

Employee benefits – IAS 19 – applies before 2013

Overview

IAS 19, 'Employee benefits', was revised in 2011 and applies from 1 January 2013. This summary deals with the previous version of IAS 19. See the summary below for the new requirements. Accounting for employee benefits, for pensions in particular, is complex. The liabilities in defined benefit pension plans are frequently material. They are long-term and difficult to measure, and this gives rise to difficulty in measuring the cost attributable to each year.

Employee benefits are all forms of consideration given or promised by an entity in exchange for services rendered by its employees. These benefits include salary-related benefits (such as wages, profit-sharing, bonuses and compensated absences, such as paid holiday and long-service leave), termination benefits (such as severance and redundancy pay) and post-employment benefits (such as retirement benefit plans). Share-based payments are addressed in IFRS 2.

Post-employment benefits include pensions, post-employment life insurance and medical care. Pensions are provided to employees either through defined contribution plans or defined benefit plans.

Recognition and measurement for short-term benefits is straightforward, because actuarial assumptions are not required and the obligations are not discounted. However, long-term benefits, particularly post-employment benefits, give rise to more complicated measurement issues.

Defined contribution plans

Accounting for defined contribution plans is straightforward: the cost of defined contribution plans is the contribution payable by the employer for that accounting period.

Defined benefit plans

Accounting for defined benefit plans is complex because actuarial assumptions and valuation methods are required to measure the balance sheet obligation and the expense. The expense recognised is not necessarily the contributions made in the period.

The amount recognised on the balance sheet is the net total of the present value of the defined benefit obligation less the fair value of plan assets adjusted for actuarial gains and losses if the corridor method is used (see 'corridor approach' below) and any unrecognised past service costs.

To calculate the defined benefit obligation, estimates (actuarial assumptions) about demographic variables (such as employee turnover and mortality) and financial variables (such as future increases in salaries and medical costs) are input into a valuation model. The benefit is then discounted to present value. This normally requires the expertise of an actuary.

Where defined benefit plans are funded, the plan assets are measured at fair value. Plan assets are tightly defined, and only assets that meet the definition of plan assets may be offset against the plan's defined benefit obligations – that is, the net surplus or deficit is shown on the balance sheet.

The re-measurement at each balance sheet date of the plan assets and the defined benefit obligation gives rise to actuarial gains and losses. There are three permissible methods under IAS 19 for recognising actuarial gains and losses:

- The OCI approach – where actuarial gains and losses are recognised immediately in other comprehensive income.
- The 'corridor approach' – where any actuarial gains and losses that fall outside the higher of 10% of the present value of the defined benefit obligation or 10% of the fair value of the plan assets (if any) are recognised in the income statement by amortising them over no more than the remaining working life of the employees.
- Faster recognition, including immediate recognition in full, in profit and loss is allowed.

IAS 19 analyses the changes in the plan assets and liabilities into various components, the net total of which is recognised as an expense or income (unless capitalised in accordance with another standard) in profit or loss. These components include:

- current service cost (the present value of the benefits earned by active employees in the current period);
- interest cost (the unwinding of the discount on the defined benefit obligation);
- expected return on any plan assets (expected interest, dividends and capital growth of plan assets);
- actuarial gains and losses, to the extent they are recognised in the income statement (see above); and
- past-service costs (the change in the present value of the plan liabilities relating to employee service in prior periods arising from changes to post-employment benefits).

Past-service costs are recognised as an expense on a straight-line basis over the average period until the benefits become vested. If the benefits are already vested, the past-service cost is recognised as an expense immediately. Gains and losses on the curtailment or settlement of a defined benefit plan are recognised in profit or loss when the curtailment or settlement occurs.

IFRIC 14, 'IAS 19 – The limit on a defined benefit asset, minimum funding requirements and their interaction', provides guidance on assessing the amount that can be recognised as an asset when plan assets exceed the defined benefit obligation creating a net surplus. It also explains how the pension asset or liability may be affected by a statutory or contractual minimum funding requirement.

Resources

Standards and interpretations

- IAS 19, 'Employee benefits'
- IFRIC 14, 'The limit on a defined benefit asset, minimum funding requirements and their interaction'
- IFRS IC items not added to the agenda for IAS 19
- IFRS IC items not added to the agenda for IFRIC 14, IAS 19

PwC guidance

- IFRS Manual of Accounting chapter 11, Employee benefits

Tools, practice aids and publications

- IFRS extracts from accounts
- Investor view 6 – improving pension disclosures
- Publication on pension and OPEB accounting: a study of the IASB's proposal

Summary of key requirements

1 IAS 19, 'Employee benefits', deals with accounting for employee benefits, including in particular pension costs. IFRIC 14 'IAS 19 – The limit on a defined benefit asset, minimum funding requirements and their interaction' gives further guidance in relation to defined benefit pension plans.

Objective and scope

2 The objective of IAS 19 is to prescribe the accounting and disclosure for employee benefits. The standard requires an entity to recognise a liability when an employee has provided service in exchange for employee benefits to be paid in the future and an expense when the entity consumes the economic benefit from service provided by an employee.

3 IAS 19 applies to all types of employee benefits (except share-based payments within the scope of IFRS 2), including:

- Short-term benefits payable during employment, such as wages, salaries, holiday pay, sick leave and profit sharing and bonuses (if due to be settled within 12 months of the end of the period in which the employees render the related service), non-monetary benefits such as medical care, housing and cars and social security contributions.
- Long-term benefits payable during employment, such as profit sharing, bonuses, deferred compensation and holiday pay (if not due to be settled within 12 months after the end of the period in which the employees render the related service), long-service leave, sabbatical leave, jubilee or other long-service benefits and long-term disability benefits.

- Termination benefits such as redundancy payments.
- Post-employment benefits such as pensions, other retirement benefits, post-employment life insurance and post-retirement medical care.

Each of these categories has different characteristics and is, therefore, accounted for differently. [IAS 19 para 4]

Benefits payable during employment

Short-term benefits

4 The accounting for wages, salaries and other short-term benefits payable in cash is generally straightforward. Where an employee has rendered service during the period the entity recognises the undiscounted amount of short-term employee benefits to be paid in exchange for that service as a liability (after deducting any amounts already paid) and as an expense, unless another standard requires or permits the inclusion of the benefits in the cost of an asset. [IAS 19 para 10].

5 IAS 19 provides guidance in respect of compensated absences, such as paid holiday and sick leave. The standard distinguishes accumulating absences, that is, those that may be carried forward and used in future periods, from non-accumulating absences that lapse if not used in full. The former are recognised when the employee renders service, and the latter are recognised when the absences occur. If employees are entitled to a cash payment for any unused entitlement on leaving the entity, the accumulated absences is vesting. If there is no such entitlement, an obligation is recognised, but its measurement takes into account the possibility that employees may leave. [IAS 19 paras 11 to 13].

- 6 An entity recognises the expected cost of profit sharing and bonus payments when:
- the entity has a present legal or constructive obligation to make such payments as a result of past events; and
 - a reliable estimate of the obligation can be made.

A present obligation arises only when the entity has no realistic alternative but to make the payments. [IAS 19 para 17]. A reliable estimate can only be made when the formal terms of the plan contain a formula for determining the amount payable; the amount payable is determined before the financial statements are authorised for issue; or past practice gives clear evidence of the amount of the entity's constructive obligation. [IAS 19 para 20].

Long-term benefits

7 It might be expected that the same accounting principles as above for short-term benefits would apply to long-term benefits payable during employment, with appropriate adjustment for increased uncertainty and the time value of money. However, the approach to accounting for long-term employee benefits is fundamentally different. With the exception that both actuarial gains and losses and past service costs are recognised immediately, long-term employee benefits are accounted for in the same way as defined benefit pension benefits (see further below). [IAS 19 para 127].

7.1 The accounting for long-term benefits involves discounting of future cash flows. Also, the complexity and length of some long-term benefit arrangements will require the use of other actuarial assumptions such as salary increases and inflation in order to calculate the obligation using the projected unit credit method. However in other long-term benefit plans, significant actuarial calculations would not generally be necessary, as certain assumptions (for example, mortality, life expectancy, asset return, etc) may not be relevant or material. In practice, the liability to be accrued would generally reflect the present value of expected cash outflows, with any unwind in the discount reflected as part of the benefit expense. The liability should be assessed and trued-up at each balance sheet period for any changes in expected cash flows. The accounting will depend on specific terms and conditions of the plan.

Termination benefits

8 In broad terms, termination benefits are amounts payable in exchange for an employee ceasing to work for an employer rather than in exchange for services provided. In this context they are similar to post-employment benefits, such as pensions. However, whereas post-employment benefits are earned throughout an employee's working life, termination benefits arise as a result of an employer's decision, such as a factory closure. Termination benefits are not earned in a literal sense, although their magnitude may be set by reference to an employee's period of service. As well as lump sum payments, termination benefits may include enhancement of retirement benefits or 'gardening leave'.

9 A liability and immediate expense in respect of termination benefits should be recognised when an entity has a demonstrable commitment 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.

[IAS 19 para 133].

10 An entity is demonstrably committed to a termination when it has a detailed formal plan and has no realistic possibility of withdrawal. [IAS 19 para 134].

11 Measurement of the liability follows the same principles as IAS 37, 'Provisions, contingent liabilities and contingent assets'. [IAS 19 paras 139, 140]. Accordingly, the amount recognised as a provision should be measured at the expected amount to be paid, subject to discounting, if the amount is due to be paid more than 12 months after the balance sheet date.

Post-employment benefits

Types of plan

12 Post-employment benefits are defined by IAS 19 as "*employee benefits (other than termination benefits) which are payable after the completion of employment*".

[IAS 19 para 7]. The most common type of post-employment benefit is a pension, although post-retirement health care is also common in some countries.

13 The accounting for post-employment benefits depends on the type of benefits that are promised.

Defined contribution plans

14 Defined contribution plans (often referred to as money purchase plans) are pension plans where the level of benefits depends on the value of contributions paid in respect of each member and the investment performance achieved on those contributions. Therefore, the employer's liability is limited to the fixed contributions it has agreed to pay – it has no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay the benefits. [IAS 19 para 7, 25].

Defined benefit plans

15 Defined benefit plans are all pension plans other than defined contribution plans. In such plans the rules specify the benefits to be paid and the entity has an obligation to finance them accordingly. The majority of these plans define benefits in relation to an employee's final salary (typically the pension will be based on a percentage of final salary for each year of pensionable service). Another form of defined benefit plan that is becoming increasingly common is the average salary plan where the pension is calculated by reference to average pay over an extended period. [IAS 19 paras 26 to 27].

Other plans

16 Defined benefit plans may be un-funded or wholly or partially funded. In funded plans, future liabilities for benefits are provided for in advance by the accumulation of assets held externally to the employing company's business, or through a qualifying insurance policy. In unfunded plans, pension liabilities are met out of the employer's own resources as they fall due. Other types of plan include multi-employer plans, state plans, group administration plans and insured plans. A description of each of these and how they are measured is given later in this summary.

Measurement and recognition – defined contribution plans

17 The accounting for a defined contribution plan is straightforward because the employer's obligation for each period is determined by the amounts to be contributed for that period. No actuarial assumptions are required to measure the obligation or the expense, and there are no actuarial gains or losses. Obligations are usually short-term in nature, and thus discounting is seldom required. [IAS 19 para 43].

18 The employer should recognise a liability for the contribution payable at the end of each period based on employee services rendered during the period, less any contributions already made. If the employer has made payments in excess

61 In order to meet the requirement of IFRS 11, the entity has to derecognise the previously equity accounted balance and recognise instead its share of assets and liabilities. The process should reflect the entity's right to assets and obligations for liabilities as specified in the contractual agreement. This is, in effect, a disaggregation of the investment balance into gross assets and liabilities. The disaggregation should be performed at the beginning of the earliest period presented. [IFRS 11 App C paras C7, C8].

62 The previous balance under the equity method could include elements other than just the share of investee's net assets. These are, for example, the investor's notional goodwill, any applicable fair value uplift and non-currents loans provided to the investment. During the disaggregation, the goodwill and non-current loans are reclassified according to their nature, whilst any fair value uplift should be allocated to the underlying assets.

63 If there is a difference between the gross value of the assets and liabilities (including goodwill) and the investment previously equity accounted, this is first offset against goodwill and then adjusted against retained earnings at the beginning of the immediately preceding period.

Joint ventures – IAS 31

Overview

Joint ventures are contractual arrangements between two or more parties where strategic financial and operating decisions for a joint economic activity are made unanimously by the entities that share control.

An entity may enter into a joint venture with another party for many reasons, and the venture may appear in an unincorporated or incorporated form. In its simplest form, a joint venture need not result in the creation of a separate entity at all. For example, 'strategic alliances' in which companies agree to work together to promote each other's products or services may also be considered joint ventures.

The key to identifying joint ventures is identifying the existence of a contractual relationship to establish joint control between two or more parties. Joint ventures fall into three categories:

- Jointly controlled operations.
- Jointly controlled assets.
- Jointly controlled entities.

The accounting treatment for the arrangement depends on the type of joint venture.

Jointly controlled operations

A jointly controlled operation involves the use of the venturers' assets and other resources rather than setting up a separate corporation, partnership or other entity. [IAS 31 para 13].

A venturer recognises in its financial statements:

- The assets that it controls and the liabilities that it incurs.
- The expenses that it incurs and its share of the income that it earns from the sale of goods and services by the joint operation.

Jointly controlled assets

Some joint ventures involve the joint control by the venturers of assets contributed to or acquired for the purposes of the joint venture. Similar to jointly controlled operations, these joint ventures do not involve establishing a separate corporation, partnership or other entity. Each venturer has control over its share of future economic benefits through its share in the jointly controlled asset. [IAS 31 paras 18, 19].

A venturer recognises in its financial statements in respect of its interests in jointly controlled assets:

- Its share of jointly controlled assets, classified according to the assets' nature.

- Any liabilities that it has incurred.
- Its share of liabilities incurred jointly with other venturers.
- Any income from the sale or use of its share of the output of the joint venture, together with its share of any expenses incurred by the joint venture.
- Any expenses that it has incurred in respect of its interest in the jointly controlled asset.

Jointly controlled entities

A jointly controlled entity involves the establishment of a separate entity, for example a corporation or partnership. Venturers contribute assets or capital to the separate entity in exchange for their interest and typically appoint members of a Board or governing committee to oversee operations. The level of contribution provided or interest obtained is not always indicative of the control in the entity. For example if two parties contribute 40% and 60% of the start-up capital for a jointly controlled entity and agree to share profits in proportion to their contributions, a joint venture will exist if the entities have a contractual agreement to establish joint control over the entity's economic activity.

Jointly controlled entities are accounted for using either proportionate consolidation or equity method accounting. Specific guidance is provided for instances where a party contributes a non-monetary asset to a jointly controlled entity in exchange for an equity interest.

Other parties to joint ventures

There may be parties to the contractual agreement who are not part of the exercise of joint control. These parties are investors and account for their interests under the relevant guidance for their investment.

Resources

Standards and interpretations

- IAS 31, 'Interests in joint ventures'
- IAS 28, 'Investments in associates'
- SIC 13, 'Jointly controlled entities – non-monetary contributions by venturers'

Exposure drafts and discussion papers

- Exposure draft 'Sale or contribution of assets between an investor and its associate or joint venture (proposed amendments to IFRS 10 and IAS 28)'

PwC guidance

- IFRS Manual of Accounting chapter 28, Joint ventures
- Questions and answers on Joint ventures

Tools, practice aids and publications

- IFRS extracts from accounts
- 'IASB updates' by topic on Joint ventures
- Straight away 100 – IASB publishes exposure draft on accounting for other net asset changes under the equity method

Summary of key requirements

Objective and scope

1 IAS 31, 'Interests in joint ventures', sets out the accounting for joint ventures and the related disclosure requirements. It provides guidance related to classification, recognition, measurement and disclosure for joint ventures. SIC 13, 'Jointly controlled entities – non-monetary contributions by venturers', provides specific guidance for non-monetary contributions to a jointly controlled entity in exchange for an equity interest.

2 All interests in joint ventures fall within the standard's scope regardless of the structures or forms under which the joint venture activities take place, except for interests in jointly controlled entities held by venture capital organisations, mutual funds, unit trusts and similar entities, including investment-linked insurance funds. An exemption from joint venture accounting is available to those entities if the investments are measured at fair value through profit and loss. A venturer holding this type of interest must make the disclosures required by IAS 31 paragraphs 55 and 56. [IAS 31 para 1].

Forms of joint venture

3 A joint venture is a contractual arrangement whereby two or more parties undertake an economic activity that is subject to joint control. Joint control is the contractually agreed sharing of control over an economic activity and exists only when the strategic financial and operating decisions require the unanimous consent of all the venturers. The standard identifies three broad types of joint ventures:

- Jointly controlled operations.
- Jointly controlled assets.
- Jointly controlled entities.

[IAS 31 paras 3, 7].

Contractual arrangement

4 Activities that have no contractual arrangement to establish joint control are not joint ventures. The contractual arrangement may be evidenced in a number of ways, for example by contract, minutes of discussion, or the articles of the joint venture. [IAS 31 paras 9, 10].

5 The contractual agreement will usually address:

- The activity, duration and reporting obligations of the joint venture.
- The appointment of the board or equivalent governing body and the voting rights of the venturers.
- The capital contributions required from the parties.
- The sharing of the venture's output, income, expenses or results.

[IAS 31 para 10].

6 The contractual agreement may identify one of the parties as the manager of the day-to-day operations. The operator does not control the joint venture, but acts within the financial and operating policies set out in the contractual agreement. [IAS 31 para 12].

7 There may be parties to the contractual agreement who are not part of the exercise of joint control. These parties are investors and account for their interests under the equity method if they are able to exercise significant influence, or as investments in accordance with IAS 39, 'Financial instruments: Recognition and measurement', if they do not.

Jointly controlled operations

8 A jointly controlled operation involves the use of the venturers' assets and other resources rather than setting up a separate corporation, partnership or other entity. [IAS 31 para 13].

9 A venturer recognises in its financial statements:

- The assets that it controls and the liabilities that it incurs.
- The expenses that it incurs and its share of the income that it earns from the sale of goods and services by the joint operation.

[IAS 31 para 15].

Jointly controlled assets

10 Some joint ventures involve the joint control by the venturers of assets contributed to or acquired for the purposes of the joint venture. Similar to jointly controlled operations, these joint ventures do not involve establishing a separate corporation, partnership or other entity. Each venturer has control over its share of future economic benefits through its share in the jointly controlled asset. [IAS 31 paras 18, 19].

11 A venturer recognises in its financial statements in respect of its interests in jointly controlled assets:

- Its share of jointly controlled assets, classified according to the assets' nature.
- Any liabilities that it has incurred.
- Its share of liabilities incurred jointly with other venturers.
- Any income from the sale or use of its share of the output of the joint venture, together with its share of any expenses incurred by the joint venture.
- Any expenses that it has incurred in respect of its interest in the jointly controlled asset.

[IAS 31 para 21].

Jointly controlled entities

Definition

12 A jointly controlled entity is a joint venture that involves establishing a corporation, partnership or other entity in which the venturer has an interest. It operates in the same way as other entities, except that a contractual arrangement between the venturers establishes joint control over the entity's economic activity. [IAS 31 para 24].

Required accounting

13 A venturer's interest in a jointly controlled entity should be recognised using proportionate consolidation or the equity method. [IAS 31 paras 30, 38].

14 The requirement to use the proportionate consolidation or equity methods to account for jointly controlled entities also applies to investors that do not have subsidiaries, but do have investments in jointly controlled entities. The financial statements prepared by these investors are known as 'economic interest', financial statements in which investments in jointly controlled entities are measured at cost or in accordance with IAS 39 (see 'Separate financial statements' below).

Proportionate consolidation

15 When proportionate consolidation is used, the standard requires the use of one of two reporting formats for proportionate consolidation: either the line-by-line basis or separate line items. [IAS 31 paras 30, 34]. The line-by-line basis involves combining the investor's share of each of the assets, liabilities, income and expense of the jointly controlled entity with the similar items, line by line, in the investor's financial statements. The separate basis involves including separate line items for its share of each of the assets, liabilities, income and expense of the jointly controlled entity.

15.1 In May 2011, the IASB issued IFRS 11, 'Joint Arrangements', which becomes effective for annual periods beginning on or after 1 January 2013 (1 January 2014 in the EU). The new guidance provides two categories for joint arrangements – joint operations and joint ventures – with less significance placed on the form of the entity and a greater significance placed on the venturer's rights to assets and obligations for liabilities. In addition, the new guidance no longer permits the use of proportionate consolidation. For more information on IFRS 11, refer to the Joint arrangements summary.

Equity method

16 IAS 31 permits the use of the equity method (refer to IAS 28, 'Investments in associates') as an alternative treatment for accounting for jointly controlled entities.