IFRS for SMEs
Section 26 *Share-based Payment*
Section 28 *Employee Benefits*

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Presenter

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Welcome to the Webinar

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Welcome to this webinar dealing with **Section 26 *Share-based Payment*** and **Section 28 *Employee Benefits*** in the **IFRS for SMEs**

AGENDA POINTS TO COVER:

1. S26: Scope and vesting conditions
2. S26: Equity-settled SBP transactions
3. S26: Cash-settled SBP transactions
4. S26: SBP transactions with cash alternatives
5. S26: Disclosures (notes to AFS)
6. S28: Short-term employee benefits
7. S28: Post-employment benefits
8. S28: Other long-term employee benefits
9. S28: Termination benefits

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IFRS for SMEs
Section 26 *Share-based Payment*

Introduction to Section 26

Scope of Section 26

- Governs accounting for all share-based payment transactions, including:
  - **Equity-settled SBP** (entity acquires goods/services as consideration for equity instruments of the entity (including shares, or share options))
  - **Cash-settled SBP** (entity acquires goods/services by incurring liabilities to the supplier of the goods/services, for amounts that are based on the price (value) of the entity's shares, or other equity instruments of the entity)
    - *These include share appreciation rights (SARs)*

  - Transactions in which entity receives/acquires goods or services, and the arrangement provides either the <u>entity or the supplier</u> of those goods or services with a **choice** of whether the entity settles the transaction in cash or by issuing equity instruments

Recognition

- Goods/services received in a SBP transaction are recognised when:
  - The goods are obtained; or
  - The services are received

DEBIT

- The entity shall recognise a corresponding increase in:
  - Equity, if goods/services were received in an *equity-settled* SBP transaction; or
  - Liabilities, if goods/services were received in a *cash-settled* SBP transaction

CREDIT

- When the goods/services received/acquired in a SBP transaction do not qualify for recognition as assets, the entity shall recognise them as expenses
  - E.g. employment benefits (P/L) etc.

ASSET v EXP

Vesting? Immediate vs Conditional

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- Could be relevant to SBP transactions **with employees**…

- If SBP's granted to employees **vest immediately**, the employee is not required to complete a specified period of service before becoming unconditionally entitled to the SBP's
  - The entity shall presume (unless evidence to the contrary exists) that services rendered by the employee as consideration for the SBP's, have been received

- If SBP's granted to employees **do not vest until** the employee completes a specified period of service, the entity shall presume that the services to be rendered by the employee as consideration for those SBP's will be received in future, during the vesting period
  - The entity shall account for those services <u>as they are rendered</u> by the employee during the vesting period, with a corresponding increase in equity or liabilities

- **The question is: when and how is the employee's RIGHT to the shares/cash <u>established?</u>**

Example: immediate vesting
(right established immediately)

- On 31 December 2019, SME ABC (Pty) Ltd grants each of their employees 10 share options in ABC (Pty) Ltd *as a reward for past performance*. There are no vesting conditions and the share options can be exercised at any stage after 31 December 2020.

- The grant date is 31 December 2019. No further conditions exist. Even if employees leave the employ of ABC (Pty) Ltd, they can still exercise their options due to the lack of vesting conditions.

- On the grant date, employees of ABC (Pty) Ltd have an <u>unconditional right</u> to 10 of ABC (Pty) Ltd's share options each.

- <u>Journal entry (31 December 2019) *(grant date)*</u>
  - Dr Employee benefits (P/L) XXX
  - Cr Equity-settled SBP reserve (SoCIE) XXX

Example: conditional vesting
(right established as condition is satisfied)

- The information stays the same as the previous example. In this example, however, exercise of the share options is conditional upon the employee working for the entity throughout 2020. This condition is therefore satisfied as the employee works over the 2020 year.

- The grant date remains 31 December 2019. A vesting condition exists. The vesting condition is a service condition. The services will only be received in 2020 (i.e. vesting period = 2020).

- Journal entry (by 31 December **2020**)
  - Dr Employee benefits (P/L) XXX
  - Equity-settled SBP (SoCIE) XXX

- *Note: If it is also a condition that the employee must still be employed by the entity at the date of exercising the share option, the vesting period still only remains the year to 31 December 2020 (employee will obviously exercise option just before leaving, as long as leaving after 31 December 2020). Forfeiture of right only occurs if leaving before 31 December 2020…*

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IFRS for SMEs
Section 26 *Share-based Payment*

Equity-settled Share-based Payment Transactions

Type 1: Equity-settled SBP's: Measurement

- How do we measure the transaction?
  - The transaction is measured at the **fair value of the goods/services received**
  - If the fair value of the goods/services cannot be reliably measured, the transaction is measured by reference to the **fair value of the equity instruments issued**
  - *I.r.o. SBP transactions involving employees, the fair value of the transaction is determined with reference to the equity instruments issued as the fair value of the services can typically not be determined with reliability…*

- When do we measure the transaction (i.e. when is the above fair value, determined)?
  - For SBP transactions with employees (and similar services), the fair value of the equity instruments is measured at the **grant date**
  - For parties other than employees, the measurement date is the date when the entity **obtains the goods or the counterparty renders the service**
    - Because the fair value of goods/services can be reliably measured…

Measurement decision diagram

Is the equity-settled SBP for employee/similar services?

NO

Can the fair value of the goods or services be reliably estimated?

YES

Measure the SBP at the fair value of the goods/services

NO

YES

Measure the SBP transaction at the fair value of the equity instruments granted

Equity-settled SBP's:
types of vesting conditions

- The grant of the equity instruments may be conditional on employees satisfying specified vesting conditions related to service or performance

Non-vesting conditions

Vesting conditions

Service conditions

Employee remains
in service for specified
period of time
(previous examples)

Performance conditions

Non-market vesting conditions

Entity achieving
specified growth
in profit figure

Market vesting conditions

Specified
increase in
share price

Equity-settled SBP's:
vesting conditions' impact on measurement

- **Service conditions** and **non-market performance conditions**
  - Entity to take ONLY these into account when estimating the **number** of equity instruments expected to vest *(i.e. market and non-vesting conditions are not taken into account)*
  - Such estimates are to be subsequently revised based on new information
  - On vesting date, the estimate shall be "trued-up" to reflect the actual number of equity instruments ultimately vested (estimate to actual)

- **Market performance conditions** and **non-vesting conditions** shall be taken into account when estimating the **fair value** of the shares or share options at the measurement date, with no subsequent adjustment, irrespective of the outcome

Equity-settled SBP's: fair value?
(if fair value of goods/services not used)

- **SHARES:** Three-tier measurement hierarchy to be used:
  - Observable market price for equity instruments granted
  - If not available, obtain entity-specific observable market data (e.g. recent transaction in entity's shares, recent independent fair valuation of the entity or its principal assets)
  - If not available or above is impracticable, indirectly measure fair value of shares (or SARs) using a valuation method that uses market data to the greatest extent practicable to estimate the fair value on the grant date in an arm's length transaction between knowledgeable willing parties

Equity-settled SBP's: fair value?
(if fair value of goods/services is not used)

- **SHARE OPTIONS and SARs:** Three-tier measurement hierarchy to be used:
  - Observable market price for share options/SARs granted
  - If not available, obtain entity-specific observable market data (e.g. recent transaction in entity's share options etc.)
  - If not available or above is impracticable, indirectly measure fair value of shares (or SARs) using an option pricing model (e.g. binomial model, Black Scholes model etc. – use market data to the greatest extent possible for the option pricing model's inputs)

Equity-settled SBP's
Example 1

- SME B (Pty) Ltd grants 100 share options to each of its 500 **employees**. Each grant is **conditional** upon the employee working for the entity over the next 3 years *(the vesting condition is therefore a service condition of three years)*. The entity estimates that, on the grant date, the fair value of each share option is R15. The fair value is measured as though there is no service condition. On the basis of a weighted average probability, the entity estimates that 20% of employees will leave during the 3-year period and therefore forfeit their rights to the share options. Everything works out per plan.

- **Journal entries?** (*500 employees x 100 options x 80% x R15.00 = R600 000 / 3 years = R200 000 p.a.)*
- <u>Year 1</u>
  - Dr Employee benefits (P/L) R200 000
  - Cr Equity-settled SBP reserve (SoCIE) R200 000
- <u>Year 2</u>
  - Dr Employee benefits (P/L) R200 000
  - Cr Equity-settled SBP reserve (SoCIE) R200 000
- <u>Year 3</u>
  - Dr Employee benefits (P/L) R200 000
  - Cr Equity-settled SBP reserve (SoCIE) R200 000
  - Dr Equity-settled SBP reserve (SoCIE) R600 000
  - Cr Share capital R600 000

Equity-settled SBP's
Example 2

- Same information as the previous example. The following differs:
  - During year 1, 20 employees leave.
  - At the end of year 1, the entity revises its estimate of the total employee departure rate over the three-year period, from 20% (100 employees), to 15% (75 employees).
  - During year 2, a further 22 employees leave.
  - At the end of year 2, the entity revises its estimate of the total employee departure rate over the three-year period, from 15%, to 12% (60 employees).
  - During year 3, a further 15 employees leave (i.e. a total of 57 employees forfeit their rights to the share options during the 3-year period). A total of 44 300 share options (i.e. [500 – 57] x 100) vested at the end of year 3.
- **Journal entries?**
- <u>Year 1</u> *(500 employees x 100 options x **85%** x R15.00 = R637 500 / 3 years = R212 500)*
  - Dr Employee benefits (P/L) R212 500
  - Cr Equity-settled SBP reserve (SoCIE) R212 500
- <u>Year 2</u> *(500 employees x 100 options x **88%** x R15.00 = R660 000 x 2/3 years = R440 000 – R212 500)*
  - Dr Employee benefits (P/L) R227 500
  - Cr Equity-settled SBP reserve (SoCIE) R227 500
- <u>Year 3</u> *(**44 300 options (actual)** x R15.00 = R664 500 – R212 500 – R227 500)*
  - Dr Employee benefits (P/L) R224 500
  - Cr Equity-settled SBP reserve (SoCIE) R224 500

Equity-settled SBP's
Example 3

- At the beginning of year 1, SME C (Pty) Ltd grants to a **senior executive** 10 000 share options, **conditional** upon:
  - The executive remaining in the entity's employment until the end of year 3 *(i.e. service condition)* <u>and</u>
  - The share price being R65.00 or more at the end of year 3 *(market performance condition).*
- The fair value of the share options (i.t.o. option pricing model) is R24 per option. This fair value only reflects the market performance condition.
- The entity estimated the service condition to be satisfied at the end of year 3, throughout the service condition.
- Both the service and market condition were satisfied at the end of year 3.
- **Journal entries?**
- <u>Year 1</u> *(10 000 x R24.00 = R240 000 / 3 years = R80 000 p.a.)*
  - Dr Employee benefits (P/L) R80 000
  - Cr Equity-settled SBP reserve (SoCIE) R80 000
- <u>Year 2</u> *(10 000 x R24.00 = R240 000 / 3 years = R80 000 p.a.)*
  - Dr Employee benefits (P/L) R80 000
  - Cr Equity-settled SBP reserve (SoCIE) R80 000
- <u>Year 3</u> *(10 000 x R24.00 = R240 000 / 3 years = R80 000 p.a.)*
  - Dr Employee benefits (P/L) R80 000
  - Cr Equity-settled SBP reserve (SoCIE) R80 000

Equity-settled SBP's

Example 4

- Same information as the previous example. The following differs:
  - Although three years of service are rendered by the executive, the share options do not vest because the market condition is not satisfied (the share price at the end of year 3, is R60.00 per share)
- **Journal entries?**
- Year 1 *(10 000 x R24.00 = R240 000 / 3 years = R80 000 p.a.)*
  - Dr Employee benefits (P/L) R80 000
  - Cr Equity-settled SBP reserve (SoCIE) R80 000
- Year 2 *(10 000 x R24.00 = R240 000 / 3 years = R80 000 p.a.)*
  - Dr Employee benefits (P/L) R80 000
  - Cr Equity-settled SBP reserve (SoCIE) R80 000
- Year 3 *(10 000 x R24.00 = R240 000 / 3 years = R80 000 p.a.)*
  - Dr Employee benefits (P/L) R80 000
  - Cr Equity-settled SBP reserve (SoCIE) R80 000

Market condition not met, but reflected in R24 fair value!

Service condition met as employee works, therefore must be recognised!

Equity-settled SBP's
Example 5

- Same information as example 3. The following differs:
  - The executive resigned during year 2.

Service condition not met, therefore must be reversed!

- **Journal entries?**
- Year 1 *(10 000 x R24.00 = R240 000 / 3 years = R80 000 p.a.)*
  - Dr Employee benefits (P/L) R80 000
  - Cr Equity-settled SBP reserve (SoCIE) R80 000
- Year 2
  - Dr Equity-settled SBP reserve (SoCIE) R80 000
  - Cr Employee benefits (P/L) R80 000
- Year 3
  - *No journal entries to process.*

Equity-settled SBP's:
Modifications

- If the entity modifies the vesting conditions in a manner beneficial to the employee (e.g. reducing exercise price of options, or reducing vesting period, or modifying or eliminating the performance condition), the entity shall take the modified vesting conditions into account in accounting for the SBP transaction, as follows:

  - If the modification increases the fair value of the equity instruments granted (or increases the number of equity instruments granted) measured immediately before and after the modification, the entity shall include the <u>incremental fair value granted</u> in the measurement of the amount recognised for services received as consideration for the equity instruments granted

  - If the modification reduces the total fair value of the SBP transaction, or apparently is not otherwise beneficial to the employee, the entity shall continue to account for the services received for the equity instruments, <u>as if the modification had never occurred</u>

Equity-settled SBP's:
Cancellations

- Cancellations and/or settlements of equity-settled SBP transactions shall be accounted for as **an acceleration of vesting**
  - The amounts that would have been received over the remainder of the vesting period, are recognised immediately

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Cash-settled Share-based Payment Transactions

Cash-settled SBP's

- The entity shall measure the goods or services acquired, and the corresponding liability incurred, **at the fair value of the liability**

- Until the liability is settled, the entity shall re-measure the fair value of the liability at each reporting date and at the date of settlement, with any changes in fair value being **recognised in profit or loss for the period**

Cash-settled SBP's
Example

- SME X (Pty) Ltd grants 100 cash SARs to each of its 500 employees, on the condition that the employees remain in its employment for the next 3 years *(service condition)*. The SARs are exercisable until the end of Year 5. During year 1, 35 employees leave. The entity estimates that a further 60 employees will leave during years 2 and 3.
- During year 2, 40 employees leave and the entity estimates that a further 25 will leave during year 3.
- During year 3, 22 employees leave.
- At the end of year 3, all SARs held by the remaining employees vest, and 150 employees exercise their SARs.
- Another 140 employees exercise their SARs at the end of year 4 and the remaining 113 at the end of year 5.
- The entity estimates the fair value of the SARs at the end of each year in which a liability is shown, as below. *The intrinsic values of the SARs at the date of exercise (which equal the cash paid out) at the end of years 3 to 5 are also indicated.*
- Year 1: Fair value: R14.40 Intrinsic value: N/A
- Year 2: Fair value: R15.50 Intrinsic value: N/A
- Year 3: Fair value: R18.20 Intrinsic value: R15.00
- Year 4: Fair value: R21.40 Intrinsic value: R20.00
- Year 5: Fair value: N/A Intrinsic value: R25.00

Fair value =
intrinsic value *plus* time value

Example (cont.)

- <u>Year 1</u>
  - (500 employees – 35 (left) – 60 (expected to leave)) x 100 SARs each x R14.40 = R583 200 x 1/3 = R194 400
  - Dr Employee benefits (P/L) R194 400
  - Cr Cash-settled SBP liability (F/P) R194 400
- <u>Year 2</u>
  - (500 employees – 75 (left) – 25 (expected to leave) x 100 SARs each x R15.50 = R620 000 x 2/3 = R413 333 – R194 400 (Yr 1) = R218 933
  - Dr Employee benefits (P/L) R218 933
  - Cr Cash-settled SBP liability (F/P) R218 933
- <u>Year 3</u>
  - (500 employees – 97 (left) – 150 (exercised) x 100 SARs each x R18.20 = R460 460 x 3/3 – R413 333 (Yr 2) = R47 127
  - Dr Employee benefits (P/L) R47 127
  - Cr Cash-settled SBP liability (F/P) R47 127
  - Dr Employee benefits (F/P) (150 x 100 SARs x R15 (intrins. val) R225 000
  - Cr Bank R225 000

Example (cont.)

- Year 4
  - (500 employees – 97 (left) – 290 (exercised)) x 100 SARs each x R21.40
    = R241 820 – R460 460 = (R218 640)
  - Dr Cash-settled SBP liability (F/P) R218 640
  - Cr Employee benefits (P/L) R218 640
  - Dr Employee benefits (P/L) (140 x 100 x R20) R280 000 (@ intrinsic value)
  - Cr Bank R280 000
- Year 5
  - SARs lapse: thus R zero – R241 820 = (R241 820)
  - Dr Cash-settled SBP liability (F/P) R241 820
  - Cr Employee benefits (P/L) R241 820
  - Dr Employee benefits (P/L) (113 x 100 x R25) R282 500 (@ intrinsic value)
  - Cr Bank R282 500

SBP's with cash alternatives

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- Some SBP transactions give either the entity or the counterparty a choice of settling the transaction in cash (or other assets) OR by a transfer of equity instruments
- The entity shall account for such transaction as a **cash-settled share-based payment transaction,** unless:
  - The entity has a past practice of settling by issuing equity instruments; OR
  - The option has no commercial substance (i.e. cash amount is likely to be lower than the fair value of the equity instrument issued)

  - These will therefore be equity-settled SBP transactions…

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Disclosures

Disclosures

- A **description** of each type of SBP arrangement that existed at any time during the period (including general terms and conditions of each arrangement, such as vesting requirements, maximum term of options granted, method of settlement (cash or equity instruments) etc.)

- Number and weighted average exercise prices of share options for each of the following groups of options:
  - Outstanding at the beginning of the period
  - Granted during the period
  - Forfeited during the period
  - Exercised during the period
  - Expired during the period
  - Outstanding at the end of the period
  - Exercisable at the end of the period

Disclosures (2)

- For equity-settled SBP transactions: information about how the entity measured the fair value of goods or services received or the fair value of the equity instruments granted
  - *If valuation method was used: the method and reason for choosing it*
- For cash-settled SBP transactions: information about how the liability was measured
- Explanations of any modifications during the period
- The total expense recognised in profit or loss for the period relating to SBP transactions
- The total CA at the end of the period for liabilities arising from SBP transactions

IFRS for SMEs
Section 28 *Employee Benefits*

Introduction to Section 28

Section 28 (similar to IAS 19)

- Deals with **employee benefits**
- *Scope exclusion = share based payment (section 26 of the IFRS for SMEs)*
- **Short-term employee benefits**
- **Post-employment benefits**
- **Other long-term employee benefits**
- **Termination benefits**
- Disclosure

<u>In this webinar:</u>
references to "IAS 19" include section 28 in the IFRS for SMEs!!

What does IAS 19 / s28 require?

- The <u>**employer**</u> must recognise:
  - A **liability** when employees have rendered services in exchange for employee benefits to be paid in the future; and
  - An **expense** when the entity consumes the economic benefit arising from services provided by an employee in exchange for employee benefits

4 categories of employee benefits

- **1. Short-term EB's**
  - Wages, salaries, social security contributions
  - Paid annual leave and paid sick leave
  - Profit-sharing and bonuses
  - Non-monetary benefits (e.g. medical care, housing, cars, and free or subsidised goods or services for current employees)

- **2. Post-employment benefits**
  - Retirement benefits (pension and lump sum payments on retirement)
  - Other post-employment benefits (e.g. post-employment life insurance, post-employment medical care)

4 categories of employee benefits

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- **3. Other long-term employee benefits**
  - Long-term paid absences, such as long-service leave or sabbatical leave
  - Jubilee or other long-service benefits
  - Long-term disability benefits
- **4. Termination benefits**
  - Voluntary
  - Involuntary

Who can EB's be paid to?

- Employees:
  - Their dependants; or
  - Their beneficiaries

- May be settled by payments made directly to:
  - Employees:
    - their spouses;
    - their children; or
    - other dependants
  - Others, such as insurance companies

*"**Employees**" may provide services to an entity on a:*

- *Full-time basis;*
- *Part-time basis;*
- *Permanent basis;*
- *Temporary basis; or*
- *Casual basis*

The term includes directors and other management personnel…

Definitions in IAS 19 / s28

- Very important definitions, as some definitions even include formulae and calculations…
  - 5 definitions of employee benefits
  - 4 definitions relating to classification of plans
  - 8 definitions relating to the net defined benefit liability (asset) ➡ SOFP
  - 6 definitions relating to defined benefit cost ➡ SOCI and OCI

IFRS for SMEs
Section 28 *Employee Benefits*
Short-term Employee Benefits

Short-term employee benefits (STEB's)

- STEB's are employee benefits (other than termination benefits) that are expected to be settled wholly before twelve months after the end of the annual reporting period in which the employee renders the related service
  - *i.e. will NOT be outstanding at the next annual reporting period*

- Recognition of all STEB's
  - When the employee has rendered service to an entity during an accounting period, the entity shall recognise the **undiscounted** amount of STEB's expected to be paid in exchange for that service:
    - As a liability (accrual), after deducting any amount already paid (overpayments to be recognised as prepaid expenses)
    - As an expense, unless another IFRS requires or permits the inclusion of the benefits in the cost of an asset (e.g. IAS 2 / s13 *Inventories*)

STEB's: Short-term paid absences

- Holidays, sickness, short-term disability, maternity, paternity, military service etc.

Vesting: entitled to cash payment when leaving
Non-vesting: no entitlement to cash payment when leaving

- Accumulating paid absences (APA's) (e.g. annual leave)
  - When employees render service that increases their entitlement to future paid absences, an obligation is recognised for vesting <u>and</u> non-vesting APA's
  - Measured @ additional cost expected to be paid due to <u>unused</u> entitlement that has accrued at end of reporting period

- Non-accumulating paid absences (NAPA's) (e.g. sick leave)
  - When the absences occur

Example: Accumulating Paid Absences (APA's)

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- An entity has 100 employees entitled to 5 working days of paid sick leave for each year. **Unused sick leave may be carried forward for one calendar year (i.e. accumulating).** Sick leave is taken first out of the current year's entitlement and then out of any balance brought forward from the previous year (FIFO basis). At 31 December 2019, the average unused entitlement is 2 days per employee. The entity reliably expects that 92 employees will take no more than 5 days of sick leave in 2020 and that the remaining 8 employees will take an average of 6½ days each. Employees do not get paid for unused sick leave when they leave the entity's employ (i.e. non-vesting).

- How much does the entity expect to pay (calculated at 31/12/2019)?
  - 8 employees x 1 ½ days per employee = 12 days of sick leave pay
  - The entity recognises a liability at 12 days of sick leave pay

Non-accumulating Paid Absences (NAPA's)

- These EB's do not carry forward, but lapse if the current year's entitlement is not utilised in full
- They also don't entitle the employee to a cash payment for unused entitlement when leaving (i.e. they are all non-vesting)
- Examples (usually, although each company can have different policy (refer previous example))
  - Sick pay
  - Maternity leave
  - Paternity leave
  - Leave pay for military service
- No expense or obligation is recognised <u>until the absence occurs</u>

Example: NAPA's

- Mr. X earns R1 000 per work day as employee benefit. This is based on a 20 work day month (on average). Mr. X is entitled to 'paid sick leave' of 5 work days per annum. If not taken, **the sick leave expires (i.e. non-accumulating)**. During the year ended 31 December 2019, Mr. X was sick for only <u>3</u> work days. The year had a total of 260 work days. Ignore tax.

- Journal entry processed by employer i.r.o. Mr. X:
  - Dr Salary (P/L) (STEB's) (257 x R1 000) R257 000
  - Dr Sick leave (P/L) (STEB's) (3 x R1 000) R3 000
  - Cr Bank R260 000

STEB's: Profit-sharing and bonus plans

- Recognised when (and only when):
  - The entity has a present legal or constructive obligation to make such payments as a result of past (obligating) events; and
  - A reliable estimate of the obligation can be made

- Some entities have no legal obligation to pay bonuses, but have a practice of paying bonuses = constructive obligation
  - Present obligation: no realistic alternative but to settle the obligation

Example: Profit-sharing plans

- A profit-sharing plan requires an entity to pay a specified proportion of its profit for the year to employees who serve throughout the year. If no employees leave during the year, the total profit-sharing payments for the year will be 3% of profit. The entity estimates that staff turnover will reduce the payment to 2.5% of profit.

- The entity therefore recognises a liability and an expense of 2.5% of profit for the year

Reliable estimate of legal/constructive obligation?

- Can be made when:
  - The formal terms of the plan contain a formula for determining the amount of the benefit; or
  - The entity determines the amounts to be paid before the AFS are authorised for issue; or
  - Past practice gives clear evidence of the amount of the entity's constructive obligation

Profit-sharing/bonuses: classification

- The obligation arises from employee service, and not from transaction with owners
  - Therefore recognised as an expense (P/L)

- If profit-share or bonus payments are not expected to be made wholly within 12 months after the end of the reporting period, they are classified as other long-term benefits

STEB's: Disclosure requirements

- No specific disclosure requirements in section 28/IAS 19
- Other standards/sections may have disclosure requirements:
  - IAS 24 / s33 *Related Parties*: disclose employee benefits for key management personnel
  - IAS 1 / s1 *Presentation of Financial Statements*: disclose the employee benefit expense

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Section 28 *Employee Benefits*

Post-employment Benefits

PEB's: Defined contribution plan

- Easy to account for; most often encountered
  - No actuarial assumptions; no actuarial gains/losses
  - Undiscounted, unless contributions settled > 12 months after reporting date

- When the employee has **rendered service** to an entity during a period, the contribution payable to the fund is recognised:
  - As a liability, reduced by the contribution already paid (overpayment = prepaid expense)
  - As an expense, unless required/permitted by another IFRS/section to capitalise to cost of an asset (e.g. IAS 2 / s13 *Inventories* and IAS 16 / s17 *Property, Plant and Equipment* etc.)

PEB's: Defined contribution plan

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- Disclosure (notes):
  - The amount recognised as an expense for defined contribution plans
  - Where required by IAS 24 / s33, disclose the contributions made to defined contribution plans in respect of key management personnel

PEB's: Defined benefit plan

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- Accounting is complex ☹
  - Actuarial assumptions affect/determine the PV of the plan obligation and the fair value of the plan assets
  - Possibility of actuarial gains/losses (i.e. due to changes in assumptions by actuaries from one period to the next)
  - Measured on a discounted basis, as employee benefits are paid years after the end of the period in which the employee rendered the service

Steps:
How to account for defined benefit plan

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- Step 1: Determine the deficit or surplus in the fund at reporting date
  - PV of defined benefit plan obligation
  - Less: Fair value of (any) plan assets
- Step 2: Determine net defined benefit liability (asset)
  - Deficit or surplus (step 1), adjusted for any effect of limiting a net defined benefit asset to the asset ceiling
- Step 3: Determine the amounts to recognise in profit or loss
  - Current service cost
  - Any past service cost <u>and</u> gains or losses on settlement
  - Net interest on the net defined benefit liability (asset)
- Step 4: Determine an accounting policy for actuarial gains/losses' treatment
  - Recognise ALL actuarial gains or losses in P/L, <u>or</u> in OCI

PEB’s: Defined benefit plan
– asset ceiling

- If there is a surplus in the defined benefit plan (PA > PO), the net defined benefit asset shall be measured at the lower of:
  - The surplus in the defined benefit plan (PA – PO); and
  - The asset ceiling
    - = PV of available FEB’s (available FEB’s = (i) reduction in future contributions or (ii) cash refunds directly to entity or into another plan with a deficit)

PEB's: Defined benefit plan
– past service cost (PSC)

- PSC = change in the PV of the defined benefit obligation resulting from a plan **amendment**, or **curtailment** (reduction)
- PSC shall be recognised as an expense, the earlier of:
  - When the plan amendment or curtailment occurs; and
  - When the entity recognises related restructuring costs, or termination benefits
- "Plan amendment" = when entity introduces/withdraws a defined benefit plan or changes the benefits payable under an existing defined benefit plan
- "Curtailment" = when entity significantly reduces the number of employees covered by a plan (e.g. closing of plant, discontinuance of operation or termination or suspension of a plan)
- PSC can be positive (benefits introduced or changed so that PV of DBO increases) or negative (benefits withdrawn or changed so that PV of DBO decreases)

PEB's: Defined benefit plan
– gains or losses on settlement

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- Gain or loss on settlement =
  - PV of defined benefit obligation being settled (as at date of settlement)
  - <u>Less</u>: the settlement price (including plan assets transferred, and other payments made directly by the entity)
- Recognised when the **settlement** occurs
- "Settlement" = entity enters into transaction that eliminates all further legal or constructive obligation for part/all of the benefits provided under a defined benefit plan
  - E.g. transfer of the employer obligations to an insurance company through the purchase of an insurance policy = settlement
  - E.g. a lump-sum cash payment to employees (under the terms of the plan) in exchange for their rights to receive specified PEB's = not a settlement

PEB's: Defined benefit plan
– what is included in plan assets?

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- Plan assets exclude the following:
  - Contributions still due by the employer to the fund
  - Non-transferable financial instruments issued by the employer and held by the fund
- Plan assets are reduced by any liabilities of the fund not relating to employee benefits (e.g. trade and other payables)
- Qualifying insurance policies are plan assets

PEB's: Defined benefit plan – what are the cost components?

- **Service cost** (current & past) = *in profit or loss*
- **Net interest** on the net defined benefit liability (asset) = *in profit or loss*
- **Remeasurements** of the net defined benefit liability (asset) = *in other comprehensive income (OCI)*
  - If accounting policy determines that actuarial gains/losses are recognised in P/L, then recognised in P/L, but other remeasurements recognised in OCI
  - Remeasurements deferred in OCI may not be reclassified to P/L subsequently, but may be moved around within equity by means of direct reserve accounting in the SOCIE (e.g. released to retained earnings from OCI etc.)
- **Actuarial gains or losses** = recognised in **P/L** or in **OCI** per accounting policy of the SME (unique to the SME)

PEB's: Defined benefit plan – remeasurements

(OCI)

- Remeasurements comprise:
  1. Actuarial gains/losses *(IF accounting policy so elects, otherwise P/L!!!!)*
  2. The return on plan assets (*)
  3. Any change in the effect of the asset ceiling (*)

(*) Excluding amounts included in net interest on net defined benefit liability (asset)

- When determining return on plan assets, an entity deducts the costs of managing the plan assets (not other admin costs)

PEB's: Defined benefit plan – net interest

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- Calculated as follows:
  - Net defined benefit obligation (or asset) x I% on 'high quality corporate bonds'
  - Both to be determined as at the start of the reporting period
  - Take account of changes in the net defined benefit liability (asset) due to contributions and benefit payments
- Net interest consists of:
  - Interest **income** on plan assets
  - Interest **cost** on the defined benefit obligation (DBO)
  - Interest on the effect of the **asset ceiling**
- Interest income on plan assets:
  - Fair value of plan assets (beginning of period) x I% on high quality corporate bonds
  - Take account of changes in plan assets due to contributions and benefit payments
  - Difference between interest income on plan assets and return on plan assets = re-measurement of the net defined benefit liability (asset) = OCI
- Interest on the effect of the asset ceiling
  - Change in effect of asset ceiling (beginning of period) x I% on high quality corporate bonds
  - Difference between that amount and the total effect of the asset ceiling = re-measurement of the net defined benefit liability (asset) = OCI

PEB's: Presentation (face of AFS)

- Offsetting of an asset on one plan against liability on another plan
  - Normal offsetting rules (for SOFP) will apply
    - Legally enforceable right to use surplus in one plan to settle obligations in another
    - Intends to net settle or realise surplus in one plan and settle obligation in another simultaneously

- IAS 19 / s28 does not specify whether an entity should distinguish current portions of assets and liabilities from non-current portions of assets and liabilities relating to PEB's

- IAS 19 / s28 does not specify how an entity should present service cost and net interest on the net defined benefit liability (asset) – use IAS 1 / s3 instead

PEB's: Disclosure (notes to AFS)

- Basically 3 main classes (summarised):
  1. Characteristics of defined benefit plans and risks associated with them
  2. Explanation of amounts in the financial statements
  3. Amount, timing and uncertainty of future cash flows

IFRS for SMEs
Section 28 *Employee Benefits*

Other Long-term Employee Benefits

Other long-term employee benefits (OLTEB's)

- Not expected to be settled wholly before 12 months after the end of the reporting period in which the employees render the related service

- Examples:
  - Long-term paid absences (long-service, sabbatical leave)
  - Jubilee or other long-service benefits
  - Long-term disability benefits
  - Profit-sharing and bonuses (not settled wholly before 12 months after the end of the reporting period…)
  - Any deferred remuneration

OLTEB's: recognition and measurement

- Simplified version of PEB's, hence no recognition in OCI of re-measurements
- All components recognised in profit or loss:
  - Service cost (past and current)
  - Net interest on the net defined benefit liability (asset)
  - Re-measurements of the net-defined benefit liability (assets)

- There are no specific disclosure requirements in IAS 19 in respect of OLTEB's (consider other standards, e.g. IAS 24/s33 *Related Parties* on key management personnel etc.)
  - **S28 (IFRS for SMEs): disclose nature of benefit, amount of obligation, extent of funding**

IFRS for SMEs
Section 28 *Employee Benefits*

Termination Benefits

Termination benefits (TB's)

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- Past obligating event is the termination of the services of the employee, rather than the rendering of services by the employee (NB)
- Two past events to look out for:
  - Entity's decision to terminate the employee's services (involuntary) , or
  - Employee's decision to accept entity's offer of TB's in exchange for terminating the services of the employee (voluntary)
- TB's exclude benefits paid at the request of an employee where no TB's were offered in the first place, and benefits paid for mandatory retirement (these are PEB's)
- Typically lump-sum payments, but could also include enhancements of PEB's or continued payment of salary for agreed period of time
- Always make sure that the employee benefit is not provided in exchange for services rendered, but rather for termination of benefits

TB's: Recognition

- An entity shall recognise a liability and corresponding expense for TB's at the earlier of the following:
  - When the entity can no longer withdraw the offer of the TB's; and
  - When the entity recognises costs for a restructuring within the scope of IAS 37/s21 and invoices the payment of the TB's
- *When can entity no longer withdraw the offer of TB's?*
  - Voluntary TB's: The earlier of:
    - The employee accepts the offer of TB's; and
    - When a restriction on the entity's ability (e.g. law) to withdraw the offer, takes effect
  - Involuntary TB's: when meeting ALL of the following criteria:
    - Actions to complete the plan indicate no significant changes will be made to plan; and
    - Plan identifies the # of employees, job classifications and locations and expected completion date of plan
    - Plan establishes the TB's that employees will receive in sufficient detail that employees can determine their TB's that they will receive

TB's: Measurement

- If expected to be settled wholly before 12 months after the end of the period in which the TB's are recognised = same as STEB's
- If not expected to be settled wholly before 12 months after the end of the period in which the TB's are recognised = same as OLTEB's
- If TB's represent enhancement of PEB's = same as PEB's
- *TB's are not provided in exchange for services rendered = TB's are not allocated to periods of service as with employee benefits*

- There are no specific disclosure requirements in IAS 19 in respect of TB's (consider other standards, e.g. IAS 24 / s33 *Related Parties* on key management personnel etc.)
  - **S28 IFRS for SMEs: disclose nature of benefit, amount of benefit, extent of funding**

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Thank you for your participation

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