IAS 19: Employee Benefits –A Summary

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1. Introduction:

1.1 IAS 19 "Employee Benefits" was originally issued in 1983 and subsequently revised in 1993, 1998 and 2000. IAS 19 (revised 2000) on which this summary is based underwent a limited amendment in 2002. The nature of the amendment is explained in section 5.4 of this paper.

1.2 IAS 19 (revised 2000), hereafter referred to as IAS 19, applies to all employee benefits offered by an employer to employees and their dependents and beneficiaries. Thus the Standard applies to employee benefits under:

(i) formal plans and agreements between an enterprise and its employees (which includes directors and other management personnel);

(ii) national, state, industry or multi-employer plans; and

(iii) informal practices giving rise to a constructive obligation.

1.3 IAS 19 identifies the following categories of employee benefits:

(a) short term employee benefits being benefits that become due within 12 months after the end of the period in which the employees render the related service. It includes items such as wages, salaries and social security contributions, paid annual leave, paid sick leave, profit sharing and bonuses;

(b) post-employment benefits such as pensions, other retirement benefits, post-employment life insurance and post-employment medical care;

(c) other long-term employee benefits including long service leave or sabbatical leave, jubilee or other long-service benefits, long term disability benefits, and if they are not payable wholly within 12 months after the end of the period, profit sharing, bonuses and deferred compensation;

(d) termination benefits; and

(e) equity compensation benefits.

2. Short-term Employee Benefits

2.1 Recognition and Measurement

2.1.1 IAS 19 requires entities to recognise the undiscounted amount of short term employee benefits:

(a) as a liability (accrued expense), after deducting any amounts already paid, and

(b) as an expense, unless another International Accounting Standard (IAS) requires or permits the inclusion of the benefits in the cost of an asset.

These requirements apply to short term compensated absences and profit sharing and bonus plans.

3 Post-employment Benefits

3.1. Types of Post-employment Benefit Plans

3.1.1 IAS 19 classifies post-employment plans into defined contribution and defined benefit plans. A defined contribution plan is any plan under which an enterprise pays fixed contributions into a separate entity (fund) and the employer's legal or constructive obligation is limited to the amount that it agrees to contribute to the fund. Consequently, actuarial risk (the benefits being less than expected) and investment risk (that assets invested will be insufficient to meet expected benefits) fall on the employee. Under IAS 19, a defined benefit plan is a post-employment benefit plan that is not a defined contribution plan. IAS 19 distinguishes between the two types of post-employment plans in the context of multiemployer plans, state plans and insured benefits.

3.1.2 State plans are post-employment benefit plans established by legislation to cover all enterprises (or all enterprises in a particular category, for example, a specific industry). They are operated by national or local government or by another body (for example an autonomous agency created specifically for this purpose) which is not subject to control or influence by the reporting enterprise. State plans are usually defined contributions plans. IAS 19 requires the enterprise to account for a state plan in the same way as for a multi-employer plan.

3.1.3 An enterprise may pay insurance premiums to fund a post-employment benefit plan. Under IAS 19 such a plan is regarded as a defined contribution plan unless the enterprise retains certain legal or constructive obligations, in which case the plan is treated as a defined benefit plan.

4 Defined contributions plans

4.1 Recognition and Measurement

4.1.1 IAS 19 requires entities to recognize the contributions payable to a defined contributions plan in exchange for services rendered by an employee during the period:

(a) in the balance sheet as a liability (accrued expense) after deducting any contributions already paid. If prepayments exceed the contribution due for service before the balance sheet date, the excess should be recognized as an asset (prepaid expense) to the extent that all prepayments are recoverable, for example, by a reduction in future payments or a cash refund

(b) in the income statement as an expense unless another IAS requires or permits inclusion of the contribution in the cost of an asset (example IAS 2 "Inventories" and IAS 16 "Property, Plant and Equipment".

4.1.2 The amount of contributions should be discounted if due more than 12 months after the end of the period in which the employees render the related service. The discount rate used is determined by reference to the market yields at the balance sheet date on high quality corporate bonds or government bonds as appropriate.

5 Defined Benefit Plans

5.1 Background

5.1.1 Defined benefit plans may be funded or unfunded. They may be funded by the employer, and sometimes the employees, making contributions into an entity or fund that is legally separate from the reporting enterprise. Accounting for defined benefit plans is more complex than for defined contributions plans because actuarial techniques and assumptions are employed to measure the defined benefit obligation and expense. There is also the possibility of actuarial gains and losses as assumptions used may differ from actual outcomes. The obligations are measured on a discounted basis because they may be settled many years after the employees render the related service.

5.1.2 The payment of benefits when they fall due depends not only on the financial position and investment performance of the fund but also on the enterprise's ability and willingness to make good any shortfall in the fund's assets. Therefore, the enterprise is in substance underwriting the actuarial and investment risks associated with the plan. Consequently the expense recognised is not limited to the contributions due for the period. An enterprise accounts for both its legal and constructive obligations in relation to a defined benefit plan.

5.2 Recognition and Measurement

Balance sheet

5.2.1 IAS 19 requires entities to recognize in the balance sheet the net total of the following as the defined benefit liability:

(a) the present value (PV) of the defined benefit obligation (gross obligations before deducting the fair value of plan assets);

(b) plus any actuarial gains(less any actuarial losses) not recognised because of the "corridor" approach (see para 5.3.2 below);

(c) minus any past service cost not yet recognised; and

(d) minus the fair value at the balance sheet date of plan assets (if any) out of which obligations are to be settled directly.

5.2.2 If the net total calculated in paragraph 5.2.1 is negative, the resulting asset recognised in the balance sheet should be the lower of:

(a) the net total calculated; and

(b) the net total of:

(i) any actuarial losses and past service costs not recognised as an expense; and

(ii) the present value (using the discount rate specified by the Standard) of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan.

An asset may arise where a defined benefit plan has been overfunded or in certain cases where actuarial gains are recognised.

Income statement

5.2.3 The enterprise should recognise in the income statement the net total of the following as expense (or income), except to the extent that another IAS requires or permits their inclusion in the cost of an asset:

(a) current service cost;
(b) interest cost;
(c) the expected return on any plan assets and any reimbursement rights;
(d) actuarial gains and losses to the extent that they are recognised;
(e) past service cost to the extent required; and
(f) the effect of any curtailment or settlement of the defined benefit plan.

5.3 Recognition of actuarial gains and losses-the corridor approach

5.3.1 Actuarial gains and losses comprise experience adjustments (the effect of differences between the previous actuarial assumptions and what has actually occurred) and the effect of changes in actuarial assumptions. They arise because actual outcomes or current forecasts differ from forecasts made in previous periods. They may arise from changes in the present value of the defined benefit obligation or the fair value of the related plan assets.

5.3.2 IAS 19 does not require immediate recognition of actuarial gains and losses unless the fluctuations in them are so great that deferral is not deemed appropriate. The Standard takes the view that actuarial gains and losses may offset each other in the long term. Thus, IAS 19 defines a 10% corridor as the range of normal variations in gains and losses. If the unrecognized actuarial gain or loss is no more than 10% of the larger of the present value of the defined benefit obligation or the fair value of plan assets, measured at the beginning of the year, it is not recognised, that is, there will be continual deferral of the accumulated net actuarial gain or loss. However, if the accumulated net actuarial gain or loss exceeds the corridor, the excess is amortized over the expected remaining working lives of the then active employee participants. The Standard permits other amortization methods subject to certain conditions. The unrecognized cumulative actuarial gains and losses (comprising those falling inside the corridor and those outside the corridor but not recognised in the income statement) will form part of the net deferred benefit liability or asset.

5.4 Limited amendment to IAS 19

5.4.1 In April 2002, the International Accounting Standards Board (IASB) agreed on a limited amendment to IAS 19 that prevent gains (losses) from being recognised solely as a result of past service or actuarial losses (gains) arising in the period. The need for the amendment arises from the interaction of two provisions of IAS 19 explained below.

IAS 19 allows deferred recognition of actuarial gains and losses. It also imposes an upper limit on the amount that can be recognized as an asset (asset ceiling). The interaction of deferred recognition and asset ceiling has given rise to a circumstance such that sometimes deferring the recognition of an actuarial <u>loss</u> (gain) leads to a <u>gain</u> (loss) being recognised in the income statement. The problem affects only those entities that have at the beginning or end of the period, a surplus in a defined benefit plan that based on the current terms of plan, the enterprise cannot fully recover through refunds or reductions in future contributions.

5.4.2 The IASB views this limited amendment to the Standard as an ‘improvement’ and has agreed to put on its agenda a comprehensive review of deferred recognition and asset ceiling. For IASB's current deliberations on IAS 19 please see IASB's convergence project summary by Anne McGeachin posted on the EDG (http://www.imf.org/forum/Message2.asp?forumid=10&messageid=340&threadid=340).

6 Other long term employee benefits

6.1 Other long term employee benefits includes items such as compensated long-service or sabbatical leave, profit sharing and bonus payments payable 12 months or more after the employee renders the related service and deferred compensation paid 12 months or more after the period in which it is earned.

6.2 The recognition and measurement requirements are a simplified version of those applied to post employment benefits. All past service costs and actuarial gains and losses are recognised immediately and the corridor approach is not used.

7 Termination benefits

7.1 These include lump sum payments, enhanced retirement benefits or other post-employment benefits and salaries paid until the end of a specified period even though no service is rendered by the related employee.

7.2 IAS 19 requires an enterprise to recognise a termination benefit as a provision and an expense immediately when it becomes demonstrably committed to the termination. If the benefits fall due more than 12 months after the reporting date, they should be discounted using the discount rate identified in the Standard.

8 Equity compensation benefits

8.1 These include benefits in such forms as (a) shares, share options, and other equity instruments issued to employees at less than the fair value at which they are issued to third parties and (b) cash payments the amount of which depend on the future market value of the enterprise's shares.

8.2 IAS 19 does not deal with the recognition of equity compensation benefits but has extensive disclosure requirements regarding such benefits.

9 Disclosure requirements

9.1 For defined contribution plans, IAS 19 requires the disclosure of the amount recognized as an expense. Other standards may require additional disclosures. For example, under IAS 24 "Related Party Disclosures", the enterprise should disclose information about contributions to defined contribution plans for key management personnel. However, for defined benefit plans, IAS 19 requires extensive disclosures.

9.2 IAS 19 does not require specific disclosures about other long-term employee benefits but disclosures might become necessary under other IASs, such as IAS 8 and IAS 24. For termination benefits, some disclosures may become necessary under IAS 37, IAS 8 and IAS 24 but there are no IAS 19-specific disclosures.

9.3 IAS 19 does not specify recognition and measurement requirements for equity compensation benefits but requires extensive disclosures in this respect. The disclosures are intended to enable uses of financial statements to assess the effect of these benefits on the enterprise's financial position, performance and cash flows. It is not expected that these benefits have much relevance in a public sector context.