IAS 19
Employee benefits

1. Objective

IAS 19 prescribes the accounting methods to be used by entities for all employee benefits during and after employment (such as wages, paid annual leave, non-monetary benefits, lump-sum payments on retirement, medical care, pension benefits). However share-based payments are dealt with in IFRS 2.

2. Scope

There are four categories of employee benefits:

- **short-term benefits** are employee benefits (other than termination benefits) corresponding to wages, paid absences (paid annual holiday leave for instance), bonuses, profit-sharing and other free or subsidised monetary benefits such as medical care, housing, cars, training. These benefits are expected to be settled within twelve months of the end of the reporting period in which the employees rendered the related services. They should not be discounted to present value;

- **post-employment benefits** are employee benefits (other than termination benefits and short-term benefits), such as retirement pensions, life insurance or long-term disability insurance. They comprise the following items:
  - ✓ **defined contribution** plans: an entity pays fixed contributions in advance into a specific entity (usually a fund). The employer's obligation is limited to the amount it agrees to pay into the fund;
  - ✓ **defined benefit** plans: an entity is under the obligation to provide the agreed benefits to its current and former employees (or even sometimes to their dependents). In this case the entity carries the actuarial risk as well as the investment risk;

- **other long-term benefits** are all employee benefits (other than short-term benefits), such as sabbatical leave, "jubilees", long-service seniority benefits. These benefits are not usually settled within twelve months of the reporting period. However since they are often of little significance in practice, IAS 19 requires a simplified accounting treatment, in particular the immediate inclusion of the actuarial differences in the profit or loss statement;

- **termination benefits**, corresponding to the sums paid by an entity on termination of an employee's employment as a result of either the entity's decision (dismissal) or the employee's decision (voluntary departure). The recognition of termination benefits is conditional on the existence of a clear and formal commitment by the entity in order to avoid excessive provisioning, particularly in the case of business combinations.

3. Accounting impact

3.1 Short-term benefits

The undiscounted amount of short-term benefits is recognized in the accounting period in which an employee rendered services to an entity.

Example 1: Paid leave and profit-sharing. Company X employs Mr. S as a sales clerk, for a fixed monthly salary of 3,000. Employee S is also entitled to paid annual leave calculated as 1/10th of his monthly salary per effective working month. The employee has not yet used any of the paid leave he is entitled to for the current year. In addition, the employee's employment agreement provides for a profit-sharing benefit worth one per thousand of net sales turnover.
The company's year-end is 30 June. On 30 June N, employee S has effectively worked for the past twelve months and will take the paid annual leave he is entitled to in August N. The net turnover of company X on 30 June N is 5,675,000.
The expenses that company X must record in its profit or loss statement on 30 June N are as follows:

Provision for paid annual leave = 3,000 × 1/10 × 12 months =	3,600
Provision for related contributions and taxes estimated at 50%, i.e.	1,800
Provision for profit-sharing on net turnover = 5,675,000 × 1‰ =	5,675

It is assumed that profit-sharing is exempt from contributions and taxes.
Expenses would be recognized as follows:

Liability for accrued paid leave (P&L)	3,600	
Debt accrued on paid leave (B/S)		3,600
Related liability on accrued paid leave (P&L)	1,800	
Social contributions, related liabilities on paid leave (B/S)		1,800
Employee profit-sharing (P&L)	5,675	
Employees, profit-sharing liability (B/S)		5,675

3.2 Post-employment benefits

1° Defined contribution plans

An entity must recognize the contributions paid in exchange for services rendered by employees as an expense.

2° Defined benefit plans

Assessing commitments for defined benefit plans is made complex because of the need to resort to actuarial calculations to measure the obligation and the expense. The future obligation must be estimated on a discounted present value basis because of the potentially long time lag between the date of payment of the benefit and the period in which the employees rendered the related service.

An entity must use the projected credit unit method (a retrospective method, the only method permitted by IAS 19) to determine the discounted present value of its obligation, the related current service cost and, when applicable, past service cost.

The actuarial assumptions used by an entity must be unbiased and reflect:

- demographic variables: employee turnover, mortality;
- financial variables: discount rate, changes in wages and benefits, medical costs, taxes related to the benefit plan.

If an employee's service in later years will lead to a materially higher level of benefit than in earlier years, an entity shall attribute benefit on a straight-line basis from:

- the date when service by the employee first led to benefits under the plan (whether or not the benefits are conditional on further service) until
- the date when further service by the employee would lead to no material amount of further benefits under the plan, other than from further salary increases.

The discount rate, reflecting the potentially long time lag that may exist between the date of payment of the benefit and the period in which an employee rendered the related service is determined by reference to market yields of high-quality corporate bonds or, where there is no deep market, the market yields on government bonds.

Example 2: Since 1 January N, company X has employed Mr. Y, age 40, whose life expectancy is 85 years. The probability that Mr. Y will still be employed in company X when he retires at the age of 65 is 65% as at the end of year N.
Retirement pensions will increase by 1.5% per annum.
Mr. X's current salary is 21,000 and increases regularly every year by 2%. The vesting coefficient per year of employment used is 0.75% and the discount rate used is 5%.

The cost of service rendered in the reporting period would be calculated as follows:

Annual salary at expected retirement date:	21,000 × 1.0225 = 34,452.73
Vested rights for year N:	34,452.73 × 0.75% = 258.40
Discount rate:	1.05^{25}
Probability rate that Mr. Y will still be employed in company X when he retires:	65%
Multiplying factor:	$[(1.015/1.05^{20}) – 1]/[(1.015/1.05) – 1] = 18.5237$

The factor 20 above is the probable number of years Mr. Y will be retired.
Current service cost: $258.40 \times 1.05^{-25} \times 0.65 \times 18.5237 = 918.76$
This amount corresponds to the expense to be recognized in year N.

The net liability (asset) to be recognized by an entity is equal to:
+ the discounted value of the obligation on closing date
– less unrecognized past service cost (where applicable)
– less the fair value of retirement plan assets directly affected (where they exist) in the settlement of the entity's obligations. This is limited to the part recoverable by the entity (non-recoverable surpluses in the form of reimbursement or reduction of future contributions are deducted from the fair value of plan assets).

Example 3: On 31 December N, company Y reports a provision for retirement plan obligations (defined benefit plan). Company Y secured the services of an actuary, who used the following information as a basis:

Current obligation value	2,000
Unrecognized past service cost	200
Fair value of plan assets (including 100 reduction in future contribution)	900

The provision reported in the balance sheet therefore would amount to 1,000 (+2,000 – 200 – 800).

The gain or loss to be recognized by an entity is equal to:
+ current service cost (variation of plan net debt)

+/- net interest on liabilities/assets (see clarification below)
+ pro rata past service cost (including unvested benefits)
+/- effect of any change, reduction or liquidation of the plan.

Net interest is the interest expense (or gain) determined by applying the discount rate of the benefit obligation to the net obligation. It comprises:

- the expense related to the unwinding of the discount relating to the obligation;
- income on plan assets;
- interest on the effect of asset ceiling (asset ceiling rule).

The difference between the actual return on plan assets and income on plan assets constitutes a remeasurement that must be recognized in other comprehensive income (OCI).

Example 4: The fair value of plan assets at the start of the reporting period is 10,000. Income from plan assets is calculated using a discount rate of 3%. According to the actuary, the expected fair value of the plan assets at the end of the period is 10,500.

Net interest is equal to 300 (10,000 x 3%) and is recognized as income.
The difference between return on plan assets and income from plan assets amounts to 200 (10,500 – 10,000 - (10,000 x 3%)) and is recognized in other comprehensive income (OCI).

3° Curtailment, amendment and settlement of a benefit plan

Whenever an entity curtails or amends the conditions of a defined benefit plan or when it substitutes a new defined benefit plan for a former one, it must determine the past service cost.
Benefits payable for service in prior years must be recognized as expenses at the earliest date. Benefits payable for future service (for all past service costs) are **recognized in the income for the period during which the change occurs.**

4° Remeasurement of defined benefits

Remeasurement of net defined benefit liability or asset comprises:

- actuarial gains and losses
- return on plan assets (excluding amounts included in financial cost)
- changes in the effect of asset ceiling, excluding amounts included in the determination of net interest on defined benefit liability/asset.

So-called “actuarial” gains and losses may result from increases or decreases in the present value of the defined benefit obligation or the fair value of the related defined benefit plan asset. They may also result from the difference between assumptions and changes in variables observed over the period. **Actuarial gains and losses are recognized in other comprehensive income (OCI) at the end of each reporting period.**

3.3 Other long-term employee benefits

These benefits are measured and recognised in the same way as defined benefits. However, remeasurement of net liabilities (of assets), including in particular actuarial gains and losses are recognised directly through profit or loss.

3.4 Termination benefits

Entities must recognise a liability and expense for termination benefits at the earlier of the following dates:

- when the entity can no longer withdraw the offer of those benefits;
- when the entity recognises costs for a restructuring that is within the scope of IAS 37 and involves the payment of termination benefits.

Termination benefits must be remeasured if they are not expected to be settled wholly before twelve months after the end of the annual reporting period.

4. Disclosure

4.1 Short-term employee benefits

This Standard does not require specific disclosure in relation to short-term employee benefits.

4.2 Defined contribution plans

Entities must disclose:

- the amount recognized as an expense for defined contribution plans;
- information about contributions to defined contribution plans for key management personnel.

4.3 Defined benefit plans

Disclosure comprises three parts:

- Characteristics and associated risks:
  - ✓ general description of the type of benefit plan (nature of benefits, description of regulatory framework in which the plan operates, etc.);
  - ✓ description of the risks to which the plan exposes the entity (for example, assets invested primarily in one class of investments, etc.);
  - ✓ description of any amendments, curtailments and settlements of the plan.
- Explanation of financial impact:
  - ✓ reconciliation of assets and liabilities recognized on the balance sheet;
  - ✓ reimbursement rights;
  - ✓ reconciliation showing movements during the reporting period and, in particular, current service cost, interest income or expense, remeasurements, past service cost, gains and losses arising from settlement;
  - ✓ fair value of plan assets disaggregated into assets that have a quoted market price and those that do not;
  - ✓ significant actuarial assumptions.
- Amount, timing and uncertainty of future cash flows:
  - ✓ sensitivity analysis for significant actuarial assumptions;
  - ✓ changes in methods and assumptions used in preparing the analysis;
  - ✓ asset-liability matching strategies;
  - ✓ any items that could have an effect on future cash flows.

If an entity participates in a multi-employer plan, it must disclose detailed information, in particular the extent to which the entity is liable to the plan.