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International Accounting Standards Board

INFORMATION FOR OBSERVERS

Meeting date:	**26 January 2009, London**
Meeting:	**Employee Benefits Working Group**
Paper:	**Section 27 of the Exposure Draft of a proposed IFRS for SMEs (retitled private entities) (Agenda paper 5, Attachment 2)**

Section 27
Employee Benefits

27.1 **Employee benefits** are all forms of consideration given by an entity in exchange for service rendered by employees, including directors and management. This section applies to four types of employee benefits:

(a) short-term employee benefits, which are employee benefits (other than termination benefits) that are due wholly within twelve months after the end of the period in which the employees render the related service;

(b) **post-employment benefits**, which are employee benefits (other than **termination benefits**) that are payable after the completion of employment;

(c) other long-term employee benefits, which are employee benefits (other than post-employment benefits and termination benefits) that are not due wholly within twelve months after the end of the period in which the employees render the related service; and

(d) termination benefits, which are employee benefits payable as a result of either:

(i) an entity's decision to terminate an employee's employment before the normal retirement date; or

(ii) an employee's decision to accept voluntary redundancy in exchange for those benefits.

27.2 Employee benefits also include **share-based payments** either in the form of equity instruments (such as shares or share options) or cash or other assets of the entity in amounts that are based on the price of the entity's shares or other equity instruments of the entity, provided the specified vesting conditions, if any, are met. An entity shall apply Section 25 *Share-based Payment* in accounting for share-based payments.

General recognition principle for all employee benefits

27.3 An entity shall recognise the cost of all employee benefits to which its employees have become entitled as a result of service rendered to the entity during the period:

(a) as a liability, after deducting amounts that have been paid either directly to the employees or as a contribution to an employee benefit fund. If the contribution paid exceeds the obligation arising from service before the **reporting date**, an entity shall recognise that excess as an asset to the extent that the prepayment will lead to a reduction in future payments or a cash refund.

(b) as an expense, unless the cost:

(i) is included in the cost of producing inventories in accordance with Section 12 *Inventories*; or

(ii) is included in the cost of property, plant and equipment in accordance with Section 16 *Property, Plant and Equipment.*

Short-term employee benefits

Examples

27.4 Short-term employee benefits include items such as:

(a) wages, salaries and social security contributions;

(b) short-term compensated absences (such as paid annual leave and paid sick leave) when the absences are expected to occur within twelve months after the end of the period in which the employees render the related employee service;

(c) profit-sharing and bonuses payable within twelve months after the end of the period in which the employees render the related service; and

(d) non-monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees.

Measurement of short-term benefits generally

27.5 When an employee has rendered service to an entity during the **reporting period**, the entity shall measure the amounts recognised in accordance with paragraph 27.3 at the undiscounted amount of short-term employee benefits expected to be paid in exchange for that service.

Recognition and measurement—short-term compensated absences

27.6 Some short-term compensated absences accumulate. Examples include annual vacation leave and sick leave that can be carried forward and used in future periods if the employee does not use the current period's entitlement in full. An entity shall recognise the expected cost of **accumulating compensated absences** when the employees render service that increases their entitlement to future compensated absences. The entity shall measure the expected cost of accumulating compensated absences at the additional amount that the entity expects to pay as a result of the unused entitlement that has accumulated at the end of the reporting period. The entity shall present the unused accumulating compensated absences that are expected to be used as a **current liability** at the reporting date.

27.7 An entity shall recognise the cost of other (non-accumulating) compensated absences when the absences occur. The entity shall measure the cost of non-accumulating compensated absences at the undiscounted amount of salaries and wages paid or payable for the period of absence.

Recognition—profit-sharing and bonus plans

27.8 An entity shall recognise the expected cost of profit-sharing and bonus payments only when:

(a) the entity has a present legal or **constructive obligation** to make such payments as a result of past events (this means that the entity has no realistic alternative but to make the payments); and

(b) a reliable estimate of the obligation can be made.

Post-employment benefits: distinction between defined contribution plans and defined benefit plans

27.9 Post-employment benefits include, for example:

(a) retirement benefits, such as pensions, and

(b) other post-employment benefits, such as post-employment life insurance and post-employment medical care.

Arrangements whereby an entity provides post-employment benefits are post-employment benefit plans. An entity shall apply this section to all such arrangements whether or not they involve the establishment of a separate entity to receive contributions and to pay benefits. In some cases, these arrangements are imposed by law rather than by action of the entity.

27.10 Post-employment benefit plans are classified as either **defined contribution plans** or **defined benefit plans**, depending on the economic substance of the plan as derived from its principal terms and conditions.

(a) Defined contribution plans are post-employment benefit plans under which an entity pays fixed contributions into a separate entity (a fund) and has no legal or constructive obligation to pay further contributions or to make direct benefit payments to employees if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods. Thus, the amount of the post-employment benefits received by the employee is determined by the amount of contributions paid by an entity (and perhaps also the employee) to a post-employment benefit plan or to an insurer, together with investment returns arising from the contributions.

(b) Defined benefit plans are post-employment benefit plans other than defined contribution plans. Under defined benefit plans, the entity’s obligation is to provide the agreed benefits to current and former employees, and actuarial risk (that benefits will cost more than expected) and investment risk fall, in substance, on the entity. If actuarial or investment experience is worse than expected, the entity’s obligation may be increased.

Multi-employer plans and state plans

27.11 Multi-employer plans and state plans are classified as defined contribution plans or defined benefit plans on the basis of the terms of the plan, including any constructive obligation that goes beyond the formal terms. However, if sufficient information is not available to use defined benefit accounting for a multi-employer plan that is a defined benefit plan, an entity shall:

(a) account for the plan in accordance with paragraph 27.13 as if it were a defined contribution plan; and

(b) disclose the fact that it is a defined benefit plan and the reason why it is being accounted for as a defined contribution plan, along with any available information about the plan’s surplus or deficit and the implications, if any, for the entity.

Insured benefits

27.12 An entity may pay insurance premiums to fund a post-employment benefit plan. The entity shall treat such a plan as a defined contribution plan unless the entity has a legal or constructive obligation either:

(a) to pay the employee benefits directly when they become due, or

(b) to pay further amounts if the insurer does not pay all future employee benefits relating to employee service in the current and prior periods.

A constructive obligation could arise indirectly through the plan, through the mechanism for setting future premiums, or through a **related party** relationship with the insurer. If the entity retains such a legal or constructive obligation, the entity shall treat the plan as a defined benefit plan.

Post-employment benefits: defined contribution plans

Recognition and measurement

27.13 The entity shall recognise the contribution payable for a period:

(a) as a liability, after deducting any amount already paid. If contribution payments exceed the contribution due for service before the reporting date, an entity shall recognise that excess as an asset.

(b) as an expense, unless the cost:

(i) is included in the cost of producing inventories in accordance with Section 12 *Inventories*; or

(ii) is included in the cost of property, plant and equipment in accordance with Section 16 *Property, Plant and Equipment.*

Post-employment benefits: defined benefit plans

Recognition

27.14 In applying the general recognition principle in paragraph 27.3 to defined benefit plans, an entity:

(a) recognises a liability for its obligations under defined benefit plans net of plan assets—its ‘defined benefit liability’ (see paragraphs 27.15–27.20); and

(b) recognises the net change in that liability during the period as the cost of its defined benefit plans during the period (see paragraphs 27.21–27.25).

Measurement of the defined benefit liability

27.15 An entity shall measure a **defined benefit liability** for its obligations under defined benefit plans at the net total of the following amounts:

(a) the **present value** of its obligations under defined benefit plans (its **defined benefit obligation**) at the reporting date (paragraph 27.17 provides guidance on discounting), minus

(b) the fair value at the reporting date of **plan assets** (if any) out of which the obligations are to be settled directly. Paragraphs 11.14–11.17 establish requirements for determining the fair values of those plan assets that are **financial assets**.

27.16 The present value of an entity’s obligations under defined benefit plans at the reporting date shall reflect the estimated amount of benefit that employees have earned in return for their service in the current and prior periods, including benefits that are not yet **vested** (see paragraph 27.23) and including the effects of benefit formulas that give employees greater benefits for later years of service. This requires the entity to determine how much benefit is attributable to the current and prior periods on the basis of the plan’s benefit formula and to make estimates (actuarial assumptions) about demographic variables (such as employee turnover and mortality) and financial variables (such as future increases in salaries and medical costs) that influence the cost of the benefit. The actuarial assumptions shall be unbiased (neither imprudent nor excessively conservative), mutually compatible, and selected to lead to the best estimate of the future cash flows that will arise under the plan.

Discounting

27.17 An entity shall measure its defined benefit obligation on a discounted present value basis. The entity shall determine the rate used to discount the future payments by reference to market yields at the reporting date on high quality corporate bonds. In countries where there is no deep market in such bonds, the entity shall use the market yields (at the reporting date) on government bonds. The currency and term of the corporate bonds or government bonds shall be consistent with the currency and estimated period of the future payments.

Actuarial valuation method

27.18 An entity shall use the **projected unit credit method** to determine its defined benefit obligations and the related current service cost and, when applicable, past service cost.

Plan introductions, changes, curtailments and settlements

27.19 If a defined benefit plan has been introduced or changed in the current period, the entity shall increase or decrease its defined benefit liability to reflect the change, and shall recognise the increase (decrease) as an expense (income) in measuring profit or loss. Conversely, if a plan has been curtailed (ie benefits or group of covered employees are reduced) or settled (the employer's obligation is completely discharged), the defined benefit obligation shall be decreased or eliminated, and the entity shall recognise the resulting gain or loss in profit or loss.

Defined benefit plan asset

27.20 If the defined benefit liability at the reporting date is less than the fair value of plan assets at that date, the plan has a surplus. An entity shall recognise a plan surplus as a defined benefit plan asset only to the extent that it is able to recover the surplus either through reduced contributions in the future or through refunds from the plan.

Cost of a defined benefit plan

27.21 An entity shall recognise the net change in its defined benefit liability during the period, other than a change attributable to benefits paid to employees during the period or due to contributions from the employer, as the cost of its defined benefit plans during the period. That cost is recognised in profit or loss, unless:

(a) it is included in the cost of producing inventories in accordance with Section 12; or

(b) it is included in the cost of property, plant and equipment in accordance with Section 16.

27.22 The net change in the defined benefit liability that is recognised as the cost of a defined benefit plan includes:

(a) the change in the defined benefit liability arising from employee service rendered during the reporting period;

(b) interest on the defined benefit obligation during the reporting period;

(c) the returns on any plan assets and the net change in the fair value of recognised reimbursement rights (see paragraph 27.26) during the reporting period;

(d) actuarial gains and losses arising in the reporting period;

(e) increases or decreases in the defined benefit liability resulting from introducing a new plan or changing an existing plan in the reporting period (see paragraph 27.19); and

(f) decreases in the defined benefit liability resulting from curtailing or settling an existing plan in the reporting period (see paragraph 27.19).

27.23 Employee service gives rise to an obligation under a defined benefit plan even if the benefits are conditional on future employment (in other words, they are not vested). Employee service before the vesting date gives rise to a constructive obligation because, at each successive reporting date, the amount of future service that an employee will have to render before becoming entitled to the benefit is reduced. In measuring its defined benefit obligation, an entity considers the probability that some employees may not satisfy vesting requirements. Similarly, although some post-employment benefits, for example, post-employment medical benefits, become payable only if a specified event occurs when an employee is no longer employed, an obligation is created when the employee renders service that will provide entitlement to the benefit if the specified event occurs. The probability that the specified event will occur affects the measurement of the obligation, but does not determine whether the obligation exists.

27.24 If defined benefits are based on future salaries, an entity shall measure its defined benefit obligations on a basis that reflects estimated future salary increases.

27.25 If defined benefits are reduced for amounts that will be paid to employees under government-sponsored plans, an entity shall measure its defined benefit obligations on a basis that reflects the benefits payable under the government plans but only if:

(a) those plans were enacted before the reporting date; or

(b) past history, or other reliable evidence, indicates that those state benefits will change in some predictable manner, for example, in line with future changes in general price levels or general salary levels.

Reimbursements

27.26 If an entity is virtually certain that another party will reimburse some or all of the expenditure required to settle a defined benefit obligation, the entity shall recognise its right to reimbursement as a separate asset. The entity shall measure the asset at fair value. In the income statement, the expense relating to a defined benefit plan may be presented net of the amount recognised for a reimbursement.

Other long-term employee benefits

27.27 Other long-term employee benefits include, for example:

(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) profit-sharing and bonuses payable twelve months or more after the end of the period in which the employees render the related service; and

(e) deferred compensation paid twelve months or more after the end of the period in which it is earned.

27.28 An entity shall recognise a liability for other long-term employee benefits measured at the net total of the following amounts:

(a) the present value of the benefit obligation at the reporting date, minus

(b) the fair value at the reporting date of plan assets (if any) out of which the obligations are to be settled directly.

An entity shall recognise the change in the liability in accordance with paragraph 27.21.

Termination benefits

27.29 An entity 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. Such payments are termination benefits.

Recognition

27.30 Because termination benefits do not provide an entity with future economic benefits, an entity shall recognise them as an expense in profit or loss immediately.

27.31 When an entity recognises termination benefits, the entity may also have to account for a curtailment of retirement benefits or other employee benefits.

27.32 An entity shall recognise termination benefits as a liability and an expense only when the entity is demonstrably committed either:

(a) to terminate the employment of an employee or group of employees before the normal retirement date; or

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

27.33 An entity is demonstrably committed to a termination only when the entity has a detailed formal plan for the termination and is without realistic possibility of withdrawal from the plan.

Measurement

27.34 An entity shall measure termination benefits at the best estimate of the expenditure that would be required to settle the obligation at the reporting date. 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.

27.35 When termination benefits are due more than twelve months after the end of the reporting period, they shall be measured at their discounted present value.

Disclosure

Disclosures about short-term employee benefits

27.36 This section does not require specific disclosures about short-term employee benefits.

Disclosures about defined contribution plans

27.37 An entity shall disclose the total cost of defined contribution plans for the period and their amounts (a) recognised in profit or loss as an expense and (b) included in the cost of an asset.

Disclosures about defined benefit plans

27.38 An entity shall disclose the following information about defined benefit plans:

(a) a general description of the type of plan, including funding policy;

(b) the entity's accounting policy for recognising actuarial gains and losses and the amount of actuarial gains and losses recognised during the period;

(c) a reconciliation of opening and closing balances of the defined benefit liability showing separately benefits paid and all other changes;

(d) an analysis of the defined benefit liability into amounts arising from plans that are wholly unfunded and amounts arising from plans that are wholly or partly funded;

(e) a reconciliation of the opening and closing balances of the fair value of plan assets and of the opening and closing balances of any reimbursement right recognised as an asset, showing separately, if applicable:

(i) contributions by the employer;

(ii) contributions by plan participants;

(iii) benefits paid; and

(iv) other changes in plan assets.

(f) the total cost relating to defined benefit plans recognised in profit or loss as an expense for the period, and the line item(s) in which they are included;

(g) the total cost relating to defined benefit plans during the period that was:

(i) included in the cost of producing inventories in accordance with Section 12; or

(ii) included in the cost of property, plant and equipment in accordance with Section 16;

(h) for each major category of plan assets, which shall include, but is not limited to, equity instruments, debt instruments, property, and all other assets, the percentage or amount that each major category constitutes of the fair value of the total plan assets;

(i) the amounts included in the fair value of plan assets for:

   (i) each category of the entity's own **financial instruments**; and

   (ii) any property occupied by, or other assets used by, the entity;

(j) the actual return on plan assets; and

(k) the principal actuarial assumptions used, including, when applicable:

   (i) the discount rates;

   (ii) the expected rates of return on any plan assets for the periods presented in the financial statements;

   (iii) the expected rates of salary increases; and

   (iv) medical cost trend rates.

Disclosures about other long-term benefits

27.39 For each category of other long-term benefits that an entity provides to its employees, the entity shall disclose the nature of the benefit, the amount of its obligation and the funding status at the reporting date, and the amount of any actuarial gains and losses arising in the current period and its **accounting policy** for such actuarial gains and losses.

Disclosures about termination benefits

27.40 For each category of termination benefits that an entity provides to its employees, the entity shall disclose the nature of the benefit, its accounting policy, and the amount of its obligation and the funding status at the reporting date.

27.41 When there is uncertainty about the number of employees who will accept an offer of termination benefits, a contingent liability exists. Section 20 *Provisions and Contingencies* requires an entity to disclose information about its contingent liability unless the possibility of an outflow in settlement is remote.