be made between vested and unearned rights),
- The resulting surplus or deficit.

The statement of net assets that can be used for benefits includes a statement showing the actuarial present value of promised retirement benefit rights or references the relevant information in the actuarial report.

If an actuarial valuation has not been prepared at the date of the financial statements, the most recent valuation shall be used as a base and the date of the valuation disclosed.

According to the standard, the method of calculating the actuarial present value of the amount of promised benefits to the employee under retirement benefit plans should be disclosed.

Calculation of the actuarial present value of promised retirement benefits is based on the promised benefits for services rendered so far under the terms of the plan, taking into account current salary levels or estimated future salary levels. In addition, the method of calculating the actuarial present value and changes in actuarial assumptions that have a significant impact is also disclosed.

In addition, the benefits promised for services rendered under the conditions specified in the plan should be considered, taking the employee's current or estimated future salaries into account and the effect of changes that could materially affect the actuarial present value of promised benefits on the plan should be explained.

The primary purpose of financial reporting for defined benefit plans is to provide periodic information about the operation of the plan and its financial resources so that the relationship between the resources created in the fund and the benefits provided by the pension plan can be evaluated. Financial statements prepared for this purpose should include the following:

- Events related to significant activities that took place during the reporting period,
- The terms of the plan and the effect of any change in plan membership,
- Transactions for the period, statements showing the financial status of the plan at the end of the period and investment performances,
- Explanations on investment policies,

Actuarial information should be included in separate reports or some of the relevant tables.

MEASUREMENT

Actuarial Present Value (APV) of Promised Retirement Benefits

While calculating the present value of expected payments within the scope of retirement benefits, the current period salary levels of the participants or the projected salary levels until their retirement are used.

Current Salary Approach	*Projected Salary Approach*
• The actuarial present value of payments for promised benefits can be calculated more objectively because it involves fewer assumptions. • Increases in retirement benefits due to salary increases constitute the obligation of the plan at the date of the salary increase. • The amount of liabilities to be paid in case of interruption or termination of the plan is closer to the actuarial present value calculated based on this approach.	• Financial information should be prepared within the framework of the going concern principle, regardless of estimations and assumptions. • Retirement benefit obligations payable in final payment plans are determined on the basis of salaries at or near the retirement date. For this reason, it is necessary to foresee the salaries, return on investment, and contributions to be made. • Failure to incorporate salary projections, while most of the funding is based on salary projections may result in the reporting of an apparent overfunding when the plan is not overfunded, or in reporting adequate funding when the plan is underfunded.

In many countries, actuarial valuation is not carried out more often than every three years. If no actuarial valuation has been done at the date of issue of the financial statements, the most recent valuation transaction is taken as a basis, and the date of the said valuation is announced.

Valuation of Plan Assets

Investments in retirement benefit plans are presented at their fair values. If these investments are securities, the market value of the securities is considered as fair value. If it is not possible to determine the fair value of the investments, the reasons for this should be explained.

Securities with a fixed redemption value that are purchased to meet the obligations of the relevant plan may be shown at their most current redemption value. In cases where investments are presented with a value other than their market value or fair value, the fair value is generally disclosed. Assets used in the activities of the fund are accounted for in accordance with the provisions of the applicable standard.

Procedures

Actuarial information in defined benefit plans may be presented in the financial statements as the following ways:

1. A table showing the net assets used as part of the fund for employee benefits during retirement, the actuarial present value of promised pension rights and the resulting surplus or deficit are included in the financial statements. The financial statements also include changes

in net assets and the APV of promised retirement benefits. In addition, a separate actuarial report describing this value may be submitted as an annex to the financial statements.

2. Financial statements containing net assets used for benefit purposes and tables showing changes in net assets should be presented. The APV of the committed severance pay is disclosed in the notes to the financial statements. An actuarial report supporting the APV of promised retirement benefits may also be included in the financial statements.
3. Financial statements that include the present value of promised retirement benefits, net assets used for benefit purposes, and statements of changes in net assets, as well as a separate actuarial report, may be presented separately.

In addition to these representations, the trustees' report and an investment report can also be submitted as an annex to the financial statements.

DISCLOSURE

Within the scope of the standard, the following matters should also be included in the financial statements related to the retirement benefit plan:

- Statement of changes in net assets available for benefits,
- A summary of significant accounting policies applied,
- The description of the plan and the impact of changes to the plan during the period.

The table of net assets that can be used for benefits should include the following:

- Appropriately classified assets at the end of the period,
- Valuation principles of assets,
- Details of investments that exceed 5% of net assets or 5% of securities that can be used for benefits or investments made with the employer,
- Liabilities other than the APV of promised retirement benefits.

The table of changes in net assets that can be used for the benefits to be provided should include the following:

- Employer and employee contributions,
- investment income,
- Benefit payment/debts
- Administrative expenses,
- Other expenses and incomes,
- Taxes calculated on income,
- Profit or loss resulting from the disposal of investments and changes in the value of investments.

Retirement benefit plans should also include actuarial reports containing the APV of promised retirement benefits based on the current or projected salary levels of employees, disclosures about the entity's funding policies, the method used to calculate that value, and significant actuarial assumptions.

EXAMPLE

Entity YY is a manufacturing enterprise with a total of 150 employees. In 2012, the entity established the “YY Entity Pension and Assistance Fund Foundation” so that its employees can receive lump-sum or monthly payments during retirement. Through this foundation, retirement benefit plans are created within the framework of IAS 26, with deductions from employees' salaries, optional payments and employer contributions. The board of the foundation is responsible for the prudent and strategic management of fund assets and benefits. For this reason, it aims to increase the performance of investments in accordance with laws and regulations in all its decisions.

The investments of the plan mostly consist of low-risk financial instruments such as government bonds and treasury bills. It also uses financial investments such as equities and derivative financial instruments. The company earns significant income from its investments.

The statement of net assets available for benefits to be issued by the business as of December, 31st, 2022 is as follows:

STATEMENT OF NET ASSETS AVAILABLE FOR BENEFITS December 31, 2022		
	2022(CU)	***2021 (CU)***
ASSETS		
Investment in the YY Entity Pension and Assistance Fund Foundation (at fair value)		
Equities	563,361	1,899,878
Bonds and Debentures	29,594,268	28,186,216
Derivatives	240,680	205,754
Property	20,828,010	20,525,528
Other Investment Instruments	123,681	132,624
Total Investments	***51,350,000***	***50,950,000***
Receivables		
Company Contributions	479,673	463,035
Accrued income	48,327	51,965
Total Receivables	***528,000***	***515,000***
Total Assets	**51,878,000**	**51,465,000**
LIABILITIES		
Accrued Liabilities	64,580	72,660
Benefits Payable	111,420	124,340
Total Liabilities	**176,000**	**197,000**
NET ASSETS AVAILABLE FOR BENEFITS	**51,702,000**	**51,268,000**

As can be understood from the statement, the entity has invested mostly in bonds and debentures in both periods and total investments of the entity are CU 50,950,000 in 2021 and CU 51,350,000 in 2022. The entity earns significant income from its investments. It is seen that entity contributions have a much smaller share in total assets in the plan than the investments and the total assets of the entity are CU 51,465,000 in 2021 and CU 51,878,000 in 2022. When we examine the debts of the entity we can see that the total debt, consisting of benefits payable and accrued liabilities, is CU197,000 in 2021 and Cu176,000 in 2022. So, net assets available for benefits are calculated as CU 51,268,000 in 2021 and CU 51,702,000 in 2022.

The statement of changes in net assets available for benefits, to be issued by the business as of December 31st, 2022 is as follows:

STATEMENT OF CHANGES IN NET ASSETS AVAILABLE FOR BENEFITS December 31, 2022		
	2022(CU)	***2021 (CU)***
ADDITIONS TO NET ASSETS		
Investment Income (Including changes in fair value)	5,135,150	5,487,170
Contributions:		
Employee	2,524,350	2,126,365
Employer	4,736,500	4,068,465
Total Addition	***12,396,000***	***11,682,000***
DEDUCTIONS FROM NET ASSETS:		
Benefits Paid to Participants	10,996,600	10,387,700
Administrative Expenses	965,400	898,300
Total Deduction	***11,962,000***	***11,286,000***
Net Increase in Net Assets	***434,000***	***396,000***
Net Assets Available for Benefits (Beginning of Year)	51,268,000	50,872,000
NET ASSETS AVAILABLE FOR BENEFITS (END OF YEAR)	**51,702,000**	**51,268,000**

Additionally, when the statement of changes in net assets available for benefits is examined, it can be seen that investment incomes have decreased compared to the previous year. However, employee and employer contributions increased as expected. So, total additions are increased. When the deductions made from the assets consisting of benefits paid and administrative expenses are examined, it can be seen that total deductions have increased. And the net increase in net assets is calculated as CU 396,000 in 2021 and CU 434,000 in 2022. With this, net assets available for benefits are calculated as CU 51,268,000 in 2021 and CU 51,702,000 in 2022.