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IAS 19, Employee Benefits – A Closer Look

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International Accounting Standard (IAS) 19, *Employee Benefits,* prescribes the accounting and disclosure for employee benefits. In April 1980, the International Accounting Standards Committee (IASC) issued the Exposure Draft E16, *Accounting for Retirement Benefits in Financial Statements of Employers*. In January 1983, the IASC issued IAS 19, *Accounting for Retirement Benefits in Financial Statements of Employers,* effective from January 1, 1985. In December 1992, the IASC issued Exposure Draft E47, *Retirement Benefit Costs.* In December 1993, the IASC issued revised IAS 19, *Retirement Benefit Costs,* as part of the 'Comparability of Financial Statements' project based on E32. IAS 19 (1993) becomes operative for financial statements covering periods beginning on or after January 1, 1995. In October 1996, the IASC issued Exposure Draft E54, *Employee Benefits.* In February 1998, the IASC issued IAS 19, *Employee Benefits,* effective from January 1, 1999. In October 2000, the IASC issued limited versions to IAS 19, effective from January 1, 2001. In May 2002, the International Accounting Standards Board (IASB) issued 'Asset Ceiling' amendment to IAS 19 (2000), effective from May 31, 2002. On December 5, 2002, the IASB proposed amendments to IAS 19 as part of the project on 'Share-based Payment'. In February 2004, paragraphs 144-152 of IAS 19 on equity compensation benefits are replaced by International Financial Reporting Standard (IFRS) 2, *Share-based Payment*. On April 29, 2004, the IASB issued the Exposure Draft of *Proposed Amendments to IAS 19* and adopted the amendments on December 16, 2004. On May 22, 2008, IAS 19 amended for 'Annual Improvements to IFRSs 2008', effective from January 1, 2009.

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Objective

The objective of IAS 19 is to prescribe the accounting and disclosure for employee benefits (that is, all forms of consideration given by an enterprise in exchange for service rendered by employees). The basic principle underlying all of the detailed requirements of the Standard is that the cost of providing employee benefits should be recognised in the period in which the benefit is earned by the employee, rather than when it is paid or payable. IAS 19 prescribes recognition, measurement and disclosure rules for expenses, liabilities and assets (for defined benefit funds only) relating to employee benefits.

Scope and Application

IAS 19 applies to the employer's accounting for all employee benefits but does not apply to share-based payments (refer to IFRS 2). IAS 19 applies to (among other kinds of employee benefits):

- wages and salaries
- compensated absences (paid vacation and sick leave)
- profit sharing plans
- bonuses
- medical and life insurance benefits during employment
- housing benefits
- free or subsidised goods or services given to employees
- pension benefits
- post-employment medical and life insurance benefits
- long-service or sabbatical leave
- 'jubilee' benefits
- deferred compensation programmes
- termination benefits.

Key Definitions

Actuarial gains and losses are the effects of differences between the previous actuarial assumptions and what has actually occurred, and the effects of changes in actuarial assumptions.
Defined benefit plans are post-employment benefit plans other than defined contribution plans.

Defined contribution plans are post-employment benefit plans under which an entity pays fixed contributions into a separate entity (a fund) and will have 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 and prior periods.
Employee benefits are all forms of consideration given by an entity in exchange for service rendered by employees.
Interest cost is the increase during a period in the present value (PV) of a defined benefit obligation which arises because the benefits are one period closer to settlement.
Other long-term employee benefits are employee benefits (other than post-employment benefits and termination benefits) which do not fall due wholly within twelve months after the end of the period in which the employees render the related service.
Past service cost is the increase in the PV of the defined benefit obligation for employee service in prior periods, resulting in the current period from the introduction of, or changes to, post-employment benefits or other long-term employee benefits. Past service cost may be either positive (where benefits are introduced or improved) or negative (where existing benefits are reduced).
Plan assets are assets held by a long-term employee benefit fund and qualifying insurance policies.
The **present value of a defined benefit obligation** is the PV, without deducting any plan assets, of expected future payments required to settle the obligations resulting from employee service in the current and prior periods.
Post-employment benefit plans are formal or informal arrangements under which an entity provides post-employment benefits for one or more employees.
Post-employment benefits are employee benefits (other than termination benefits) which are payable after the completion of employment.
Short-term employee benefits are employee benefits (other than termination benefits) which fall due wholly within twelve months after the end of the period in which the employees render the related service.
Return on plan assets is interest, dividends and other revenue derived from the plan assets, together with realised and unrealised gains or losses on the plan assets, less any costs of administering the plan and less any tax payable by the plan itself.
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
- an employee's decision to accept voluntary redundancy in exchange for those benefits

Vested employee benefits are employee benefits that are not conditional on future employment.

Prescribed Accounting Treatment

Types of Employee Benefits

IAS 19 deals with the following employee benefits:
• short- term benefits (e.g. wages)
• post-employment benefits (e.g. post-employment medical care)
• other long term benefits (e.g. long service leave)
• termination benefits
When an employee has rendered service to an entity during a reporting period, the entity shall recognise the amount of the associated employee benefit cost as an expense unless the cost is included in the cost of another asset such as inventories or property, plant and equipment. An associated liability is recognised to the extent that any amount of employee benefit remains unpaid to the employee.

Measurement

All short-term employee benefits, and termination benefits payable within 12 months of reporting date, are recognised at undiscounted amounts, with all other benefits being recognised at PV. The measurement takes account of legal and constructive obligations to employees, and uses the amounts expected to be paid in respect of the service.

Discounted amounts — discount rate

For discounted amounts, the discount rate used is that for high quality corporate bonds matching the currency and term of the liability. If there is no deep market, the rate used is the government bond rate, also matching the currency and term of the liability.

Short-term employee benefits

Short-term employee benefits include wages and salaries, and payment for short-term compensated absences such as sick leave and annual leave, where the absences are expected to occur within 12 months after the end of the period in which the employees render the related service. It also includes profit-sharing and bonuses payable in the same 12 month timeframe, and non-monetary benefits (e.g. medical care, housing and free or subsidised goods) for current employees. For short-term employee benefits the undiscounted amount of the benefits expected to be paid in respect of service rendered by employees in a period should be recognised in that period. The expected cost of short-term compensated absences should be recognised as the employees render service that increases their entitlement or, in the case of non-accumulating absences, when the absences occur.

Profit-sharing and Bonus Payments

The enterprise should recognise the expected cost of profit-sharing and bonus payments when, and only when, it has a legal or constructive obligation to make such payments as a result of past events and a reliable estimate of the expected cost can be made.

Post-employment Benefit Plans

The accounting treatment for a post-employment benefit plan will be determined according to whether the plan is a defined contribution or a defined benefit plan:

Under a defined contribution plan, the enterprise pays fixed contributions into a fund but has no legal or constructive obligation to make further payments if the fund does not have sufficient assets to pay all of the employees' entitlements to post-employment benefits.

A defined benefit plan is a post-employment benefit plan other than a defined contribution plan. These would include both formal plans and those informal practices that create a constructive obligation to the enterprise's employees.

Defined Contribution Plans

For defined contribution plans (including multi-employer plans, state plans and insured schemes where the obligations of the employer are similar to those arising in relation to defined contribution plans), the cost to be recognised in the period is the contribution payable in exchange for service rendered by employees during the period. No actuarial assumptions are required. The entity shall recognise the contribution payable to a defined contribution plan in exchange for the service as follows: (a) as a liability after deducting paid contributions and where there is a prepaid expense an asset shall be recognised; and (b) as an expense unless another standard permits the inclusion of the contribution as an asset.

If contributions to a defined contribution plan do not fall due within 12 months after the end of the period in which the employee renders the service, they should be discounted to their present value.

Defined Benefit Plans

At the reporting date, the entity recognises a defined benefit liability comprising:

- the PV of the defined benefit obligation
- plus any actuarial gains (less any actuarial losses) not recognised
- minus any past service cost not yet recognised
- minus the fair value (FV) of any plan assets out of which the obligations are to be settled directly

The PV of the defined benefit obligation should be determined using the Projected Unit Credit Method. Valuations should be carried out with sufficient regularity such that the amounts recognised in the financial statements do not differ materially from those that would be determined at the reporting date. The assumptions used for the purposes of such valuations should be unbiased and mutually compatible. The rate used to discount estimated cash flows should be determined by reference to market yields at the balance sheet date on high quality corporate bonds.

Actuarial gains and losses arise from unanticipated changes in, or changes in assumptions underlying, either the PV of the defined benefit obligation or the FV of any related plan assets. Causes of actuarial gains and losses include:

- changes in the discount rate
- current period employee turnover retirement and mortality rates differing from those expected
- changes in expectations about future period employee turnover retirement and mortality rates and salary levels
- the actual return on plan assets differing from expectations.

On an ongoing basis, actuarial gains and losses arise that comprise experience adjustments (the effects of differences between the previous actuarial assumptions and what has actually occurred) and the effects of changes in actuarial assumptions. In the long-term, actuarial gains and losses may offset one another and, as a result, the enterprise is not required to recognise all such gains and losses immediately. IAS 19 specifies that if the accumulated unrecognised actuarial gains and losses exceed 10% of the greater of the defined benefit obligation or the fair value of plan assets, a portion of that net gain or loss is required to be recognised immediately as income or expense. The portion recognised is the excess divided by the expected average remaining working lives of the participating employees. Actuarial gains and losses that do not breach the 10% limits described above (the 'corridor') need not be recognised - although the enterprise may choose to do so.

Over the life of the plan, changes in benefits under the plan will result in increases or decreases in the enterprise's obligation.

Past service cost is the term used to describe the change in the obligation for employee service in prior periods, arising as a result of changes to plan arrangements in the current period. Past service cost may be either positive (where benefits are introduced or improved) or negative (where existing benefits are reduced). Past service cost should be recognised immediately to the extent that it relates to former employees or to active employees already vested. Otherwise, it should be amortised on a straight-line basis over the average period until the amended benefits become vested.

If the calculation of the balance sheet amount as set out above results in an asset, the amount recognised should be limited to the net total of unrecognised actuarial losses and past service cost, plus the present value of available refunds and reductions in future contributions to the plan.

The entity recognises income or expense on a net or gross basis comprising:
• current service cost
• interest cost
• expected return on plan assets and reimbursement rights
• actuarial gains and losses
• past service cost recognised during the period

Current service cost is the increase in the PV of the defined benefit obligation resulting from employee service in the current period.

Expected return on plan assets is calculated by multiplying the plan assets at the start of the reporting period by the expected rate of return on them for the reporting period.

Termination benefits

For termination benefits, IAS 19 specifies that amounts payable should be recognised when, and only when, the enterprise is demonstrably committed to either:

terminate the employment of an employee or group of employees before the normal retirement date; or

provide termination benefits as a result of an offer made in order to encourage voluntary redundancy.

The enterprise will be demonstrably committed to a termination when, and only when, it has a detailed formal plan for the termination and is without realistic possibility of withdrawal from that plan. Where termination benefits fall due after more than 12 months after the balance sheet date, they should be discounted.

Prescribed Disclosures

Extensive disclosures are required for defined benefits plans and include reconciliations of the present value of the defined benefit obligation, the fair value of plan assets and the total expenses recognised. It is important to note that an asset related to one plan cannot be set-off against a liability related to a separate plan unless there is a legally enforceable right to use a surplus in one plan to settle obligations under the other plan. This is consistent with IAS 1, *Presentation of Financial Statements*' requirement not to offset assets against liabilities of a similar nature. Disclosures for other employee benefits covered by IAS 19 may be required by IAS 1, IAS 24, *Related Party Disclosures* and IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*.

2002 Amendment - 'Asset Ceiling'

The final 'asset ceiling' amendment issued in May 2002 prevents the recognition of gains solely as a result of deferral of actuarial losses or past service cost, and prohibits the recognition of losses solely as a result of deferral of actuarial gains. This can happen if an entity has a surplus in a defined benefit plan and cannot, based on the current terms of the plan, recover that surplus fully through refunds or reductions in future contributions. In such cases, deferral of past service cost and actuarial losses that arise in the period will increase the cumulative unrecognised net actuarial losses and past service cost. If that increase does not result in a refund to the entity or a reduction in future contributions to the pension fund, a gain would have been recognised under IAS 19 prior to this amendment. This amendment, however, prohibits recognising a gain in these circumstances. The opposite effect arises with deferred actuarial gains that arise in the period. This amendment prohibits recognising a loss in these circumstances.

2004 Amendment Concerning Reporting Actuarial Gains and Losses

On April 29, 2004, the IASB issued the Exposure Draft of *Proposed Amendments to IAS 19, Employee Benefits: Actuarial Gains and Losses, Group Plans and Disclosures*. On December 16, 2004, the IASB finalised an amendment to IAS 19 to allow the option of recognising actuarial gains and losses in full in the period in which they occur, outside profit or loss, in a statement of recognised income and expense. This option is similar to the requirements of the UK standard, FRS 17, *Retirement Benefits*. The Board concluded that, pending further work on post-employment benefits and on reporting comprehensive income, the approach in FRS 17 should be available as an option to preparers of financial statements using IFRSs. The amendment also provides guidance on allocating the cost of a group defined benefit plan to the entities in the group.

2008 Amendment – Improvements to IAS 19

The IASB published on May 22, 2008, “Improvements to IFRSs 2008”. IAS 19 was amended based on this project in the following areas:

Curtailments and negative past service cost: Clarification that:
• when a plan amendment reduces benefits, the effect of the reduction for future service is a curtailment and the effect of any reduction for past service is a negative past service cost;
• negative past service cost arises when a change in the benefits attributable to past service results in a reduction in the present value of the defined benefit obligation; and
• a curtailment may arise from a reduction in the extent to which future salary increases are linked to the benefits payable for past service.
In addition, references to ‘materiality’ have been replaced with ‘significant’ in paragraph 111 of IAS 19.

Plan administration costs: Amendment of the definition of 'return on plan assets' to require the deduction of plan administration costs only to the extent that such costs have not been reflected in the actuarial assumptions used to measure the defined benefit obligation.

Replacement of term 'fall due': Amendment of the definitions of 'short-term employee benefits' and 'other long-term employee benefits' to refer to when the benefits are 'due to be settled', rather than when they 'fall due'. The final Standard refers to when employee benefits are 'due to be settled' whereas the Exposure Draft referred to when the employee becomes entitled to the benefits.

Guidance on contingent liabilities: Removal of the reference to 'recognition' in relation to contingent liabilities as it was inconsistent with IAS 37, which states that an entity should not recognise a contingent liability.

IFRIC Interpretation

The International Financial Reporting Interpretations Committee (IFRIC) of the IASB has issued the following Interpretation relating to IAS 19:

- IFRIC 14: IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction (issued on July 4, 2007, effective from January 1, 2008)

IFRIC 14 addresses three issues:
- when refunds or reductions in future contributions should be regarded as 'available' in the context of paragraph 58 of IAS 19;
- how a minimum funding requirement might affect the availability of reductions in future contributions; and
- when a minimum funding requirement might give rise to a liability.

IFRIC 14 applies to all post-employment defined benefits and other long-term employee defined benefits. Minimum funding requirements are defined as "any requirement to fund a post-employment or other long-term defined benefit plan" and would therefore include both statutory and contractual requirements. Paragraph 58 of IAS 19 (the so-called 'asset-ceiling test') limits the measurement of a defined benefit asset to the total of any cumulative unrecognised net actuarial losses and past service cost, and the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan.

In many countries, laws or contractual terms require employers to make minimum funding payments for their pension or other employee benefit plans. This enhances the security of the retirement benefit promise made to members of an employee benefit plan. Normally, such statutory or contractual funding requirements would not affect the measurement of the defined benefit asset or liability. This is because the contributions, once paid, become plan assets and the additional net liability would be nil. However, paragraph 58 of IAS 19 limits the measurement of the defined benefit asset to the 'present value of economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan.' IFRIC 14 addresses the interaction between a minimum funding requirement and the limit placed by IAS 19.58 on the measurement of the defined benefit asset or liability.

When determining the limit on a defined benefit asset in accordance with IAS 19.58, under IFRIC 14 entities are required to measure any economic benefits available to them in the form of refunds or reductions in future contributions at the maximum amount that is consistent with the terms and conditions of the plan and any statutory requirements in the jurisdiction of the plan. The entity's intentions on how to use a surplus (for instance, whether the entity intends to improve benefits rather than reduce contributions or get a refund) must be disregarded. Such economic benefits are regarded as available to an entity if the entity has an unconditional right to realise them at some point during the life of the plan or when the plan is settled, even if they are not realisable immediately at the reporting date. Such an unconditional right would not exist when the availability of the refund or the reduction in future contribution would be contingent upon factors beyond the entity's control (for example, approval by third parties such as plan trustees). To the extent the right is contingent, no asset would be recognised.

At the January 2009 IASB Meeting, the staff presented a proposed amendment to IFRIC 14 to clarify the accounting where an entity makes voluntary prepaid contributions and there is a minimum funding requirement. The staff recommended an approach that would treat the prepayment as partially recoverable. However, many Board members felt that the whole of the prepayment is recoverable and, hence, full recognition of the prepayment was appropriate. The chairman took the vote and the Board agreed to full recognition. The amendment is to be exposed in due course.

Discussion Paper on Employee Benefits

On March 27, 2008, the IASB published for comment a Discussion Paper (DP) - *Preliminary Views on Amendments to IAS 19, Employee Benefits*. The DP represents the first step in a comprehensive project on the accounting for post-employment benefit promises. This step is limited in scope to the following issues:

- The deferred recognition of some gains and losses arising from defined benefit plans (currently IAS 19 allows multiple options for deferring recognition)
- Presentation of defined benefit liabilities
- Accounting for benefits that are based on contributions and a promised return
- Accounting for benefit promises with a 'higher of' option

Therefore, the DP focuses on improvements to IAS 19. In the longer term, the IASB intends to work with the US Financial Accounting Standard Board (FASB) towards a common standard on post-employment benefit promises. Because that project will take many years to complete, the IASB concluded that short-term improvements are needed to provide users with better information about post-employment obligations.

Among the IASB's preliminary views are the following:

- Recognise all changes in the value of plan assets and in the post-employment benefit obligation in the financial statements in the period in which they occur. This means, among other things, removing the options for deferred recognition of gains and losses in defined benefit plans.
- Classify benefit promises into defined benefit promises and contribution-based promises.
- Measure contribution-based promises (which include cash-balance plans), as follows:

  The measurement of the entity's liability for a contribution-based promise should be based on current best estimates, unbiased, probability-weighted amounts, and observable market values where they exist. Also, the entity should assume that the benefit promise does not change. The IASB believes that the measurement attribute *fair value assuming that the benefit promise does not change* best expresses this approach.

- Recognise unvested past service cost in the period of a plan amendment.
- Recognise both vested and unvested contribution-based promises as a liability.

Allocate the benefits earned under a contribution-based promise to periods of service in accordance with the benefit formula.

The IASB does not express a preliminary view on the presentation of the components of post-employment benefit cost in comprehensive income (within or outside of profit and loss). Instead, several alternatives are discussed and comments invited by September 26, 2008.

At the February 2009 IASB Meeting, the staff presented the most recent proposed project timetable for the post-employment benefits project. The plan provides for an exposure draft to be published in November 2009 with a 120-day comment period and a final IFRS in the first half of 2011.

Comparative Indian Standard

The Accounting Standard issued by the Institute of Chartered Accountants of India (ICAI) comparative to IAS 19 is AS 15, *Employee Benefits.* AS 15 is based on the current IAS 19.

The major differences between IAS 19 and AS 15 are:
Difference due to removal of alternatives: Unlike IAS 19, AS 15 does not provide any option with regard to recognition of actuarial gains and losses. It requires such gains and losses to be recognised immediately in the statement of profit and loss.
Conceptual Difference: Regarding recognition of termination benefits as a liability, it is felt that merely on the basis of a detailed formal plan, it would not be appropriate to recognise a provision since a liability cannot be considered to be crystallised at this stage. Accordingly, AS 15 provides criteria for recognition of a provision for liability in respect of termination benefits on the basis of the general criteria for recognition of provision as per AS 29, *Provisions, Contingent Liabilities and Contingent Assets* (corresponding to IAS 37).

Conclusion

As the first phase of the project, the IASB issued the DP to reconsider accounting for some post-employment employee benefits, including Pensions. The second phase of the project will aim for a comprehensive review of all post-employment employee benefits. The final IFRS to be issued in 2011 would significantly improve the Pension Accounting.

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