

## DRAFT SECTIONS OF THE IFRS-BASED CODE ON 'BENEFITS PAYABLE DURING EMPLOYMENT' AND 'TERMINATION BENEFITS'

### 6.3 BENEFITS PAYABLE DURING EMPLOYMENT

#### 6.3.1 Introduction

6.3.1.1 Authorities shall account for benefits payable during employment in accordance with *IAS 19 Employee Benefits*, except where interpretations or adaptations to fit the public sector are detailed in the Code. *IPSAS 25 Employee Benefits* is based on *IAS 19*, and provides additional guidance for public sector bodies.

6.3.1.2 Benefits payable during employment include:

- (a) 'shorter-term employee benefits;' and
- (b) 'other longer-term employee benefits'.

6.3.1.3 Shorter-term employee benefits are those falling due wholly within 12 months after the end of the period in which the employees render the related service. Other longer-term benefits are those not falling wholly within 12 months of the balance sheet date. The approach to accounting for other longer-term benefits payable during employment is fundamentally different from short-term employee benefits. With certain exceptions other longer-term benefits are accounted for in the same way as defined benefit post employment benefits.

#### *Interpretations for the Public Sector Context*

6.3.1.4 The Code includes the following interpretations:

- (a) *IAS 19* permits alternative approaches to the recognition of actuarial gains and losses. The first is that only those actuarial gains and losses falling outside an agreed corridor are recognised in the Income and Expenditure Account; the second is that all actuarial gains and losses are recognised in reserves (ie in the Statement of Total Recognised Gains and Losses (STRGL)). Only the second of these approaches is permitted; that is the use of the corridor approach is not available.
- (b) The discount rate to be used to discount liabilities shall be based on yields on high quality corporate bonds in accordance with *IAS 19*. The adaptation contained in *IPSAS 25* to apply a discount rate that reflects the "time value of money" has not been adopted by the Code.
- (c) *IAS 19* requires long-term disability benefit to be accounted for as an 'other long-term benefit'. An *IPSAS 25* interpretation of *IAS 19* requires that in certain circumstance an authority should consider whether some or all long-term disability payments should be accounted for in the same way as defined benefit post employment

benefits rather than as 'other long-term benefit'. The *IPSAS 25* interpretation has been adopted by the Code

## **6.3.2 Short-term Employee Benefits**

### **Introduction**

6.3.2.1 Short-term employee benefits are employee benefits (other than termination benefits) that are due to be settled within twelve months after the year end of the period in which the employee renders the service. Short-term employee benefits include:

- (a) wages, salaries and social security contributions
- (b) short-term compensated absences
- (c) bonuses and similar payments
- (d) non-monetary benefits.

### **Accounting Requirements**

#### *Wages and salaries and social security contributions*

6.3.2.2 A liability (accrued expense) shall be recognised and an expense (unless the Code requires or permits inclusion in the cost of an asset). If the amount paid in the accounting period exceeds the accrued expense, an asset (prepaid expense) shall be recognised to the extent that the prepayment will lead to a reduction in future payments or a cash refund.

#### *Short-term compensated absences*

6.3.2.3 Compensated absences are periods during which an employee does not provide services to the employer, but benefits continue to be paid. Compensated absences may be 'accumulating' or 'non-accumulating'. The distinction is important as it determines the timing of recognising an expense.

6.3.2.4 Accumulating absences are those that are carried forward and can be used in future periods if the current period entitlement is not used in full. In local authorities annual leave, flexi-time and time in lieu would usually be accumulating. Accumulating absences may be either vesting or non-vesting. Where vesting, employees who leave are entitled to a cash payment in respect of any unused entitlement; where non-vesting, benefits lapse if an employee leaves.

6.3.2.5 Accumulating compensated absences shall be:

- (a) recognised when employees render services that increases their entitlement to future compensated absences
- (b) measured as the additional amount that the authority expects to pay as a result of unused entitlement that has accumulated at the balance sheet date.

The obligation is recognised even if the compensating absences are non-vesting. The possibility that employees may leave before they use an accumulating non-vesting entitlement and their entitlement lost shall be taken into account in measuring the obligation.

- 6.3.2.6 Non accumulating absences are those that cannot be carried forward for use in future periods if the current period entitlement is not used in full. Sick leave, maternity leave, paternity leave and jury service will usually be non-accumulating. Non-accumulating compensated absences shall be recognised when the absence occurs.

*Bonuses and similar payments*

- 6.3.2.7 Additional remuneration – a ‘bonus’ – may be paid where some measure of performance, whether of the individual, work group or organisation, is achieved. In local authorities such arrangements can take a number of forms including arrangements similar to ‘profit sharing’ in the private sector. The expected cost of bonuses shall be recognised, when, and only when:

- (a) the authority has a present legal or constructive obligation to make such payments as a result of past events; and
- (b) a reliable estimate of the obligation can be made.

A ‘present obligation’ exists when, and only when, the entity has no realistic alternative but to make the payments. An entity can make a reliable estimate of its legal or constructive obligation under a bonus plan when, and only when:

- (a) the formal terms of the plan contain a formula for determining the amount of the benefit;
- (b) the entity determines the amounts to be paid before the financial statements are authorised for issue; or
- (c) past practice gives clear evidence of the amount of the entity's constructive obligation.

- 6.3.2.8 Under some arrangements, employees receive their bonus only if they remain employed for a specified period (ie there is a ‘vesting’ period). Such plans create a constructive obligation as employees render service that increases the amount to be paid if they remain in service until the end of the vesting period. The measurement of such constructive obligations shall reflect the possibility that some employees may leave without receiving bonus payments.

*Non-monetary benefits*

- 6.3.2.9 The cost of providing non-monetary benefits (ie ‘benefits in kind’), including housing, cars and free or subsidised goods or services shall be

recognised according to the same principles as benefits payable in cash. The amount recognised as a liability and an expense shall be the cost to the employer of providing the benefit.

### **6.3.3 Other Long-term Employee Benefits**

#### **Introduction**

6.3.3.1. Other long-term employee benefits are employee benefits (other than post employment benefits and termination benefits) that do not fall due wholly within twelve months after the end of the period in which the employees render the related services. They would often not be significant at local authorities either because they rarely occur or the sums involved are insignificant; although long-term disability benefit may be significant at some authorities. Other long-term employee benefits include:

- (a) long-term compensated absences such as long service or sabbatical leave
- (b) jubilee or other long-service benefits
- (c) long-term disability benefits
- (d) bonuses payable twelve months or more after the end of the period in which the employees render the related service
- (e) deferred compensation paid twelve months or more after the period in which it is earned.

#### **Accounting requirements**

6.3.3.2 Other long-term employee benefits are accounted for on similar principles to post retirement benefits but their measurement is not subject to the same degree of uncertainty as the measurement of post-employment benefits and therefore a simplified method of accounting is used. This differs from the accounting required for post-employment benefits since:

- (a) actuarial gains and losses are recognised immediately in the Income and Expenditure Account; and
- (b) all past service cost is recognised immediately in the Income and Expenditure Account.

6.3.3.3 The amount recognised as a liability for other long-term employee benefits shall be the net total of the following amounts:

- (a) the present value of the defined benefit obligation at the balance sheet date;
- (b) minus the fair value at the balance sheet date of plan assets (including any re-imbursment right (if any) out of which the obligations are to be settled directly.

6.3.3.4 The amount recognised as an expense shall be the net total of the following amounts. All of which shall be recognised immediately in the Income and

Expenditure Account (unless the Code requires or permits inclusion in the cost of an asset):

- (a) current service cost
- (b) interest cost
- (c) the expected return on any plan assets and on any reimbursement right recognised as an asset
- (d) actuarial gains and losses;
- (e) past service cost; and
- (f) the effect of any curtailments or settlements.

It is possible that the amount to be recognised will be income rather than an expense, in which case the amount to be recognised is the lower of (a) to (f) above 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.

Long-term disability benefit

- 6.3.3.5 Under the Code long-term disability benefits are usually accounted for as an 'other longer-term benefit' since in accordance with *IAS 19* they are presumed not to be subject to the same degree of uncertainty as the measurement of post employment benefits. However, in accordance with *IPSA 25* this is a 'rebuttable presumption' under the Code; and where this presumption is rebutted an authority shall consider whether some or all long-term disability payments should be accounted for in the same as defined benefit post employment benefits. This interpretation of *IAS 19* was introduced by *IPSAS 25* because disability benefits related to certain areas of service provision, such as the military, may be financially highly significant and related gains and losses highly volatile. This has been adopted by the Code since similar considerations may apply to certain local authority services such as police forces and fire and rescue services, where long-term disability benefit may be both material and volatile.
- 6.3.3.6 If the level of long-term disability benefit depends on the length of service, an obligation arises when the service is rendered. Measurement of that obligation reflects the probability that payment will be required and the length of time for which payment is expected to be made. If the level of benefit is the same for any disabled employee regardless of years of service, the expected cost of those benefits is recognised when an event occurs that causes a long-term disability.

#### **6.3.4 Disclosure**

- 6.3.4.1 There are no specific disclosure requirements but other provisions of the Code, may require disclosures, for example, where the expense resulting from such benefits is material.

#### **Statutory accounting and disclosure requirements**

- 6.3.5.1 There are no statutory accounting requirements or disclosure requirements specifically relating to benefits payable during employment.

#### **Changes since SORP 2009**

- 6.3.6.1 Short-term employee benefits were not covered by the SORP. There is no UK accounting standard that deals with short-term employee benefits. As a result, differing accounting treatments of items such as annual leave may have developed. An approach based on *IAS 19* will necessitate a change in accounting policies for many authorities.
- 6.3.6.2 Long-term employee benefits were not covered by the SORP, except for 'long-term disability benefits' (called 'incapacity benefit' in the SORP). Long-term disability benefits are treated as a type of defined benefit pension benefit in the SORP. In the Code they are not classed as a 'post retirement benefits' but rather as 'other long-term employee benefits'. The difference is that under the Code the net total expense is charged to the Income and Expenditure Account; whereas under the SORP, the difference between the expected cost and amount actually incurred was treated as an actuarial gain or loss and charged to the STRGL. However, the Code has adopted an *IPSAS 25* interpretation that allows long-term disability benefits to be accounted as defined benefit retirement benefits in certain circumstances (see paragraph 6.3.3.5).

## **6.4 TERMINATION BENEFITS**

### **6.4.1 Introduction**

6.4.1.1 Termination benefits are dealt with separately from other employee benefits because the event which gives rise to an obligation is the termination rather than employee service. Termination benefits are payable as a result of either:

- (a) an employer's decision to terminate an employee's employment before the normal retirement date; or
- (b) an employee's decision to accept voluntary redundancy in exchange for those benefits.

Voluntary early retirement under scheme rules is not a termination benefit since such benefit is a right of all scheme members. They are post employment benefits, rather than termination benefits and shall be accounted for as post employment benefits.

6.4.1.2 Termination benefits are often lump-sum payments, but also include:

- (a) enhancement of retirement benefits; and
- (b) salary until the end of a specified notice period if the employee renders no further service that provides economic benefits to the entity.

### **6.4.2 Accounting requirements**

6.4.2.1 Termination benefits shall be recognised as a liability and an expense when, and only when, the entity is demonstrably committed to either:

- (a) terminate the employment of an employee or group of employees before the normal retirement date; or
- (b) provide termination benefits as a result of an offer made in order to encourage voluntary termination of employment.

6.4.2.2 An authority is 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. The detailed plan shall include, as a minimum:

- (a) the location, function, and approximate number of employees whose services are to be terminated;
- (b) the termination benefits for each job classification or function; and

- (c) the time at which the plan will be implemented. Implementation shall begin as soon as possible and the period of time to complete implementation shall be such that material changes to the plan are not likely.

An authority may be committed, by legislation, by contractual or other agreements with employees or their representatives or by a constructive obligation based on business practice, custom or a desire to act equitably, to make payments (or provide other benefits) to employees when it terminates their employment.

- 6.4.2.3 Termination benefits do not provide an authority with future economic benefits and are recognised in the Income and Expenditure Account immediately. Where termination benefits are recognised, the authority may also have to account for a curtailment of retirement benefits or other employee benefits.
- 6.4.2.4 Where termination benefits fall due more than 12 months after the balance sheet date, they shall be discounted using the discount rate determined by reference to market yields at the balance sheet date on high quality corporate bonds.
- 6.4.2.5 In the case of an offer made to encourage voluntary redundancy, the measurement of termination benefits shall be based on the number of employees expected to accept the offer.

#### **6.4.3 Disclosure**

- 6.4.3.1 Where there is uncertainty about the number of employees who will accept an offer of termination benefits, a contingent liability exists. Disclosure of the contingent liability shall be made unless the possibility of an outflow in settlement is remote.
- 6.4.3.2 Termination benefits may need to be disclosed where the nature and amount of an expense is material.

#### **Statutory accounting and disclosure requirements**

- 6.3.5.1 There are no statutory accounting requirements or disclosure requirements relating to termination benefits. However, where termination benefits are in the form of pension enhancements (usually in the form of 'added years') they shall be treated as pension costs for the purposes of the statutory transfer between the Pension Reserve and the General Fund of the amount by which pension costs calculated in accordance with the Code are different from the contributions due under the pension scheme regulations.

#### **Changes since SORP 2009**

- 6.3.6.1 The SORP included termination benefits as one type of past service cost, whereas in accordance with *IAS 19* the Code deals with the matter

separately from past service costs. Under the SORP past service costs were recognised in the Income and Expenditure Account on a straight-line basis over the period in which the increase in benefit vests. Termination benefits would usually vest immediately and so would be charged to Income and Expenditure Account immediately. IAS 19 also requires termination benefits to be charged to the Income and Expenditure Account immediately, so no practical impact arises from the differences between the SORP and the Code.

Subsequently Updated