IFRS Accounting Standards discussion fora:
IAS 19 *Employee Benefits*

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WORLD BANK GROUP

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Aims

- Develop a more cohesive understanding of IFRS accounting and reporting for employee benefits in Ethiopia
- Enhance capacity in Ethiopia to apply IAS 19 *Employee Benefits* more consistently

Applicable version of IFRS Accounting Standards

Unless specified otherwise, the accounting requirements that are the subject matter of this discussion forum are IFRS Accounting Standards as issued by the International Accounting Standards Board that are applicable for annual period beginning on or after 1 January 2023 without early applying new and amended IFRS Accounting Standards that have a later mandatory application date.

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IAS 19 Employee Benefits

» Issue 1: Severance Pay

» Issue 2: Staff off-market loans

Issue 1: Severance pay

Severance Pay
What do you think?

Ethiopian Labour law creates an obligation for an employer to pay an employee severance pay in most circumstances where employment terminates. The severance pay is determined based on the length of service of the employee.

Does severance pay qualify as post-employment benefit or an other long-term benefit? Can it be determined without the use of actuary service? Does the obligation actually arise and is it appropriate to provide for it? Currently many entities accrue for the immediate liability, is this in compliance with IFRS?

Severance Pay
Summary of discussion

Issue 1.1 Does severance pay qualify as post-employment benefit or an 'other long-term benefit'?

Discussants consensus view

- Employee benefits are split into four categories (see next slides)
- Severance pay is not
  - a post-employment benefit - it is paid to staff member on termination of services, not after the completion of employment
  - a termination benefit - it does not arise from either of the two conditions listed (see next slide)
  - a short-term benefit – it accumulates over many years
- Therefore, severance pay is an 'other long-term benefit'

Severance Pay
Types of employee benefits (IAS 19)

Classification	Employee benefits…
Short-term employee benefits	… that are expected to be settled wholly before twelve months after end of the annual reporting period in which the employee rendered the related service (excluding termination benefits).
Post-employment benefits	… that are payable after completion of employment (excluding termination benefits and short-term employee benefits)
Other long-term benefits	… (excluding short-term employee benefits, post-employment employee benefits and termination benefits)
Termination benefits	… provided in exchange for termination of employment as a result of either: (i) termination by employer; or (ii) employee voluntarily accepting the employer's termination offer.

Severance Pay
Summary of discussion

Issue 1.2 Can it be determined without the use of actuary service?

Discussants' consensus view

IAS 19 requires an "other long-term benefit' to be measured[1]:

» By accumulating the liability over time as employee provides related services

» Using an actuarial technique that estimates the ultimate cost to the entity in return for service in current and past periods (projected unit credit method)

» Discounted primarily to reflect time value of money (between balance sheet date and expected ultimate payment date), and

» Adjusted in each period for: Changes to previous estimates, Changes in discount rate and Unwind of time value of money

1 IAS 19.57

Severance Pay
Summary of discussion

Issue 1.2 Can it be determined without the use of actuary service?

Discussants' consensus view

» An actuarial technique does not necessarily require the services of an actuary

» IAS 19.60 notes that '*In some cases, estimates, averages and computational short cuts may provide a reliable approximation of the detailed computations illustrated in this Standard.*'

» Applying a simplified approach on a stardardised template may produce materially correct outcomes

Severance Pay
Summary of discussion

Issue 1.3 Does the obligation actually arise and is it appropriate to provide for it?

Discussants' consensus view: Yes

» IAS 19.1 requires an entity to recognize a liability when an employee has provided service in exchange for employee benefits to be paid in the future

» Severance benefits accumulate over time as a consequence of past service provided by an employee

Severance Pay
Summary of discussion

Issue 1.4 Currently many entities accrue for the immediate liability, is this in compliance with IFRS?

Discussants' consensus view

» It is possible that the immediate liability is a reasonable approximation of the actuarially determined liability (within materiality limits)

» However, this will differ from an entity to entity and will require a materiality determination at each reporting date

Issue 2: Staff off-market loans

Staff off-market loans
What do you think?

An entity is generally required to initially recognise a financial asset or liability at its fair value plus or minus[1] transaction costs directly attributable to the acquisition or issue of the financial asset or financial liability.[2]

Employers normally gives loans to their employees at significantly lower interest rate, can this be treated as an employee benefit?

[1] In the case of a financial asset or financial liability not at fair value through profit or loss
[2] IFRS 9.5.1.1

Staff off-market loans
Summary of discussion

Employers normally gives loans to their employees at significantly lower interest rate, can this be treated as an employee benefit?

Discussants' consensus view

» The loan is accounted for at fair value at initial recognition (typically the present value of expected cash flows discounted using the market rate)

» IFRS 9.B5.1.1 requires an expense be recognized for the difference between the loan and its fair value, unless the difference qualifies for recognition an another type of asset

» The difference created by an off market staff loan is incurred by an entity in exchange for services previously rendered, or to be rendered by employees

Example
Staff off-market loans

» Entity makes a Br100 000 loan to a member of staff

» Market interest rate is 10%, staff loans are advanced to eligible staff at 5%

» Loans are repayable in 60 equal monthly instalments of Br1 887

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Example
Staff off-market loans

	A (description)	B (cash flows)
1	Monthly payments	1 887
2	Interest rate	10%
3	Monthly interest rate	0.8333%
4	# of Installments	60
5		88 818

Using Excel to calculate Present Value

Cell B5 contains: =PV(B3,B4,B1)

Cash advance of Br100 000, less initial loan of Br88 818 equals:
Br 11 182 cost of off-market loan

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Staff off-market loans
Summary of discussion continued

How should the difference be accounted for?

Discussants' consensus view

» If the loan binds staff member to remain employed for a period or provide some other future service, then the cost must be recognized as an expense over the future service period of the related future service

» Otherwise the expense is recognised immediately

Example *continued*	Debit	Credit
Dr Loan to staff	88 818	
Dr Staff expense	11 182	
Cr Cash balance		100 000