

TREASURY ANALYSIS – INTERNATIONAL ACCOUNTING STANDARDS

AASB 119 “Employee Benefits” (July 2004) replaces AASB 1028 “Employee Benefits”

Major impacts of changes

- Superannuation - defined benefit plans – AASB 119 impacts the Crown and agencies whose unfunded superannuation (or surplus) is *not* assumed by the Crown, as follows -
 - Higher unfunded superannuation liability (or lower surplus) in the balance sheet because a lower discount rate must be used. The defined benefit obligation must be discounted using the government bond rate, rather than the expected rate of return on plan assets.
 - Greater volatility in the income statement and balance sheet, because the discount rate is based on market expectations *at* each reporting date.
 - Calculation and disclosure of the unfunded superannuation liability (or surplus) on two bases:
 - For recognition in the balance sheet - using the government bond rate;
 - For disclosure in the notes – using the expected rate of return on plan assets.
 - Additional disclosures, including current service cost; interest cost; expected return on plan assets; actuarial gains and losses; and past service costs.
 - Inclusion of both employer *and* employee superannuation assets and liabilities in the calculation of the net superannuation liability / asset.
- Other employee benefits
 - A more detailed methodology is required to calculate other long-term employee benefits (e.g. LSL), based on the method used to calculate the defined benefit superannuation obligation.
 - Annual leave that is a long term employee benefit must be measured at present value, where discounting is expected to have a material impact.
 - All annual leave and any unconditional LSL (whether or not it is expected to be settled within 12 months) must be presented as a current liability in the Balance Sheet.

Key features of Standard

Scope

- AASB 119 prescribes recognition, measurement and disclosure requirements for all forms of employee benefits, except share based payments. This includes short term employee benefits, post employment benefits, other long term employee benefits and termination benefits.
- AASB 119 replicates the requirements of AASB 1028 in most respects. However, AASB 119 requires entities to recognise a liability for unfunded superannuation. This was not previously required under Australian Accounting Standards. However, the NSW public sector has recognised this liability voluntarily.

Post employment benefits- defined contribution plans

- *Definition* (para 7) – Defined contribution plans are those where the entity pays fixed contributions into a separate fund e.g. specifically defined, say as a percentage of salary. An entity’s obligation is limited to its fixed contribution. In NSW, this includes the First State Superannuation Scheme. In these plans, members carry all the investment risk. If the investments perform poorly, member benefits are directly affected.
- *Recognition and measurement* (para 44-45) – An entity must recognise contributions payable for service provided by an employee, as a liability and an expense. Contributions must be discounted where they fall due after 12 months (para 45).
- *Disclosure* (para 46) – An entity must disclose the amount recognised as an expense for defined contribution plans.

Post employment benefits – defined benefit plans

- *Definition* (para 7) – Defined benefit plans are plans other than defined contribution plans. In NSW, this includes the State Authorities Superannuation Scheme; State Superannuation Scheme; Police Superannuation Scheme and the State Authorities Non-Contributory Superannuation Scheme (Basic Benefit). The formula for calculating the defined benefit is generally specified in terms of years of service / membership of the fund and average salary level over the last year / few years. The employer carries the investment risk. If investment returns are low, the employer may need to increase its contributions to allow the fund to meet its required payouts.

Recognition – defined benefit plans

- *Balance sheet* (para 54) – must recognise the *net* total of the:
 - Present value of the defined benefit obligation at reporting date;
 - Minus any past service cost not yet recognised (para 96); and
 - Minus fair value of plan assets at reporting date.
 - *Asset ceiling* - Any surplus recognised in the balance sheet is limited to the net of any unrecognised actuarial losses from past service costs (refer para 96) and the present value of economic benefits that will arise due to reduced contributions or surplus that can be returned to the employer (para 58-58A).
- *Income statement* (para 61-62) – must recognise *net* total of the following as an expense or income:
 - *Current service cost* – This is the increase in the present value of the defined benefit obligation resulting from employee service in the current period (para 7, para 63-91).
 - *Interest cost* – This is the increase in the present value of the defined benefit obligation which arises because the benefits are one period closer to settlement (para 7 and 82). AASB 119 treats interest cost inconsistently with AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*. AASB 119 includes interest cost in the calculation of employee benefits, while AASB 137 includes interest cost as a borrowing cost (AASB Action Alert Number 75, June 2004).
 - *Expected return on plan assets* – This is based on market expectations at the beginning of the period, for returns over the life of the related obligation; and on any reimbursement rights (para 104A-107).
 - *Actuarial gains and losses* – These are experience adjustments (e.g. difference between expected and actual return on plan assets) and effects of changes in actuarial assumptions (para 7 and Aus92.1). Actuarial gains and losses must be immediately and fully recognised when incurred (para Aus 92.1).
 - *Past service cost (to the extent required to be recognised)* – This is the increase in the defined benefit obligation from changes to post employment benefits relating to employee service in prior periods (para 7 and 96).
 - *Curtailments or settlements* – These are amendments to the terms of the plan and/or number of employees covered by the plan (para 109-110).

Measurement – defined benefit obligation – key steps

- *Apply an actuarial valuation method* (para 64-66) - Use the ‘projected unit credit method’ where each period of service gives rise to an additional unit of benefit.
- *Attribute benefit to periods of service* (para 67-71) - Based on the plan’s benefit formula unless this provides a materially higher benefit in later years, in which case a straight line method must be used.
- *Make actuarial assumptions* (para 72-91) - About demographic (e.g. mortality rates) and financial variables (discount rate, CPI, salary increases, investment earnings) that affects the cost of the benefit.
- *Discount rate* (para 78 and Aus78.1) - The rate used to discount the defined benefit obligation is determined by reference to the market yields *at the reporting date* on government bonds. AASB 119 states that Australia does not have an active and liquid market in high quality corporate bonds.

Presentation and Disclosure – defined benefit plans

- *Offset* – Offsetting an asset of one plan with the liability of another is only permitted when the entity (para 116):
 - Has a legal right of set off; and
 - Intends to settle on a net basis, or to realise the surplus in one plan and settle the obligation under the other plan simultaneously.
- *Disclosure* about defined benefit plans (in total or separately for each plan) including (para 120-125) -
 - Accounting policy for recognising actuarial gains/ losses and description of the type of plan.
 - Reconciliation of assets and liabilities recognised in the balance sheet, including the present value of the defined benefit obligation and fair value of plan assets.
 - Reconciliation showing movements during the period in the net liability (or asset) recognised.
 - Total expense for each of the following and line item of the income statement in which included - current service cost; interest cost; expected return on assets; reimbursement right; actuarial gains and losses; past service cost; effect or curtailment or settlement.
 - Actual return on plan assets and on any reimbursement right.
 - Principal actuarial assumptions used at the reporting date.
 - Surplus or deficit on a funding basis *using the expected rate of return on plan assets* in accordance with AAS 25 *Financial Reporting by Superannuation Plans* (para Aus 121.1)
 - Other funding disclosures, including the current contribution recommendations; the funding method and economic assumptions used to make the contribution and funding recommendations (para Aus121.1).
 - Details of the nature of any asset or liability recognised in the balance sheet (para Aus 121.2).

Other long term employee benefits e.g. LSL (para 128-130)

- Other long term employee benefits (para 7) - These are long term benefits other than post employment benefits and termination benefits, that do not fall due wholly within 12 months. These benefits must be measured on the same basis as for defined benefit plans, except an entity must immediately recognise all past service costs.

Main differences compared to previous Australian requirements

Post employment benefits – superannuation

- AASB 119 applies to post employment benefits such as superannuation and medical costs. Previously, these types of benefits were excluded from the scope of AASB 1028 and so there was no requirement to recognise unfunded superannuation liabilities. But, unfunded superannuation has been recognised voluntarily by the NSW public sector – refer ‘impact on the public sector’.

Other long term employee benefits

- *Methodology* - Other long term employee benefits (e.g. LSL) must be calculated using the same methodology as applied to defined benefit plans. The AASB 119 methodology is more detailed compared to the LSL guidance in AASB 1028.
- *Present value vs nominal measurement* - AASB 119 requires short term employee benefits (i.e. due within 12 months) to be measured at nominal amount. Long term employee benefits (i.e. due after 12 months) must be measured at present value (para 128). This is similar to AASB 1028, except that AASB 1028 provided that wages, salaries, annual leave and sick leave must be measured at nominal amounts in *all* circumstances. So, where wages, salaries, annual leave and sick leave are long term rather than short term employee benefits, AASB 119 requires present value measurement; while AASB 1028 required nominal measurement.

Current versus short term employee benefits

- AASB 119 uses the terms ‘short-term’ and ‘long-term’ to distinguish between different types of employee benefits. In contrast, for presentation in the Balance Sheet, AASB 101 distinguishes between ‘current’ and ‘non-current’ assets and liabilities. However, the definition of current / non-current is different to short-term / long-term. In accordance with AASB 101, any unconditional entitlement such as annual leave and unconditional LSL must be presented as a current liability in the Balance Sheet. Previously, the current / non-current classification was based on whether or not the liability was expected to be settled within 12 months. This means, for example, that while unconditional LSL must be classified as ‘current’ in the Balance Sheet (per AASB 101), it must still be recognised and measured as a long term employee benefit (per AASB 119, para 66).

Impact on the public sector

Unfunded superannuation

- The AASB 119 defined benefit requirements *only* impact on the following agencies:
 - The Crown, which has assumed the unfunded superannuation liability for most budget dependent agencies.
 - Other agencies, where the unfunded superannuation (or superannuation surplus) liabilities are *not* assumed by the Crown.

There will be no impact for agencies whose superannuation is assumed. For the Crown and agencies whose superannuation is *not* assumed, the main impacts are as follows.
- Higher unfunded superannuation (or lower superannuation surplus) in the balance sheet because a lower discount rate is used -
 - AASB 119 requires that the defined benefit obligation is discounted using the government bond rate, rather than the expected rate of return on plan assets, as previously used in NSW.
 - This will increase the unfunded superannuation liability (or decrease superannuation surplus), because the expected rate of return on plan assets is higher than the government bond rate.
- Greater volatility in the income statement and balance sheet, as the discount rate (para 77) is based on market expectations *at* each reporting date.
 - Previously, for the NSW public sector, the discount rate was based on long term expectations rather than a point in time measure.
 - This means that a greater degree of volatility will be introduced as the discount rate will vary from year to year. In the past the discount rate was held constant for a number of years.
- Requirement to calculate and disclose the unfunded superannuation liability on two bases:
 - For recognition in the balance sheet – the AASB 119 liability discount rate and methodology is used;
 - For disclosure in notes to the accounts - the expected rate of return on plan assets (i.e. funding basis) and the AAS 25 methodology is used. This disclosure is used to assess the level of future contributions and reflects the plans’ investment strategy as well as the employer’s long-term funding plan.
- Additional disclosures – AASB 119 requires additional disclosures, including disclosure of the current service cost, interest cost, expected return on plan assets, actuarial gains and losses and past service costs.
- Inclusion of employee superannuation assets and liabilities - AASB 119 only refers to ‘plan’ assets and liabilities and does not distinguish between employer and employee assets and liabilities. Application of AASB 119 requires the inclusion of both employer *and* employee superannuation assets and liabilities in the calculation of the net superannuation liability / asset. By itself, this change will not impact on the Balance Sheet or the Operating Statement, as by definition employee liabilities are matched by employee assets. However, the change will be reflected in the detailed note disclosure information.

GFS / GAAP convergence

- *Comprehensive income* – As part of the GFS / GAAP convergence project (refer AASB 1049), the AASB has adopted a single comprehensive income statement for the general government sector. If this is applied at the entity level in the future, the net superannuation expense is likely to be split between ‘transactions’ and ‘re-measurements’. This may help address volatility concerns by separately identifying the impact of actuarial gains and losses.

Policy and Implementation issues (see attached)

- AASB 1 requires an entity’s estimates under Australian equivalents to IFRS to be consistent with estimates made for the same date under previous GAAP. Adjustments are only made for any differences in accounting policies or errors (AASB 1, para 31).
- Therefore, agencies will need to review employee benefit assets and liabilities for any differences in accounting policies (e.g. discount rate) as at 1 July 2004.
- Actuarial advice for the unfunded superannuation liability (or superannuation surpluses) has been provided centrally to agencies using the actuary for the Pooled Fund and Energy Industries Superannuation schemes. The actuary has applied the discount rate and other financial assumptions consistently for all state sector agencies to determine the unfunded superannuation liability or surplus recognised in agencies’ balance sheets.

Recent AASB/IASB Developments

- A revised version of AASB 119 was issued in December 2004. The revised Standard applies to annual reporting periods beginning on or after 1 January 2006, but allows for early adoption from 1 January 2005. The main difference compared to the July 2004 version of the Standard is the introduction of the following two additional options for the recognition of actuarial gains and losses associated with a defined benefit plan:
 - Full recognition directly in retained earnings;
 - The corridor approach (which spreads the actuarial gains/losses).
- Treasury’s Mandates (refer NSWTC 06/14) clarify that the amended AASB 119 (December 2004) will not be early adopted. This means that agencies will adopt the July 2004 version of AASB 119 (which this Treasury Analysis is based on) in the first AEIFRS financial report. Accordingly, agencies must fully recognise actuarial gains and losses through profit or loss.

This summary has been written in general terms and is intended for general reference only. Agencies should review the contents of the AASB Standard to determine its application in particular circumstances.

SUMMARY OF POLICY, IMPLEMENTATION & SYSTEM ISSUES
AASB 119 “EMPLOYEE BENEFITS”
TREASURY & AGENCIES

	Issue	Treasury Policy		System/ Implementation Issue	Mandate Options for GFS Harmonisation	Budget / Total State Sector Issues
		Mandate Option	Additional Guidance			
1	Calculation and disclosure of the unfunded superannuation liability on two bases - - Actuarial advice on impact of the adoption of AASB 119 at 1/7/04 and subsequently		✓ refer NSWTC 06/10	✓		✓
2	Unfunded superannuation liability - additional disclosures regarding - - Components of superannuation expense - Surplus or deficit on a funding basis		✓ refer NSWTC 06/10	✓		✓
3	Long service leave – review for any changes in methodology		✓ refer NSWTC 06/09	✓		✓
4	Present value measurement of any wages, salaries, annual leave and sick leave that are long term employee benefits (where material).		✓ refer NSWTC 06/09	✓		✓
5	All annual leave and any unconditional LSL (whether or not expected to be settled within 12 months) must be presented as a current liability in the Balance Sheet.		✓ refer NSWTC 06/09	✓		✓