

FRS 102 – Employee benefits

Robert Kirk highlights the treatment of Employee Benefits under the new accounting standard FRS 102.

Up until now the preparation of financial reports under local SSAPs and FRSs only covered the accounting treatment of retirement benefits. Under the new FRS 102 the topic has been considerably expanded to include employee benefits earned and received whilst working as well as those that will be received during an employee's retirement years.

Section 28 of FRS 102 covers all forms of consideration given by an entity to its employees and directors in exchange for services rendered. One exception is, however, the accounting treatment of share-based payment transactions as these are covered separately by Section 26 of the standard.

FRS 102 covers the following types of employee benefits:

- Short-term employee benefits that are expected to be settled before 12 months after the end of the reporting period in which the employee renders the service.
- Post-employment benefits payable to employees after completion of employment i.e. pensions and possibly medical care.
- Other long-term employee benefits other than short-term employee benefits; and
- Termination benefits as a result of an entity's decision to terminate an employee's employment before the normal retirement date or an employee's decision to accept voluntary redundancy in exchange for those benefits.

Short-term benefits

This includes those benefits which the entity expects to settle within 12 months after the year-/period-end. Examples of these would include:

- Wages, salaries and social security contributions
- Paid annual leave and paid sick leave
- Profit-sharing and bonuses; and
- Non-monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees.

From a practical view it is probably the compulsory recognition of holiday pay that may cause problems for those companies who are currently not accruing for that expenditure at their period end. It is particularly important for those reporting entities that have a holiday year end which differs from their accounting year end and for those companies which permit employees to carry forward holidays into the following year

Example - holiday pay

A company has a year-end of 31 March 2016 and is mandated to report under FRS 102 for its accounting year commencing on 1 April 2015. The holiday year runs from 1 January to 31 December each year and as at 31 March 2016 its employees have accrued holiday entitlement which will either be paid to them or taken as unused leave in the following financial year.

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Assume there is only one employee in the company that is entitled to 28 days leave in the year but has not carried forward any days from the previous year and has also not been on holiday in the January to March quarter. That individual has earned one quarter of their holiday rights to 31st March 2016 and is therefore entitled to 25% x 28 days leave = 7 days multiplied by their daily wage rate, say €400 thus creating an expense and accrual of €2,800 for that year.

Holiday pay may prove to be tricky particularly for companies who do not keep accurate records of annual leave. In my own college it is particularly a problem in accruing for academic staff holiday pay as academic contracts have no specific holiday leave – the employee works for the number of hours required to do the job!!

Profit-sharing and bonus plans

Some companies operate profit-sharing and bonus arrangements for their employees. When such arrangements are in place the entity must make provision for such amounts, but only when:

- There is 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.

These two above may seem familiar to many as they relate to the provisions and contingencies section. Essentially, such amounts should only be provided if the entity has an obligation at the balance sheet date to make such payments and these payments are made in the subsequent accounting period. One would expect that these accruals have been included already in reporting entities balance sheets.

Retirement benefits (Pensions and medical care)

FRS 102 provides guidance relating to both defined contribution and defined benefit pension plans. The accounting treatment already adopted in FRS 17 'Retirement Benefits' is largely retained, particularly the need to write-off deficits and surpluses on defined benefit schemes immediately to reserves and through other comprehensive income but there are some subtle changes to Section 28 as a result of the changes

to the international equivalent, IAS 19 'Employee Benefits'.

There are no changes to the way in which a defined contribution pension plan will be accounted for as the actuarial and investment risks do not fall on the part of the reporting entity. Companies will, therefore, continue to simply charge the contributions payable to profit and loss as they arise.

Defined benefit plans are inherently more complex to account for. As investment risk and actuarial risk do, in substance, fall on the part of the reporting entity then the company must account for the defined benefit plan in its financial statements. There are exceptions, however, when a defined benefit plan is accounted for as a defined contribution plan. That occurs in a multi-employer scheme where none of the employers are able to identify their share of any actuarial deficit or surplus so they are permitted to charge instead the contributions payable but they must state in their disclosures the overall deficit of the scheme and also include a description of the extent to which the entity can be liable to the plan for other entities obligations under the terms and conditions of the multi-employer scheme.

Actuaries

Unlike FRS 17 there is no requirement to engage an independent actuary to perform the actuarial valuation needed to calculate the defined benefit obligation nor does FRS 102 require a comprehensive valuation to be done annually provided the actuarial assumptions have not changed significantly. This paragraph recognises that where no significant changes have occurred, the defined benefit obligation can be measured by adjusting the prior period measurement for changes in employee demographics (for example employee numbers and salary levels).

However, as the assumptions and calculations can be quite complex it would be doubtful if reporting entities could avail of this simplification and also if they are under the audit threshold would an independent auditor be happy with the directors or their staff undertaking this exercise?

Annual expense for defined benefit plans

The requirements in FRS 102 relating to the annual expense are based on the revisions to IAS 19 'Employee Benefits' which occurred in 2011 and was implemented in 2013. The cost that should be included in profit or loss will be made up of:

- The change in the net defined benefit liability arising from employee service rendered during the reporting period in profit or loss (i.e. current service cost);
- Net interest expense/income on the net defined benefit liability/asset during the reporting period; and
- The cost of any plan introductions, benefit changes, curtailments and settlements

However, remeasurements (actuarial gains and losses) on the net defined benefit liability/asset must be reported in other comprehensive income via reserves.

The net interest expense/income on the net defined benefit liability/asset is calculated by multiplying the net defined benefit liability/asset by the discount rate as determined at the start of the accounting period. In doing this calculation, the entity must consider any changes in the net defined benefit liability during the period as a result of contribution and benefit payments. This revised treatment, which replaces the finance charge and expected return on plan assets, where income is credited with the expected long-term yield on the assets in the fund, may increase the annual benefit expense and have a potential impact on earnings as most companies are currently in deficit on their pension schemes and the interest income on assets will probably be less than the previous expected return on assets.

Presentational differences

Section 28 does not include the same requirement to present the surplus or deficit in a defined benefit pension plan on the face of the balance sheet after 'other net assets' as FRS 17 currently does. As a consequence, a deficit in a defined benefit pension plan could be included within 'provisions' and surpluses could go within 'other assets' i.e. treated as normal liabilities or assets.

In addition, FRS 17 currently requires a reporting entity to show the defined benefit pension plan net of any related deferred tax considerations. FRS 102 makes no explicit requirement for this to be done and as such a company could include deferred tax in relation to a defined benefit pension plan within other deferred tax.

Example – defined benefit scheme

The following information relates to the defined benefit pension scheme of Peabody Ltd:

The present value of the scheme obligations at 1st March 2015 was €54m while the fair value of the scheme assets at that date was €52m. During the financial year ended 28th February 2016 a total of €3m was paid into the scheme in contributions. Current service cost for the year was calculated at €5m and the actual benefits paid were €6m. The applicable interest cost for the year was 7% and the expected return on assets was 10%.

The present value of the scheme obligations at 28th February 2016 was calculated at €56m and the fair value of the scheme assets at that date was €55m.

Statement of Financial Position (Extract)

Pension liability	56m – 55m	€1m
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Statement of Comprehensive Income (Extract)

Current service cost	€5m	(P&L)
Net interest expense	€0.14m	(P&L)
	(3.78 – 3.64)	
Remeasurements	€3.14m gain	(OCI)

Present value of obligation as at 1st March 2014	54.00
Interest cost (€54m x 7%)	3.78
Current service cost	5.00
Benefits paid	(6.00)
Remeasurement (Actuarial gain)/loss	(0.78)
Present value of obligation as at 28th February 2015	<u>56.00</u>

Fair value of assets as at 1st March 2014	52.00
Interest income on plan assets (€52m x 7%)	3.64
Contributions to the scheme	3.00
Benefits paid	(6.00)
Remeasurement (Actuarial gain)/(loss)	<u>2.36</u>
Fair value of plan assets as at 28 th February 2015	<u>55.00</u>

Overall actuarial gain/loss for the year
(2.36 gain + 0.78) = 3.14 gain



Other long term benefits

In Ireland there are likely to be relatively few long term benefits earned by employees apart from pensions. They could be due sabbatical leave, long term profit bonus schemes or long term disability benefits.

These should only be provided for if the reporting entity has a probable legal or constructive obligation and that it can be reliably measured. In addition care needs to be made in measuring the liability as the time value of money may become material and the liability would then need to be discounted.

Termination benefits

Compulsory redundancy packages are already covered in Section 21 *Provisions and contingencies* but this section covers early retirement and voluntary redundancy schemes. The recognition criteria are the same i.e. there must be a legal or constructive obligation as evidenced by the entity being demonstrably committed to the expenditure by informing the employees of the schemes and also providing them with details of the formal plan.

However, in addition the company must make its best estimate of the number of staff who are likely to accept either of these schemes and because they are often kept open for more than one year there could also be a case for discounting the amount payable to present value.

Conclusion

Employee benefits will therefore largely continue to be accounted for in much the same way under FRS 102. However, if entities are not currently providing for unpaid holiday leave this will have to be adjusted on the date of transition which means for December year ends going back to the 1st January 2014 and creating a liability at that time. In addition, the changes to the way in which defined benefit pension plans are calculated may also have some minor impact on entities' financial statements. The long term benefits and termination benefit sections are unlikely to cause many problems as very few non listed companies have such schemes.