

Understanding the measurement of liabilities in accordance with IAS 19 *Employee Benefits*

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Aim

- » The aim of this session is to enhance knowledge and understanding, in the Ethiopian accountancy market, of the best liabilities measured in accordance with IAS 10 *Employee Benefits*.
- » *[Note: the valuation session that follows after the coffee break is dedicated to enhancing skills in the Ethiopian accountancy market in the practical application of measuring liabilities using the projected unit credit method in accordance with IAS 19 Employee Benefits in the Ethiopian context.]*

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Ethiopian context

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Ethiopian context:
Which employee-benefit liabilities do Ethiopian companies have?
Summary of class discussion

1. Short-term employee benefits: wages salaries, bonus, leave benefits, etc.
2. Long service awards
3. Defined-contribution pension schemes
4. Defined-benefit pension schemes
5. Legal obligation per proclamation no 377/2003 Article number 39 and 40, further amended by proclamation no 494/2006 article number 2.

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Ethiopian context:
Example 1 Ethiopian Airlines Group: extract from Statement of Financial Position as of 30 June 2021 (ETB)

NON-CURRENT LIABILITIES			
Long term loans	2(k),20	110,519,999,739	89,472,803,316
Provision for maintenance	2(n),21	1,989,705,448	1,377,127,013
Lease liabilities	2(c),29B	109,222,026,756	92,127,102,064
Employee benefit	22	645,728,071	477,942,719
Deferred Tax Liability	23	6,675,617	0
Deferred and non-current liabilities	24	1,957,386,925	1,200,227,818
		224,341,522,556	184,655,202,930
CURRENT LIABILITIES			
Trade and other liabilities	2(j),25	20,809,826,985	16,403,349,810
Contract Liabilities	30	30,837,997,235	21,047,015,322
Profit Tax Payable	26	8,607,070	0
State dividend payable curent portion		0	110,131,034
Current maturity of lease Liabilities	2(c),29B	16,336,369,843	12,373,480,965
Current maturity of long term loans	20	18,925,273,886	15,451,812,026
		86,918,075,019	65,385,789,157
TOTAL EQUITY AND LIABILITIES		470,086,186,042	369,965,880,872

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Ethiopian context, example 1 Ethiopian Airlines Group: in Note 2 Summary of Significant Accounting Policies and note 22 Employee Benefit Obligation, identifies the following items...

1. Statutory **defined-contribution** pension scheme (employer and employee makes contributions of 11% and 7% respectively).
2. **Defined-benefit** pension scheme.
3. **Retirement benefit award**: ETB6,000 + ETB500 for every year >20 years.
4. **Short-term** employee benefits: wages salaries, bonus, leave benefits and other allowances and incentives.
5. Legal obligation **per proclamation** no 377/2003 Article number 39 and 40, further amended by proclamation no 494/2006 article number 2.
6. **Long service award** payable at completion of specified anniversaries (20, 25, 30, 35,40) of employment.

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**Ethiopian context:
Example 1: Ethiopian Airlines Group: extract from note 3.
Significant accounting estimates, judgements and assumptions**

C. Defined benefits plans

The cost of the defined benefits of long service awards, severance pay, and retirement awards and the present value of these defined benefit obligations are determined using actuarial valuations. An actuarial valuation involves making various assumptions that may differ from actual developments in the future. These include the determination of the discount rate; future salary increases and mortality rates. Due to the complexities involved in the valuation and its long-term nature, a defined benefit obligation is highly sensitive to changes in these assumptions. All assumptions are reviewed at each reporting date.

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Ethiopian context

Example 2 Commercial Bank of Ethiopia: Extract from Consolidated Statement of Financial Position as at 30 June 2021 (ETB)

Liabilities

Deposits due to other banks		364,945,567	1,109,055,430
Customers' deposits	21	735,295,983,493	593,041,145,062
Current tax liabilities	25	6,337,242,247	5,954,265,633
Provisions	22	1,528,010,488	1,389,959,157
Finance lease obligations	20	394,843,317	249,694,124
Dividends	24	9,571,909,473	7,771,189,170
Employee benefits	23	6,459,952,329	6,614,840,691
Other liabilities	24	177,539,624,174	153,326,630,375
Total Liabilities		937,492,511,088	769,456,779,642

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Ethiopian context

Example 2 Commercial Bank of Ethiopia: extract from Notes to the Consolidated Financial Statements 30 June 2021

(23) EMPLOYEE BENEFITS

i. Movements in the Present Value of Defined Benefit Obligations (DBO)

	30 June 2021	30 June 2020
DBO at 01 July	6,614,840,691	2,766,551,435
Current service costs	2,169,259,631	1,583,636,237
Interest cost	853,181,858	356,843,857
Past service cost for seniority recognition	(463,658)	-
Past service due to plan amendment	6,196	-
Payments for the year	(1,640,656,280)	(1,280,120,821)
Expense charged to income	7,996,168,438	3,426,910,708
Actuarial gains (losses) recognized in other comprehensive income	(1,536,216,109)	3,187,929,983
DBO at 30 June	6,459,952,329	6,614,840,691

This defined benefit plan expose the Group to actuarial risks, such as longevity risk, currency risk, interest risk and market risk.

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Ethiopian context

Example 2 Commercial Bank of Ethiopia: extract from Notes to the Consolidated Financial Statements 30 June 2021

[22] PROVISIONS

	Bonuses	Cash Prize Award	Legal	Unutilized O/D, LC and Guarantee	Total
Balances at 30 June 2019	548,285,021	-	64,916,278	48,828,844	662,030,144
Increases (decrease) recorded in income	525,035,191	116,563,214	80,950,417	5,380,191	727,929,013
Balances at 30 June 2020	1,073,320,212	116,563,214	145,866,695	54,209,036	1,389,959,157
Increases (decrease) recorded in income	1,141,551,353	122,891,273	(10,002,174)	67,894,171	1,322,334,624
Provisions used during the year	(1,065,203,434)	(116,563,214)	(2,516,643)	-	(1,184,283,291)
Balances at 30 June 2021	1,149,668,131	122,891,273	133,347,878	122,103,206	1,528,010,488

Bonus represent short-term benefits arising from past services provided by employees and are expected to pad within the next 12 months.

Legal provisions represent various claims that are pending outcome at the courts. These amounts are estimates of the likely legal claims that may not be ruled in the Group's favor.

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Types of employee benefits?

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Types of employee benefits: defined categories
Summary of class discussion

Classification	Description/definition: IAS 19 Employee Benefits.
Short-term employee benefits	Expected to be settled <u>wholly</u> before twelve months after the end of the annual reporting period in which the employee rendered the related service (excluding termination benefits).
Termination benefits	Provided in exchange for the termination of an employee's employment as a result of either: (i) termination by the employer; or (ii) employee voluntarily accepting the employer's termination offer.
Other long-term employee benefits	Excluding short-term employee benefits, post-employment employee benefits and termination benefits.

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Types of employee benefits: defined categories
Summary of class discussion

Classification	Description/definition: IAS 19 Employee Benefits.
Post-employment benefits	Payable after the completion of employment (excluding termination benefits and short-term employee benefits).
<ul style="list-style-type: none"> defined contribution 	Entity pays fixed contributions into a separate entity and has no obligation to pay further contributions relating to employee service in the current and prior periods.
<ul style="list-style-type: none"> defined benefit 	Other than defined contribution plans.

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Types of employee benefits: defined categories

Summary of class discussion

Classification	Description/definition: IFRS 2 <i>Share-based Payment</i> .
Cash-settled	Entity acquires services from employee in exchange for amounts that are based on the price (or value) of the entity's shares.
Equity-settled	Entity receives employee services in exchange for equity instruments of the entity (including shares or share options).

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Employee benefits: which sub-classification of employee benefit?

Summary of class discussion

- » An entity's contracts of employment provide each employee with:
 - » 20 days paid **sick leave** per year. Carry forward 1 year, thereafter forfeit if unused. **short-term**
 - » 25 days **holiday leave** per year. Carry forward 2 years, thereafter forfeit if unused. **other long-term**
 - » 60 days paid **maternity/paternity leave** per child. Forfeit if not taken within 24 months of the birth of a child. **other long-term**
 - » A **performance bonus** equal to 100 cash **share appreciation rights**, on condition that the employee remains in its uninterrupted employment for five years. **cash-settled share-based payment**
 - » After 25 years of uninterrupted service a **long-service bonus** equal to one month's pay at the then current salary. **other long-term**
 - » For each year of service, a **pension** equal to 2% of final annual salary. **post-employment defined-benefit**

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When are employee benefits recognised?

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Employee benefits recognition criteria: requirements

Classification	Recognition criteria	Standard
Employee benefit liability	Recognise <u>when the employee has rendered the service in exchange for which the benefit is expected to be paid.</u> However, <u>termination benefits</u> are recognised at the earlier of: <ul style="list-style-type: none">• when the entity can no longer withdraw the offer; and• when the entity recognises a restructuring provision (eg in accordance with IAS 37) including the termination benefits.	IAS 19
Cash-settled share-based payment liability	Recognise the services received (and the liability to pay for those services) <u>as the employees render the services.</u> In effect, spread over the vesting period.	IFRS 2

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How are employee benefits measured?

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How are employee benefit obligations measured? *Summary of class discussion*

IAS 19 Employee Benefits	At initial recognition	Subsequent measurement
Short-term	Accrual, no discounting	Accrual, no discounting
Termination	Accrual, with discounting, unless short term	Accrual, with discounting, unless short term
Other long-term	Projected unit credit (PUC) method	PUC method
Post-employment defined contribution	Accrual, no discounting	Accrual, no discounting
Post-employment defined benefit	PUC method	PUC method

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How are employee benefit liabilities measured? Summary of class discussion

Measurement	Initial and subsequent measurement	Standards
Fair value	The plan asset 'component' of the (net) liability for a funded defined benefit post-employment benefit plan or other long-term employee benefit.	IAS 19 <i>Employee Benefits</i>
Fair value variant	Cash-settled share-based payments.	IFRS 2 <i>Share-based Payment</i>
Grant-date fair value variant	Equity-settled share-based payments.	IFRS 2 <i>Share-based Payment</i>

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Accrual

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Short-term employee benefits (slide 1 of 6 slides) examples: undiscounted future cash flow measurement

Employee A is one of many employees that started work at the reporting entity on 1 January 2023. Employee A's contract of employment includes the following **short-term employee benefits**:

- » Salary ETB1,000 per working day (increasing by 10% each year on 1 January) + plus benefits:
 - » 20 working days paid sick leave per year (carry forward 1 year, thereafter paid in cash if unused);
 - » 25 working days holiday leave per year (carry forward 1 year, thereafter forfeit if unused);
 - » 5 working days paid relocation leave (forfeit if not taken in the year in which employment commences); and
 - » A loyalty bonus of up to 10 of the accrual year's working days salary provided specified performance targets are satisfied in the year and conditional on Employee A remaining in the uninterrupted employment of the company for the ensuing 12 months.

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Short-term employee benefits (slide 2 of 6 slides) examples: undiscounted future cash flow measurement

Employee A's leave and bonus records:

Benefit type	Accrued in 2023 (days)	Used in 2023 (days)	Forfeited in 2023 (days)	Carried forward to 2024 (days)	Expected to forfeit in 2024	Expected to used or paid out in 2024
Sick leave	20	5	-	15	-	15 days
Holiday leave	25	10	-	15	10 days	5 days
Relocation leave	5	3	2	-	-	-
Loyalty bonus	5	-	-	5	20% probability	80% probability

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Short-term employee benefits (slide 3 of 6 slides)
examples: undiscounted future cash flow measurement
Summary of class discussion

At 31/12/2023, in accordance with IAS 19, the reporting entity would measure its obligation for Employee A's **sick leave** at? Choose 1 of:

	Calculation	ETB
1)	ETB1,100 (2024 day's salary) x 35 working days	38,500
2)	ETB1,100 (2024 day's salary) x 20 working days	22,000
3)	ETB1,100 (2024 day's salary) x 15 working days	16,500
4)	ETB1,000 (2023 day's salary) x 35 working days	35,000
5)	ETB1,000 (2023 day's salary) x 20 working days	20,000
6)	ETB1,000 (2023 day's salary) x 15 working days	15,000
7)		0

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Short-term employee benefits (slide 4 of 6 slides)
examples: undiscounted future cash flow measurement
Summary of class discussion

At 31/12/2023, in accordance with IAS 19, the reporting entity would measure its obligation for Employee A's **holiday leave** at? Choose 1 of:

	Calculation	ETB
1)	ETB1,100 (2024 day's salary) x 15 working days	16,500
2)	ETB1,100 (2024 day's salary) x 10 working days	11,000
3)	ETB1,100 (2024 day's salary) x 5 working days	5,500
4)	ETB1,000 (2023 day's salary) x 15 working days	15,000
5)	ETB1,000 (2023 day's salary) x 10 working days	10,000
6)	ETB1,000 (2023 day's salary) x 5 working days	5,000
7)		0

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Short-term employee benefits (slide 5 of 6 slides)
examples: undiscounted future cash flow measurement
Summary of class discussion

At 31/12/2023, in accordance with IAS 19, the reporting entity would measure its obligation for A's **relocation leave** at? Choose one of:

	Calculation	ETB
1)	ETB1,100 (2024 day's salary) x 5 working days	5,500
2)	ETB1,100 (2024 day's salary) x 3 working days	3,300
3)	ETB1,100 (2024 day's salary) x 2 working days	2,200
4)	ETB1,000 (2023 day's salary) x 5 working days	5,000
5)	ETB1,000 (2023 day's salary) x 3 working days	3,000
6)	ETB1,000 (2023 day's salary) x 2 working days	2,000
7)		0

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Short-term employee benefits (slide 6 of 6 slides)
examples: undiscounted future cash flow measurement
Summary of class discussion

At 31/12/2023, in accordance with IAS 19, the reporting entity would measure its obligation for Employee A's **loyalty bonus** at? Choose 1 of:

	Calculation	ETB
1)	ETB1,100 (2024 day's salary) x 5 working days	5,500
2)	ETB1,100 (2024 day's salary) x 4 working days	4,400
3)	ETB1,100 (2024 day's salary) x 1 working day	1,100
4)	ETB1,000 (2023 day's salary) x 5 working days	5,000
5)	ETB1,000 (2023 day's salary) x 4 working days	4,000
6)	ETB1,000 (2023 day's salary) x 1 working day	1,000
7)		0

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Projected unit credit method

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Defined benefit obligation measurement

example: projected unit credit method (slide 1 of 3 slides)

- » On 1 January 2023 Entity C introduces an experimental long-term bonus scheme to incentivise its most highly skilled employees to remain with the company from their 60th birthday until mandatory retirement on their 70th birthday.
- » For the further 10 years of continued service Entity C will pay each incentivised employee a bonus equal to the salary otherwise earned in the 12 months to their 70th birthday.
- » Mrs C owns 60% of the equity of Entity C. The remaining equity is held by 5 members of Mrs C's family and 4 friends.
- » Entity C is funded 50% per cent by bank loans and **25% by its other creditors.**

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Defined benefit obligation measurement
example: projected unit credit method (slide 2 of 3 slides)
What do you think?

Date	Number of scheme employees	Employees expected to remain to 31/12/2022	Current annual salary (ETB)	Estimated salary for 2022 (ETB)	(Assumed) Market yield on high quality corporate bonds maturing on 31/12/2022
01/01/2023	100	80	100,000	235,795	9%
31/12/2023	98	80	100,000	162,520	10%
31/12/2024	95	70	110,000	197,947	3%
31/12/2025	93	74	115,500	246,215	8%

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Defined benefit obligation measurement
projected unit credit method (slide 3 of 3 slides)
Summary of class discussion

Date	Expected vesting (employees)	Expected 2022 salary	Service factor = years service/10	Discount factor = $1/(1+i)^n$	Amount (ETB)
01/01/2023	80	235,795	0	0.422410807	-
Expense					551,395
31/12/2023	80	162,520	0.1	0.424097618	551,395
Expense					1,636,258
31/12/2024	70	197,947	0.2	0.789409234	2,187,653
Expense					1,001,685
31/12/2025	74	246,215	0.3	0.583490395	3,189,338

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Judgements and estimates

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Liabilities selected judgements and estimates

Employee benefits: IAS 19

Short-term: estimating the extent of expected future payments when vesting conditions and forfeitures

Post-employment defined benefits and other long-term employee benefits:

- demographic actuarial assumptions: rates and age of mortality (during and after retirement), employee turnover, disability, early retirement, applicable dependent frequency, etc
- financial actuarial assumptions (based on market expectations): determining discount rate, benefit levels, (if medical benefits) future medical costs, etc

Termination: existence (recognition) and extent (measurement) of constructive obligations.

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Liabilities selected judgements and estimates

Cash-settled share-based payments: IFRS 2

Classification: when choice exists between cash-settled or equity-settled

Measurement:

- measuring the fair value of unlisted shares
- adjusting value if holder is not entitled to dividend in the vesting period
- determining appropriate model to use to value share options and inputs for that model

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Regulatory mini-case studies

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ESMA's request for clarification from IFRS Interpretations Committee Summary of class discussion

Assuming no prior period error, **is the following change in measurement a change of: 1) accounting policy; or 2) accounting estimate?**

Issue	IAS 8 and
10. A change in the basket of high quality corporate bonds (for example, from AA-rated bonds to A-rated bonds) used to determine the discount rate when applying the projected unit credit method (an actuarial valuation method) to measure the economic value (a principle) of a defined-benefit pension plan obligation in accordance with IAS 19 <i>Employee Benefits</i> .	IAS 19

(see Appendix A to Agenda Paper 11A *Review of IAS 8 - Distinction between changes in accounting policies and changes in accounting estimates*, May 2015 IASB meeting
<http://www.ifrs.org/Meetings/MeetingDocs/IASB/2015/May/AP11A-Disclosure-Initiative.pdf>)

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FRC(UK) regulatory mini-case study: Example of better disclosure: IAS 19 discount rate

Extract from BT Group plc Annual Report 2021, p160 (**emphasis added**)

“Approach to set the assumption IAS 19 requires that the discount rate is determined by reference to **market yields** at the reporting date on **high quality corporate bonds**. The **currency and term** of these should be consistent with the currency and estimated term of the pension obligations.....The discount rate model has been **updated over the year to use a wider universe of corporate bonds to derive the yield curve**. The revised model is a standard approach developed by our external actuary. The revised model leads to a 20bps increase in the discount rate at 31 March 2021 and a corresponding **£1.7bn reduction in the BTPS liabilities**.”

FRC (UK): “This disclosure explains how the discount rate has been determined with reference to the requirements of a particular standard. The company explains a change in the model in the year, and quantifies the impact on the discount rate and liability.”

Source: FRC(UK) Thematic Review: Discount Rates, May 2022 (p14)

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FRC(UK) regulatory mini-case study: Example of better disclosure: IAS 19 basis of plan asset valuation

Extract from Coats Group plc, Annual Report 2017, page 113 (**emphasis added**)

“Basis of **asset valuation** Under IAS 19, plan assets must be valued at the bid market value at the balance sheet date. For the main asset categories:

- » **Equities and bonds listed on recognised exchanges** are valued at **closing bid prices**;
- » **Other bonds** are measured using a combination of **broker quotes and pricing models** making assumptions for credit risk, market risk and market yield curves;
- » Global **real estate** assets are valued on either a fair value approach as provided by the investment manager or **notional bid valuations** provided by the investment managers due to investments being held within a single priced pooled investment vehicle;
- » Certain **unlisted investments**, for example derivatives and insurance contracts, are valued using a model based valuation such as a **discounted cash flow**; and
- » **Diversified investment funds** are valued at fair value which is typically the **Net Asset Value** provided by the investment manager”

Source: FRC(UK) Corporate Reporting Thematic Review Reporting by Smaller Listed and AIM Quoted Companies, November 2018 (p22)

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