



# **Updates on New IFRS**

## ***IAS 19 Employee Benefits (Revised)***

***March 7, 2013***

** ERNST & YOUNG**  
*Quality In Everything We Do*

# Agenda

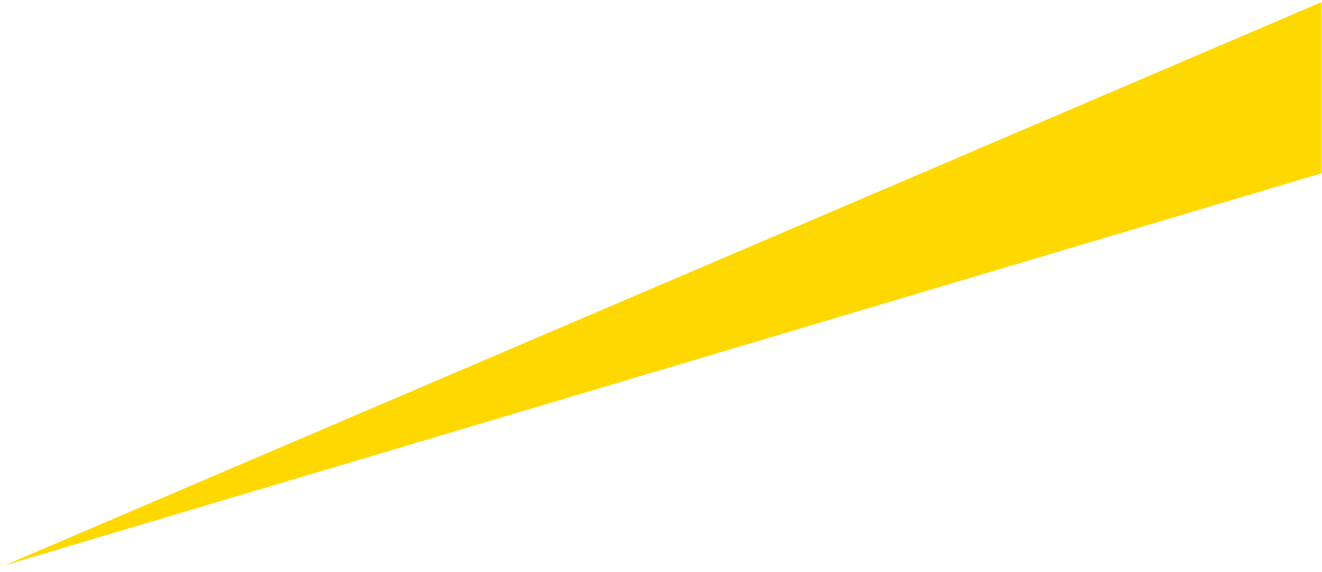
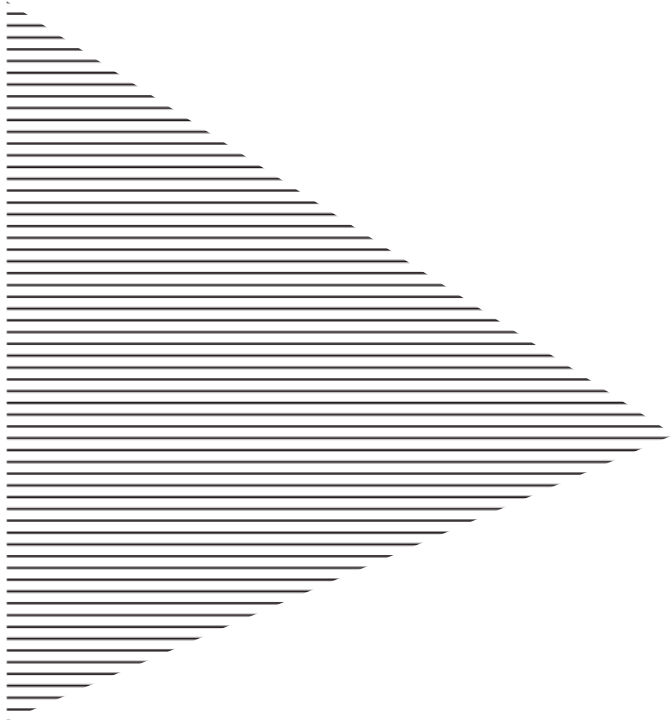
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- ▶ Introduction
- ▶ Significant Changes
  - ▶ Defined benefit plans
    - ▶ Removal of corridor approach
    - ▶ Change in the components of net defined benefit liability (asset)
    - ▶ Modified disclosures
  - ▶ Other recognition and measurement changes
    - ▶ Distinction between short term and long-term benefits
    - ▶ Termination benefits
- ▶ Effective date and transition

# Revisions to IAS 19: Introduction

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- ▶ Issued in June 2011
- ▶ Concludes the IASB's limited scope improvements to IAS 19
- ▶ Key objectives:
  - ▶ Create greater consistency in accounting for employee benefits
  - ▶ Provide more targeted disclosure requirements
- ▶ Impact of revisions could range from significant to immaterial depending on:
  - ▶ Type of employee benefits an entity provides
  - ▶ Accounting options selected under the current IAS 19



# Significant Changes: Defined Benefit Plans

# Removal of Corridor Approach

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- ▶ Under IAS 19, the following reporting options for the recognition of actuarial gains and losses were available:
  - ▶ Immediate recognition through OCI
  - ▶ Immediate recognition through profit or loss
  - ▶ Deferred recognition through profit or loss (i.e., corridor approach)
- ▶ IAS 19R eliminates these reporting options by requiring immediate recognition through OCI.
- ▶ Under IAS 19R, there is immediate recognition of changes in pension related assets and liabilities

# Removal of Corridor Approach (cont'd)

## *Illustration*

(CU '000)		Scenarios		
		1	2	3
Fair value plan assets	A	7,000	2,100	5,000
Defined benefit obligation	B	6,800	2,300	5,600
Cumulative unrecognized actuarial gains (losses)	C	980	(330)	(480)
Net balance sheet defined benefit asset (liability):				
Current IAS 19	A-(B+C)	(780)	130	(120)
IAS 19R	A-B	200	(200)	(600)

*Note: assumes no unrecognized past service costs on transition and ignores the impact of any asset ceiling limits.*

# Removal of Corridor Approach (cont'd)

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- ▶ Actuarial gains and losses recognized in OCI shall not be reclassified to profit or loss in subsequent periods
- ▶ Entity may transfer those amounts recognized in OCI within equity

## Implications:

- ▶ Actuarial gains and losses will permanently bypass profit or loss
- ▶ Increase balance sheet volatility for those entities currently applying the corridor approach, which could impact their key balance sheet metrics or debt covenants on a continuing basis.

# Changes to the Components of the Net Defined Liability/Asset

Prior to Amendment	As Amended
<p>Current service cost</p> <p>Past service cost</p> <p>Curtailment/Settlement</p> <p>Interest Cost</p> <p>Expected Return on Plan Asset</p> <p>Actuarial gains and losses from obligation</p> <p>Actuarial gains and losses from plan assets</p> <p>Effect of Limit</p>	<p>Current service cost</p> <p>Past service cost</p> <p>Gain or loss on settlement</p> <p>Net interest on defined benefit liability (asset)</p> <p>Remeasurement of the net defined benefit (asset)</p> <ul style="list-style-type: none"> <li>- Actuarial gains and losses from obligation</li> <li>- Return on plan assets*</li> <li>- Change in effect of asset ceiling*</li> </ul> <p>* excluding amounts recorded as net interest</p>



# Components of Net Defined Liability/Asset

## *Recognition of Net Interest*

Prior to Amendment	As Amended
Current service cost	Current service cost
Past service cost	Past service cost
Curtailment/Settlement	Gain or loss on settlement
Interest Cost	Net interest on defined benefit liability (asset)
Expected Return on Plan Asset	
Actuarial gains and losses from obligation	Remeasurement of the net defined benefit (asset)
Actuarial gains and losses from plan assets	- Actuarial gains and losses from obligation
Effect of Limit	- Return on plan assets*
	- Change in effect of asset ceiling*
	* excluding amounts recorded as net interest

# Components of Net Defined Liability/Asset

## *Recognition of Net Interest (cont'd)*

Prior to Amendment	As Amended
Current service cost	Current service cost
Past Service cost	Past service cost
Curtailment/Settlement	Gain or loss on settlement
<b>Interest Cost</b>	Net interest on defined benefit liability (asset)
<b>Expected Return on Plan Asset</b>	Remeasurement of the net defined benefit (asset)

**Interest Cost-** Interest cost is computed by multiplying the discount rate as determined at the start of the period by the present value of the defined benefit obligation throughout that period

**Expected Return on Plan Asset -** expected return on plan assets is based on market expectations at the beginning of the period for returns over the entire life of the related obligation.

# Components of Net Defined Liability/Asset

## *Recognition of Net Interest (cont'd)*

Prior to Amendment	As Amended
Current service cost	Current service cost
Past Service cost	Past service cost
Curtailment/Settlement	Gain or loss on settlement
Interest Cost	Net interest on defined benefit liability (asset)
Expected Return on Plan Asset	

Net interest – Net interest expense (income) represents the change in the defined benefit obligation and the plan assets as a result of the passage of time.

Interest rate should be the discount rate used to measure the obligation.

Effectively, plan assets will now produce a credit to income based on bond yields irrespective of actual composition of plan assets.

# Net interest income (expense) - example

## Assumptions at beginning of the annual period:

Fair value of plan assets CU 300 (expected return - 8%)

Defined benefit obligation CU 320 (discount rate – 5%)

Net pension liability CU 20

*Note: excludes impact of contributions and benefit payments made during the period*

### Current IAS 19

Expected return – CU 24  
( $300 * 8\%$ )

DB interest cost - CU 16  
( $320 * 5\%$ )

Net CU 8

### Revised IAS 19

Net interest expense – CU 1  
( $20 * 5\%$ )

# Components of Net Defined Liability/Asset

## *Past service cost and curtailments*

Prior to Amendment	As Amended
Current service cost	Current service cost
Past service cost	Past service cost
Curtailment/Settlement	Gain or loss on settlement
Interest Cost	Net interest on defined benefit liability (asset)
Expected Return on Plan Asset	
Actuarial gains and losses from obligation	Remeasurement of the net defined benefit (asset)
Actuarial gains and losses from plan assets	- Actuarial gains and losses from obligation
Effect of Limit	- Return on plan assets*
	- Change in effect of asset ceiling*
	* excluding amounts recorded as net interest

# Immediate Recognition of Past Service Cost

- ▶ Past service cost will be expensed when the plan amendment occurs regardless of whether or not they are vested.
- ▶ Definition of past service cost was revised to include curtailment.

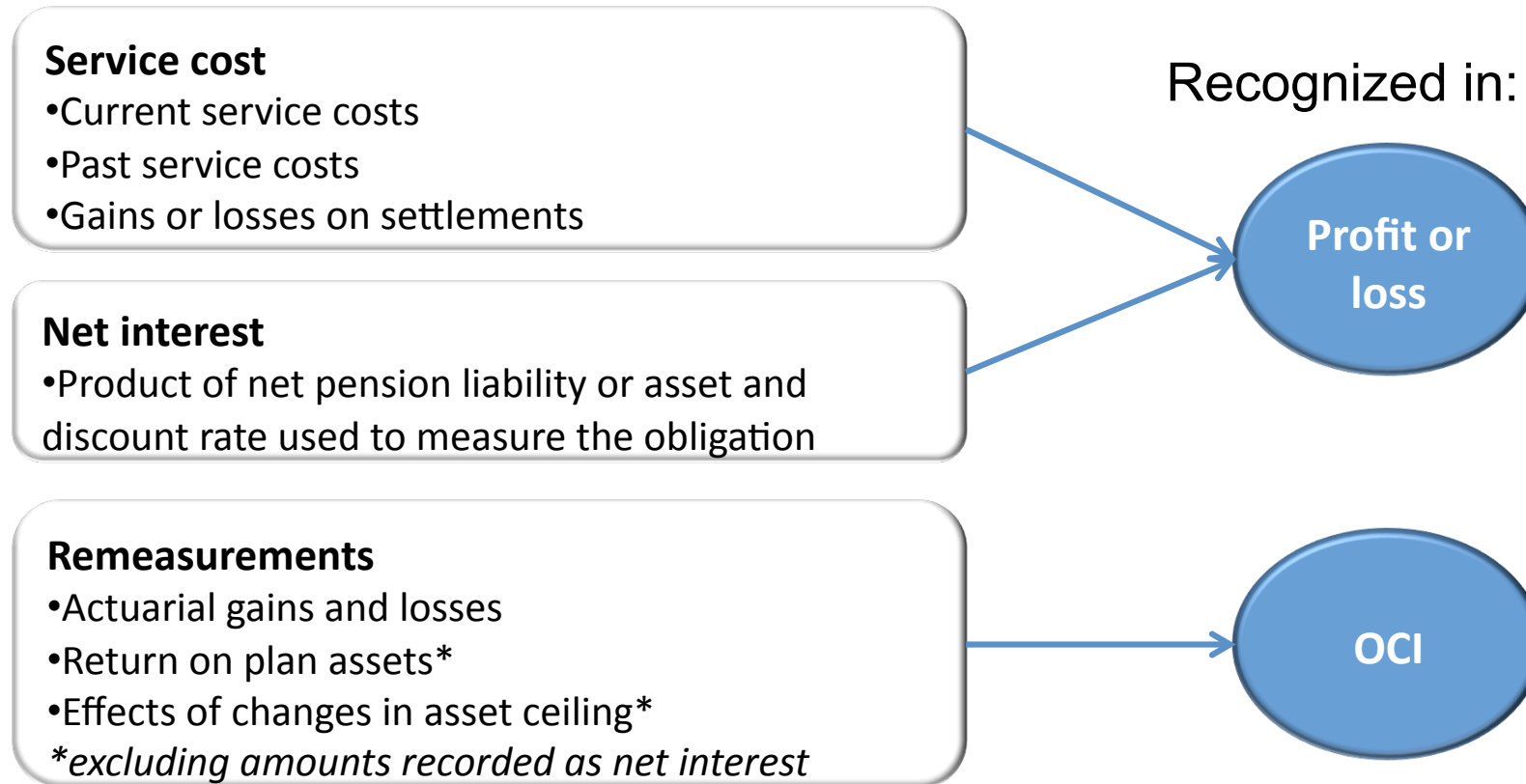
Prior to amendment	As amended
Past service cost is the change in the present value of the defined benefit obligation for employee service in prior periods, resulting in the current period from the introduction of, or changes to, post-employment benefits or other long-term employee benefits.	Past service cost is the change in the present value of defined benefit obligation for employee service in prior periods, resulting from a plan amendment (introduction or <u>withdrawal of</u> , or changes to, a defined benefit plan) or a <u>curtailment</u> .

- ▶ Distinction between past service cost and curtailments was necessary prior to amendment because curtailments were recognized immediately, but unvested service cost was recognized over the vesting period.

# Components of Net Defined Liability/Asset Remeasurements

Prior to Amendment	As Amended
Current service cost	Current service cost
Past service cost	Past service cost
Curtailment/Settlement	Gain or loss on settlement
Interest Cost	Net interest on defined benefit liability (asset)
Expected Return on Plan Asset	
Actuarial gains and losses from obligation	Remeasurement of the net defined benefit (asset)
Actuarial gains and losses from plan assets	- Actuarial gains and losses from obligation
Effect of Limit	- Return on plan assets*
	- Change in effect of asset ceiling*
	* excluding amounts recorded as net interest

# Presentation of Components of Net Defined Liability/Asset



Note: IAS 19 does not specify where an entity should present Service cost and Net interest in the statement of income. An entity presents those components in accordance with IAS 1.



# Post-employment benefits

## Modified disclosures

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- ▶ Disclosures required by the revised IAS 19 will make it easier for users to assess matters such as:
  - ▶ Characteristics of a company's defined benefit plans
  - ▶ The amounts recognized in the financial statements
  - ▶ Risk arising from defined benefit plans, including sensitivity analysis
  - ▶ Participation in multi-employer plans

# Post-employment benefits

## *Additional disclosure requirements*

### Characteristics of defined benefit plans

- A description of the risks to which the plan exposes the entity, focused on any unusual, entity-specific or plan-specific risks, and of any significant concentrations of risk.

### Amounts recognized in the financial statements

- Segregate and disclose the impact of actuarial gains or losses resulting from changes in demographic assumptions from those relating to financial assumptions
- Disaggregate the fair value of the plan assets into classes that distinguish the nature and risks of those assets

# Post-employment benefits

## *Additional disclosure requirements (cont'd)*

Amount, timing  
and uncertainty  
of future cash  
flows

- Sensitivity analysis for each significant actuarial assumption
- Asset-liability matching strategies
- Information about the maturity profile of the defined benefit obligation

Multi-employer  
plans

- Description of any withdrawal or wind-up agreements
- Level of participation in a multi-employer plan

# Post-employment benefits

## *Other changes*

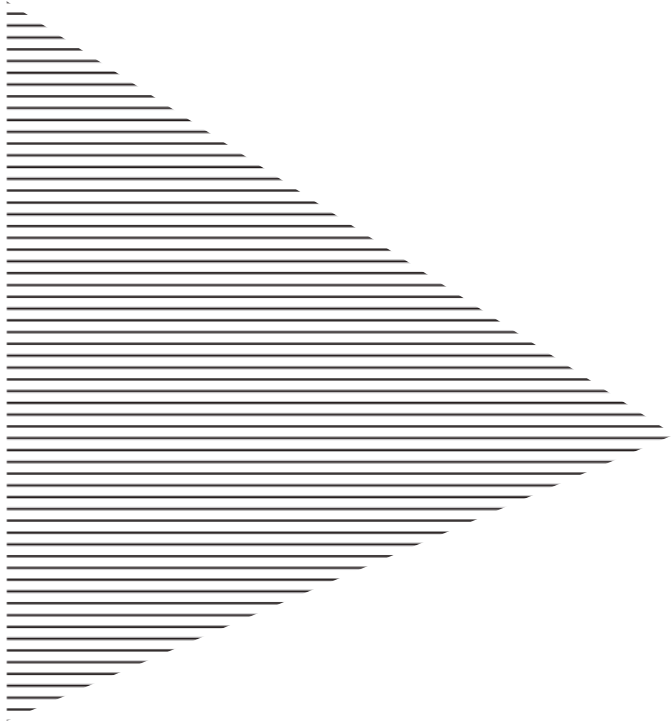
Subject	Summary
Lump sum or ongoing payment(s)	<ul style="list-style-type: none"> <li>Clarification: estimated proportion of plan members who will select each form of settlement option set out in the plan constitutes a demographic assumption (i.e., considered a remeasurement recognised through OCI)</li> </ul>
Tax payable by plan	<ul style="list-style-type: none"> <li>Included in DBO, if relates to taxes payable by the plan on contributions relating to service before the reporting date or on benefits resulting from that service.</li> </ul>
Costs of managing plan assets	<ul style="list-style-type: none"> <li>Return on plan assets will only be reduced by costs of managing plan assets.</li> </ul>
Expected mortality rates	<ul style="list-style-type: none"> <li>Clarification: mortality assumptions used to determine DBO are current estimates</li> </ul>

# Post-employment benefits

## *Other changes*

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Subject	Summary of change(s)
Risk-sharing and conditional indexation/employee contributions	<ul style="list-style-type: none"><li>- Employee contributions to ongoing cost of plan reduce current service cost</li><li>- Employee (or third party) contributions receivable are included in DBO</li><li>- Requirements for employees to reduce or eliminate a deficit and performance targets have to be considered in DBO</li></ul>



# Other IAS 19 Revisions

# Change in the Basis of Distinction Between Short-term and Long-term Benefits

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- ▶ The distinction between long-term and short-term benefits is now based on **when an employee is expected to receive the benefit** rather than when the employee becomes entitled to it.
  - ▶ Example: If paid holiday may be taken at any time, but is expected to be rolled up for a number of years and taken as a sabbatical, it would be accounted for as a long-term benefit.
- ▶ Long-term benefits are recognized and measured in the same way as pensions but all movements in previous estimates (i.e., remeasurements) will be recorded in profit and loss.

# Compensated absences – annual leave liability – Example

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- ▶ An entity provides 30 days of accumulating annual leave to all of its employees. The annual leave will continue to rollover if not taken in the first year. Any leave rolled-over to subsequent periods will be paid out in the event of termination of employment of the employee.
- ▶ At the end of the entity's annual reporting period 31 December 2013\*), the entity notes the following:
  - ▶ The entity has 2,000 employees as at 31 December 2013
  - ▶ These employees have an average outstanding leave credits of 16 days per employee as at 31 December 2013
  - ▶ Based on historical trends, 50% (8 days) of the outstanding leave is expected to be taken in the next twelve months and 25% (4 days) in each of the subsequent two years

\* Assumes adoption of new standard is on January 1, 2013



# Compensated absences – annual leave liability – Example (cont'd)

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- ▶ At the end of the entity's annual reporting period (31 December 2013), the entity notes the following (cont'd):
  - ▶ Employees' average salary is \$70,000, with 3% increases expected per annum
  - ▶ Turnover is expected to be 20% per annum
  - ▶ The discount rates which match the maturity of the expected cash flows at the reporting date are 2.8%, 3.0% and 3.2%
  - ▶ Average of 260 working days per annum
- ▶ As the outstanding annual leave is not expected to be settled wholly within 12 months of the end of the annual reporting period, the benefit will be classified as a long-term employee benefit.

# Compensated absences – annual leave liability – Example (cont'd)

The annual leave liability would be calculated as follows:

	2014	2015	2016
Number of employees at beginning of year (with 20% turnover)	2,000	1,600	1,280
Rollover days taken in year	8	4	4
Expected salary (with 3% increases)	72,100	74,263	76,491
Expected cash flows for leaves taken during the year	4,436,923 <sup>1</sup>	1,828,012	1,506,284
Expected cash flow for employees who will resign/be terminated <sup>2</sup>	887,385 <sup>3</sup>	365,602	-
Total expected cash flows	5,324,308	2,193,614	1,506,284
Discount rate%	2.8	3.0	3.2
Discounted amount	5,179,288	2,067,692	1,370,464
Benefit obligation at 31 December 2013			\$8,617,444

<sup>1</sup>  $2,000 \times 72,100 \times 8/260$

<sup>2</sup> Assume terminated/resign at end of financial year

<sup>3</sup>  $400 \times 72,100 \times 8/260$

The liability of 8,617,444 differs with current IAS 19 where the annual benefit would be considered a short-term benefit and the liability would be 8,873,846 ( $2,000 \times 72,100 \times 16/260$ )

# Termination benefits

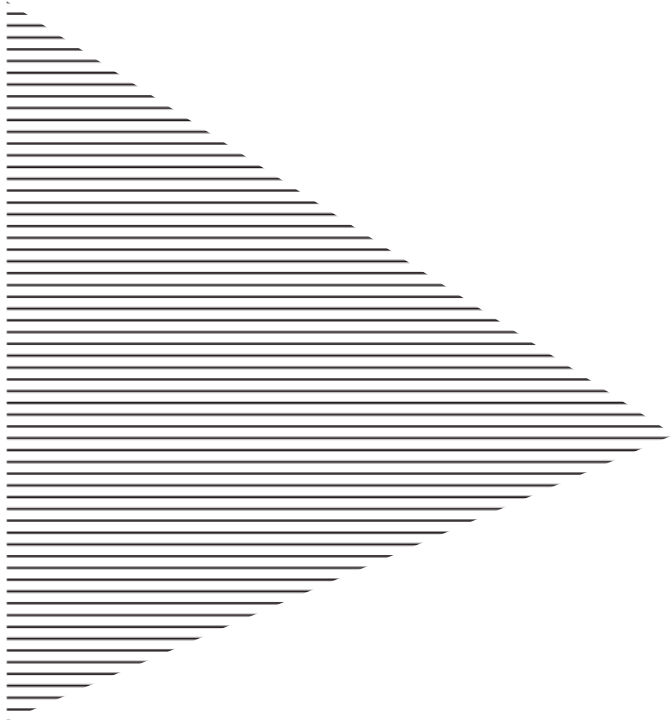
## *Main proposals and business impact*

### Termination benefits

- Not conditional on future service being provided
- Short period between offer and actual termination required
- Recognise when entity can no longer withdraw offer of benefits (or earlier, if part of a wider restructuring)
- **Measured** like employment benefits

### Benefits in exchange for future service

- Conditional on future service being provided
- Long period between offer and actual termination
- Available under ongoing scheme
- **Accounted** for as employment benefits



# Effective Date and Transition

# Effective date and transition

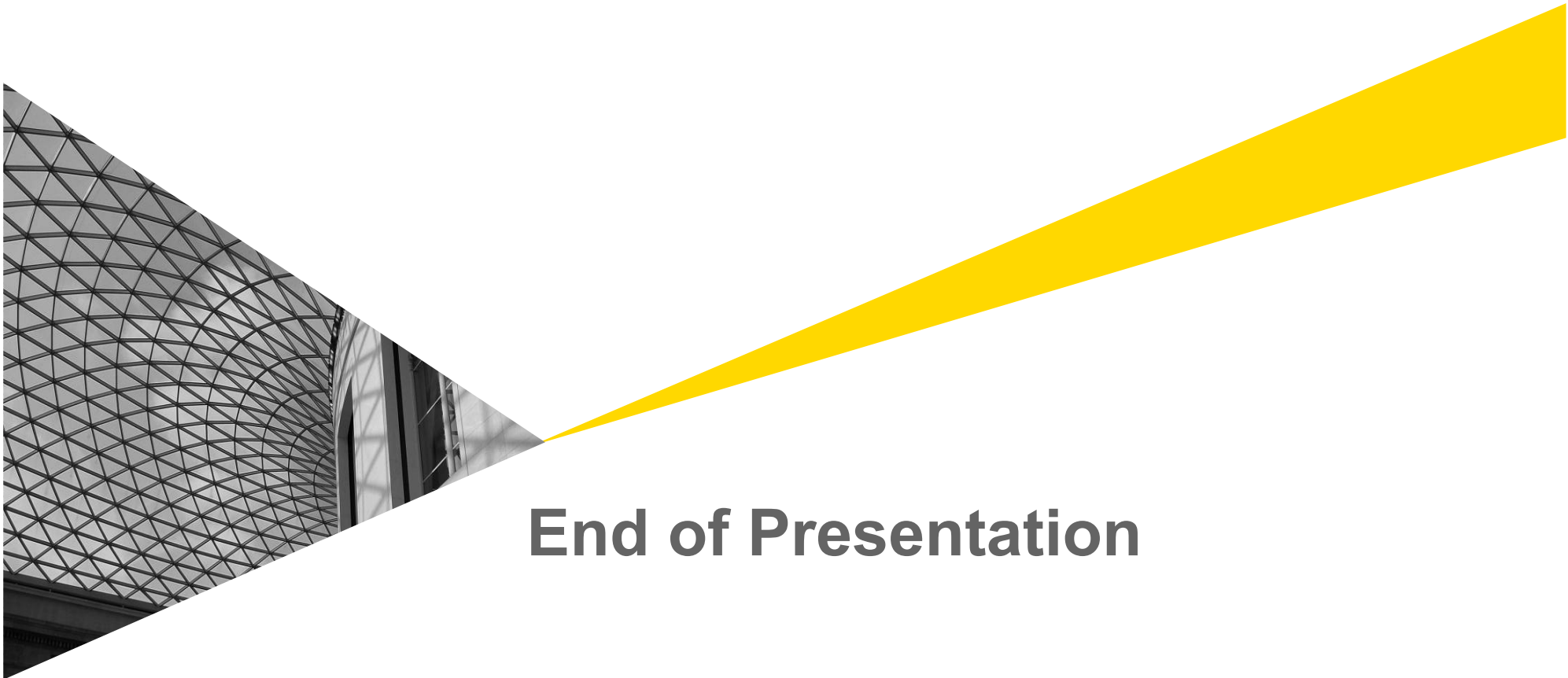
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- ▶ Effective for annual periods beginning 1 January 2013
- ▶ Earlier application is permitted.
- ▶ Retrospective application in accordance with IAS 8 with limited exceptions:
  - ▶ No requirement to restate carrying amount of assets outside the scope of IAS 19 (e.g., employee benefit costs capitalised during the construction of property, plant and equipment)
  - ▶ Not required to present comparative DBO sensitivity disclosures until periods beginning 1 January 2014

# Accounting impact

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- ▶ Significant impact on accounting, however little impact on processes, data and information systems
  - ▶ Possible exceptions:
    - ▶ Entities affected by new requirements for distinguishing short-term and long-term employee benefits
    - ▶ Requirements for additional disclosures (e.g., quantitative sensitivity of the DBO, separate impact of demographic and financial assumptions)



**End of Presentation**