Accounting for Employee Benefits (AASB 119)

General Requirements

-Employee benefits (EB): all forms of consideration given by an entity in exchange for services rendered by employees.
-On costs, such as payroll tax and workers compensation insurance are not employee benefits.

-**Short-term EB:** EB benefits (other than termination benefits) that are due to be settled within 12 months after the end of the period in which the employees render the related service. Includes

- Wages, salaries, and social security contributions
- Short-term compensated absences that are payable within 12 months after the end … (e.g. paid annual leave and paid sick leave)
- Profit sharing and bonuses payable within 12 months after the end…
- Non-monetary benefits (e.g. subsidised or free goods and services)

-Long-term EB: Includes

- Post-employment benefits (e.g. retirement pensions and post employment medical care)
- Other long term EB (e.g. long service leave, sabbatical leave, long-term disability benefits, profit sharing and bonuses payable 12 months or more after the end of the period in which it is earned, and deferred compensation paid 12 months or more after the end of the period in which it is earned).

Two bases for measuring employee benefits liabilities:
1. Nominal basis: measures liabilities at the undiscounted amount that will ultimately be paid to settle the liability. This basis must be used for short-term EB.
2. Present value basis: It discounts amounts that are expected to be paid in the future in settlement of the liability. This basis is required for long-term EB liabilities.

- Rate to be used to discount the estimated future cash outflows is '**market yields at the end of the reporting period** on high quality corporate bonds'. However, in countries like Australia that has insufficiently active and liquid market for corporate bonds, government bond yields are used. E.g. if EB liability is expected to be settled in 20 years time in AUD, appropriate discount is the current yield on 20 year Australian Government bonds.

Wages and Salaries

-Two components:

- Monetary: cash paid to the employee, including income tax payable withheld by employer and forwarded to the tax office
- Non-monetary: other benefits, e.g. payment of health insurance premiums, housing, vehicles, and free or subsidised goods and services (e.g. low interest loans)

-W&S will generally be recognized as an expense and a liability (accrued expense), except to the extent that any amount already paid satisfies the definition and recognition criteria for assets (prepaid expenses). Use nominal basis of measurement.

Example: One year contract at an annual salary package=$52000. Package consists of cash=46800 and car expenses=5200. Income tax of 350/week is deducted from salary. $64.week deducted for health insurance premiums payable to Medibank.

Dr Wages and salaries expense	1000	
Cr Car expenses payable		100
PAYG tax payable		350
Medibank contributions payable		64
Cash at bank		486

When amount collected is remitted,

Dr PAYD tax payable	350	
Medibank Contributions payable	64	
Cr Cash at bank		414

If, at the end of period, four days' wages were owing

Dr W&S expense	800	
Cr Accrued wages payable		800

Compensated absences

1. Annual leave

-Expected cost of the annual leave should be recognized as L and E when employees provide the services that increase their entitlement. Entitlement is accrued on a daily basis.

-Measured using nominal basis because absences are expected to occur within 12 months after end of **period …**

Jones is paid an annual salary of 52000 (1000/week with PAYG tax instalment of 386.71) with an entitlement to 4 weeks' annual leave and a 17.5% annual leave loading.

The cost of the leave to company is

52000 x 4/52 x 1.175 =4700

Pay weekly salary

Wages and salary expense	1000	
PAYG tax payable		386.71
Cash at bank		613.29

Accrue Annual leave entitlement

Annual leave expense	90.38	
Annual leave payable		90.38

*If Jones takes one week's leave, she is paid 1000 x 1.175 or 1175.

Payment of one week's leave

Annual leave payable	1175	
Cash at bank		1175

Annual leave expense	90.38	
Annual leave payable		90.38

*The effect of these entries is an annual wages expense of 48000 and annual leave expense of 4700, which is spread evenly over the 52 weeks of the year.

2. Sick leave

-Classified into:

- **Non-accumulating sick leave**: annual entitlement which if not taken during a particular year, it lapses and a new entitlement begins for the next year.

- Recognition of expense and liability only when absence occurs, i.e. when sick leave is taken. This is because employee service does not increase amount of the benefit.

Example: Company has a weekly payroll of 70000. It provides employees with 10 working days; non-accumulating sick leave entitlement each year. Experience suggests that 85% of its employees will take their full entitlement each year. An employee who has a weekly salary of 350 takes two days of sick leave.

Sick leave expense	140	
Cash at bank/ sick leave payable		140

*350 x 2/5=140

- **Accumulating sick leave**: allows an employee to carry forward unused sick leave for use in subsequent periods.
  - Liability is recognized as employees provide service that increases their entitlement to future paid sick leave.
  - Accumulating sick leave give rise to vesting and non-vesting entitlements:
    - Vesting SLE: obligation that will ultimately be paid by the employer. Employee has the right to the full amount of the accumulate sick leave entitlement. If employee retires, resigns or is fired, employer has to pay any accumulated SLE. SL amount=100% of accumulated SL.
    - Non-vesting SLE: not an unconditional legal obligation of employer. They become payable only when there is a valid claim by employees. If employment ceases, employees receive no compensation for any unused sick leave.

Example: Company has a total weekly payroll of 80000. It provides 40 employees with 10 working days' accumulating sick leave entitlement each year. 10 of these employees are entitled to vesting sick leave and the amount of weekly payroll attributable to them is 10000. The remaining 30 employees are entitled to non-vesting sick leave. Experience suggests that 85% of employees will take their full sick leave entitlement each year.

Annual sick leave measurement

Vesting sick leave	20000 (10000 x 2 weeks x 1.00)
Non-vesting SL	119000 (70000 x 2 weeks x 0.85)
	139000

Each week's journal entries:

Sick leave expense	2673	
Sick leave payable		2673

*Vesting sick leave: 20000/52 (385/week), plus non-vesting: 119000/52 (2288)= 2673

Non-vesting SL is recognized as liability only to the extent it is expected to be taken so need to adjust for the probability it will be used before separation from the employer

Post-employment benefit

Classification of post-employment benefit arrangements:

- *Defined contribution plans* are post-employment benefit plans under which an entity pays fixed contributions into a separate entity (a fund) and will have no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods. In consequence, **actuarial risk (that benefits will be less than expected) and investment risk** (that assets invested will be insufficient to meet expected benefits) fall, in substance, on the employee.
    - Liability is measured on an undiscounted basis, unless benefits do not fall wholly within 12 months after the period in which the employees rendered the service.
- *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 are worse than expected, the entity's obligation may be increased.
    - Requires the measurement of PV of EB's obligation and benefits expense. There is a possibility of actuarial gains and losses (diff between previous actuarial assumptions and what has actually occurred).

The amount recognized as a liability for defined benefit plan

+ PV of the obligation at the reporting date
-FV at the reporting date of plan assets (if any) out of which the obligations are to be settled directly
=amount of liability

-Two types of PE costs are borne by an employer:

- normal cost: the expense that should be paid by the employer for post-employment entitlements earned by employee during the reporting period. These amounts are determined by actuarial calculations in the case of a defined benefit plan.
- past-service cost: arises when a defined benefit PE plan is introduced by an established employer, or when the plan's benefit are increased,

*When a plan is adopted, there will be a past-service cost to fund the benefits that have accrued to employees prior to that date. Similarly, when a plan is amended, there will be a past-service cost to fund the increased benefit payable over the employees' entire period of eligible service.

Two ways to account for PEB costs:

- Form method: Assumption that the trust that manages the superannuation plan is a separate independent legal entity. It accepts that the legal form of relationship between employer and the trust is the substance of the relationship. Hence, employer's obligation are satisfied when it provides resources to trustees. Assets and liabilities of plan are the responsibility of trustees rather than the employer.
- Net worth method: PEB is not completely separate from the employer. Hence,employer does not satisfy its obligations by making payments to the plan because
    - Plan is part of the same economic entity.
    - The plan's A and L are the employer's A and L.

Other long-term benefits

1. Long service leave

-Calculation of LSL liability requires judgment and estimations. Need to consider:

- The probability that the employee will stay with the employer until such time they are entitled to LSL
- Changes in salary (pay increases and promotions)
- When LSL will be taken
- Appropriate discount rate determined by:
    - reference to market yields at the reporting date on high quality corporate bonds in absence of deep market in such bonds, market yields on government bonds is used

-In general, for LSL purposes, employment can be divided into three periods

- Preconditional period: early years provide no long-service leave entitlement if employee resigns
- Conditional period: Employee has LSL entitlement that dates from the commencement of employment. During this period, an employee is usually not entitled to take long service leave, but is eligible for a pro-rata LSL payment if employment ceases
- Unconditional period: Employee becomes eligible to take long-service leave and is entitled to full payment on resignation.

Example: Company provides employees with 13 weeks' LSL after 15 years of continuous service. Preconditional=years 1-3, conditional=years 4-10, and unconditional=after year 10, but are not permitted to take leave until after 15 years of service.

a) Calculation of LSL obligation

-Obligation for LSL is based on projected annual salary of employees when they become unconditionally entitled to the leave.

-On 30 June 2011, employee has completed 10 years of continuous service. Employee has accumulated 10/15 x 13/52 years' leave, which will be paid at $57000 (projected salary in year 10) per annum. Value of **accumulated LSL** is=

Period of continuous service x LSL entitlement x projected salary

10/15 x 13/52 x 57000=9500

-Since employee is now unconditionally entitled to LSL, there is 100% probability that the leave will be taken or paid out. (Times probability of 1)

-PV basis of measurement- discount rate= 5-year yield on government bonds

-LSL liability (PV)

Accumulated LSL x discount rate x probabiliy

9500 x 1/ (1.04)^5 x 1.00= 7808.31

(b) General journal entry to record LSL expense

-Cannot recognize all 7808.31 because LSL expense=increase in LSL liability over the reporting period.

-Have to calculate balance of LSL liability at the end of the previous year.

-Redo the whole process. Answer=6323.62

LSL expense	1484.69	
Liability for LSL		1484.69

UNDERSTANDING BOX:

Conclusion for Annual leave and sick leave

- Non accumulating-recognize expense only when it is claimed
- Accumulating (Accrue liability needed because entitlement increases as service is provided)
  - Vesting (Definitely will be paid) 100% probability=keep accruing
  - Non-vesting (Not 100% will be paid-depends on how much is claim)=so need to adjust to the proability of the employee taking the leave!