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Accounting for Employee Entitlements

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PREFACE

Application of the Standard

This Standard applies to each private sector reporting entity, each public sector reporting entity employing any accrual basis of accounting and each other public sector reporting entity to the extent practicable in relation to its first reporting period that ends on or after 30 June 1995 and later reporting periods. The Standard may be applied to earlier reporting periods.

Main Features of the Standard

The Standard:

- (a) defines "employees", "employers" and "employee entitlements";
- (b) requires that employees' entitlements to wages and salaries, annual leave, long service leave, sick leave, non-monetary benefits, medical benefits, retirement, termination, retrenchment and redundancy payments be recognised as liabilities in an employer's financial statements where the employer has a present obligation based on services rendered by employees up to the reporting date;
- (c) requires wages and salaries, annual leave and sick leave (irrespective of whether they are expected to be settled within twelve months of the reporting date) and other employee entitlement liabilities expected to be settled within twelve months of the reporting date to be measured at their nominal amounts (based on current remuneration rates and undiscounted cash flows);
- (d) requires other (long-term) employee entitlement liabilities to be measured at their present value;
- (e) requires disclosure of a range of relevant matters, including certain disclosures about an employer's superannuation obligations and ownership-based remuneration schemes; but
- (f) does *not* specify recognition and measurement requirements in relation to an employer's superannuation obligation to employees and to employee compensation in the form of ownership-based remuneration schemes (see below).

Exclusion of Recognition and Measurement Requirements for Superannuation and Ownership-Based Remuneration Schemes

The Public Sector Accounting Standards Board (PSASB) and the Australian Accounting Standards Board (AASB) are continuing their consideration of the issues relating to the recognition and measurement of an employer's superannuation obligations. Many responses to Exposure Draft ED 53 "Accounting for Employee Entitlements" addressed this aspect of the Exposure Draft and raised a number of issues which have warranted further consideration by the Boards. Before completing their deliberations, the Boards intend to hold a Public Hearing to provide further opportunity for input from interested parties. Following analysis of the responses received at the Public Hearing, the Boards will finalise accounting standards for the recognition and measurement of an employer's superannuation obligations and will amend this Standard.

The Boards intend to deal separately with requirements for the recognition and measurement of ownership-based remuneration schemes.

AUSTRALIAN ACCOUNTING STANDARD AAS 30 "ACCOUNTING FOR EMPLOYEE ENTITLEMENTS"

Citation

- 1 This Standard may be cited as Australian Accounting Standard AAS 30 "Accounting for Employee Entitlements".

Accounting Standards and Commentary

STANDARDS

- 2 **The accounting standards set out in this Standard are shown in bold print. Commentary is shown in normal print immediately after the accounting standards to which it relates, as an aid to the interpretation of the accounting standards.**

Application and Operative Date

STANDARDS

- 3 **This Standard:**
- (a) **applies to general purpose financial reports of:**
 - (i) **each private sector reporting entity;**
 - (ii) **each public sector reporting entity using any accrual basis of accounting; and**
 - (iii) **each other public sector reporting entity, to the extent practicable;**
 - to which Accounting Standards operative under the Corporations Law do not apply, in relation to its first reporting period that ends on or after 30 June 1995 and later reporting periods;**
 - (b) **may be applied by an entity specified in paragraph 3(a) to a reporting period that ends before 30 June 1995;**

- (c) **does not apply to the recognition and measurement of expenses, liabilities, assets and revenues arising in respect of employee entitlements in the form of superannuation; and**
- (d) **does not apply to the recognition and measurement of expenses, liabilities, assets, revenues and equity arising in respect of employee entitlements in the form of ownership-based remuneration schemes.**

4 **An entity which is not a reporting entity shall, when it prepares a financial report which it purports to be a general purpose financial report, apply this Standard as if it is a reporting entity.**

COMMENTARY

5 Accounting Standards operative under the Corporations Law apply to companies and to other entities required by legislation, ministerial directive or other government authority to apply such Standards. Reporting entities which are not required to apply Accounting Standards operative under the Corporations Law are required to apply this Standard.

Statement of Purpose

STANDARDS

- 6 **The purpose of this Standard is to:**
- (a) **prescribe the methods to be used when accounting for employee entitlements in the preparation of general purpose financial reports; and**
 - (b) **establish requirements for the disclosure of information about employee entitlements in the general purpose financial reports.**

COMMENTARY

7 Statement of Accounting Concepts SAC 2 "Objective of General Purpose Financial Reporting" states that general purpose financial reports shall provide information useful to users for making and evaluating decisions about the allocation of scarce resources. Such

decision making is likely to involve users in assessing the performance, financial position and financing and investing activities of the reporting entity. The establishment of an accounting standard for employee entitlements will assist users in making these assessments by providing relevant and reliable information about employee entitlements in the financial report and by ensuring that employee entitlements are accounted for on a consistent basis.

Application of Materiality

STANDARDS

- 8 **The accounting standards set out in this Standard shall, in accordance with Australian Accounting Standard AAS 5 "Materiality in Financial Statements", apply to the financial report where such application is of material consequence. Information about employee entitlements is material if its omission, non-disclosure or misstatement has the potential to adversely affect:**
- (a) **decisions about the allocation of scarce resources made by users of the financial report; or**
 - (b) **the discharge of accountability by the management or governing body of the entity.**

COMMENTARY

- 9 In deciding whether an item is material, its nature and amount usually need to be evaluated together.

Definitions

STANDARDS

- 10 **In this Standard:**
- "assets" means service potential or future economic benefits controlled by the entity as a result of past transactions or other past events;**
- "contributions by owners" means service potential or future economic benefits that have been contributed to the entity by parties external to the entity, other than those which result in**

liabilities of the entity, that establish a financial interest in the net assets of the entity which:

- (a) conveys entitlements both to distributions of service potential or future economic benefits by the entity during its life, such distributions being at the discretion of the ownership group or its representatives, and to distributions of any excess of assets over liabilities in the event of the entity being wound up; and/or**
- (b) can be sold, transferred or redeemed;**

"distributions to owners" means service potential or future economic benefits distributed by the entity to all or part of its ownership group, either as a return on investment or as a return of investment;

"economic entity" means a group of entities comprising the parent entity and each of its subsidiaries;

"employee" means a natural person appointed or engaged under a contract of service, whether on a full-time, part-time, permanent, casual or temporary basis;

"employee entitlements" means benefit entitlements which employees accumulate as a result of the rendering of their services to an employer up to the reporting date, and include, but are not limited to, wages and salaries (including fringe benefits and non-monetary benefits), annual leave, sick leave, long service leave, superannuation and other post-employment benefits;

"employer" means an entity, including an economic entity, which consumes the services of employees in exchange for providing employee entitlements;

"entity" means any legal, administrative, or fiduciary arrangement, organisational structure or other party (including a person) having the capacity to deploy scarce resources in order to achieve objectives;

"equity" means the residual interest in the assets of the entity after deduction of its liabilities;

"expenses" means consumptions or losses of service potential or future economic benefits in the form of reductions in assets or increases in liabilities of the entity, other than those relating to distributions to owners, that result in a decrease in equity during the reporting period;

"general purpose financial report" means a financial report intended to meet the information needs common to users who are unable to command the preparation of reports tailored so as to satisfy, specifically, all of their information needs;

"liabilities" means future sacrifices of service potential or future economic benefits that the entity is presently obliged to make to other entities as a result of past transactions or other past events;

"ownership-based remuneration scheme" means a share ownership plan or similar arrangement whereby employees are compensated for their services, wholly or in part, by being offered an opportunity to acquire equity in the employer;

"parent entity" means an entity which controls another entity;

"recognised" means reported on, or incorporated in amounts reported on, the face of the profit and loss or other operating statement or of the statement of financial position (whether or not further disclosure of the item is made in notes thereto);

"reporting date" means the end of the reporting period to which the financial report relates;

"reporting entity" means an entity (including an economic entity) in respect of which it is reasonable to expect the existence of users dependent on general purpose financial reports for information which will be useful to them for making and evaluating decisions about the allocation of scarce resources;

"revenues" means inflows or other enhancements, or savings in outflows, of service potential or future economic benefits in the form of increases in assets or reductions in liabilities of the entity, other than those relating to contributions by owners, that result in an increase in equity during the reporting period; and

"subsidiary" means an entity which is controlled by a parent entity.

Employees, employers and employee entitlements

COMMENTARY

- 11 For the purposes of this Standard, an "employee" is defined to encompass all natural persons who are appointed or engaged under a contract of service. Independent sub-contractors and other natural persons who are appointed or engaged under a contract for services and who are not subject to the direction of the employer in respect of the manner of execution of those services are not "employees" for the purposes of this Standard. In addition, entities that are not natural persons are not "employees" for the purposes of this Standard.
- 12 This Standard applies to accounting for all types of employee entitlements, whether or not they are specifically referred to in this Standard. Expenses which are consequential to the employment of employees, but which are not the entitlements of employees, such as payroll tax and other similar on-costs, should also be recognised as liabilities and expenses where the employee entitlements to which they relate have been recognised as liabilities and expenses in accordance with this Standard. For example, where the settlement of employee entitlement liabilities, such as long service leave, will give rise to the payment of employment on-costs, such as payroll tax, a liability should be recognised for those on-costs as well as for the employee entitlements.

Recognition of Employee Entitlement Expenses, Liabilities, Assets and Revenues

STANDARDS

- 13 **Employee entitlement expenses, liabilities, assets and revenues shall be recognised when, and only when:**
- (a) **they are capable of being measured reliably; and**
 - (b) **in respect of:**
 - (i) **expenses, it is probable that the consumption or loss of service potential or future economic benefits has occurred;**
 - (ii) **liabilities, it is probable that settlement will be required;**

- (iii) **assets, it is probable that the service potential or future economic benefits will eventuate; or**
- (iv) **revenues, it is probable that the inflow or other enhancement or saving in outflows of service potential or future economic benefits has occurred.**

COMMENTARY

- 14 As employers consume employees' services, an obligation to compensate employees for those services, and thus an expense of the employer, usually arises. These expenses will normally result in either cash outflows in the current reporting period or, if they have not been paid as at the reporting date, liabilities of the employer.
- 15 Some employee entitlements that are paid or become payable during the reporting period (such as wages, salaries and associated costs) may give rise to service potential or future economic benefits and thus qualify for recognition as assets rather than as expenses. For example, Australian Accounting Standard AAS 2 "Measurement and Presentation of Inventories in the Context of the Historical Cost System" requires employee entitlement costs, such as wages and salaries, to be included when determining the cost of the asset "work in progress". This is because labour costs associated with work in progress represent part of the cost of acquiring the service potential or future economic benefits embodied in those assets. The consumption of the service potential or future economic benefits associated with the work in progress, and therefore the expense, will not occur until the work in progress is converted to finished goods and subsequently sold.
- 16 Employee entitlement liabilities need not arise solely from legal obligations. Employee entitlement liabilities arising from equitable or constructive obligations may also qualify for recognition. For example, an employer's long service leave liability usually comprises both legal and constructive components, as discussed in paragraphs 36 to 38.
- 17 In addition to satisfying the definition of liabilities in paragraph 10, for employee entitlement liabilities to be recognised it must be probable that settlement will be required and that the liabilities can be measured reliably. In some instances, such as wages, salaries and annual leave, settlement in relation to each employee will usually be required. However, where employee entitlements vest over a number of reporting periods assessing the probability of settlement will be more complex. Liabilities which involve multiple individual employee claims with

differing probabilities of settlement, such as long service leave, should be considered on a group basis, rather than on the basis of individual claims. Using this basis and information about the history of employees remaining in the entity's employ for the period of time necessary to qualify for long service leave, a reliable measure of the employer's liability for long service leave can usually be determined.

- 18 Revenues arise in relation to employee entitlements in the rare circumstances where a related liability (or part thereof) is forgiven, or where a reassessment of a related liability results in the amount of that liability decreasing from one reporting date to the next. For example, where an employer's long service leave liability decreases from one reporting date to the next because of a change in circumstances, such as a significant reduction in the size of the workforce, revenues in the form of savings in estimated future cash outflows would arise.
- 19 In addition to satisfying the definition of revenues in paragraph 10, for employee entitlement revenues to be recognised it must be probable that inflows or other enhancements or savings have occurred and that the revenues can be measured reliably. Assessments of the probability of revenues having arisen will usually be straightforward and will be linked to the recognition of decreases in employee entitlement liabilities. Paragraph 56 of this Standard requires revenues and expenses arising out of some employee entitlement types to be disclosed on a net basis.
- 20 It is expected that the use of appropriate estimation techniques will usually provide measurements which are sufficiently reliable to meet the recognition criteria.

Measurement of Liabilities, Expenses, Assets and Revenues

STANDARDS

- 21 **Liabilities which arise in respect of:**
- (a) **wages and salaries, annual leave and sick leave regardless of whether they are expected to be settled within twelve months of the reporting date; and**
 - (b) **other employee entitlements expected to be settled within twelve months of the reporting date;**

shall be measured at their nominal amounts.

- 22 **Subject to paragraph 21, employee entitlement liabilities shall be measured as the present value of the estimated future cash outflows to be made by the employer in respect of services provided by employees up to the reporting date.**
- 23 **In measuring liabilities in accordance with paragraph 22, the interest rates attaching, as at the reporting date, to the appropriate national government guaranteed securities shall be used to discount estimated future cash outflows. The national government guaranteed security rates used shall be those attaching to securities which have terms to maturity that match, as closely as possible, the terms of the related liabilities.**

COMMENTARY

- 24 The nominal basis of measurement has been specified for those employee entitlement liabilities which are expected to be settled within twelve months of the reporting date and also for wages and salaries, annual leave and sick leave. The nominal basis of measurement uses remuneration rates current as at the reporting date and does not discount cash flows to their present value. For other employee entitlement liabilities, this Standard specifies the present value basis of measurement. Where the present value basis of measurement is required to be used, factors which increase estimated future cash outflows in respect of present obligations, such as future increases in remuneration rates, should be taken into account since they constitute part of the ultimate amount which the employer has a present obligation to pay to employees as a result of employees' services up to the reporting date.
- 25 The portion of the increase in the liability for employee entitlements from the previous reporting date to the current reporting date which is due to discounted employee entitlements not yet settled being one period closer to settlement, conceptually, ought to be recognised as interest expense of the current reporting period. However, the view adopted in this Standard is that the cost of distinguishing that component of the increase in employee entitlement liabilities exceeds the benefit that may be gained from reporting it separately as interest expense. Accordingly, such an increase is to be included in employee entitlement expenses for the current reporting period.

- 26 This Standard requires estimated future cash outflows to be discounted to present value when measuring certain employee entitlement liabilities. Conceptually, the rates used to discount estimated future cash outflows to present value for the purposes of measuring liabilities should be market-determined, risk-adjusted discount rates. However, the position adopted in this Standard is that in view of the difficulty of determining reliably market-determined, risk-adjusted discount rates in respect of employee entitlement liabilities, it is appropriate to specify more precisely the rates which should be used. Accordingly, this Standard requires use of the rates attaching to national government guaranteed securities for discounting estimated future cash outflows to their present value.
- 27 National government guaranteed securities means any securities guaranteed by the appropriate national government, including bonds issued by national government instrumentalities which are guaranteed by the national government. Rates attaching to these securities may be determined in either the primary or secondary markets for those securities and should be rates current in those markets as at the reporting date. This will enable rates to be determined by reference to securities with terms to maturity which match closely the terms of the estimated future cash outflows being discounted.
- 28 In Australia, national government guaranteed securities means Commonwealth Government guaranteed securities. In determining the employee entitlement liabilities of subsidiaries which are situated in foreign countries, the rate used to discount estimated future cash outflows to present value shall be the rate attaching to the national government guaranteed securities of the appropriate foreign countries.
- 29 This Standard requires all employee entitlement liabilities to be measured as at each reporting date. This requirement reflects the need to report reliably on liabilities as at the reporting date and on expenses and revenues for the reporting period.
- 30 This Standard sets out the principles to be applied in accounting for employee entitlements rather than the specific computational means of applying those principles. The use of estimation techniques in measuring expenses, liabilities, assets and revenues is acceptable where the resultant information can be relied upon to represent faithfully, without bias and undue error, the underlying transactions or events.

Wages, salaries and annual leave

COMMENTARY

- 31 Wages and salaries (including "non-salary" components of a wage or salary package, such as payments by the employer of an employee's personal expenses and the related fringe benefits tax) and entitlements for annual leave (including annual leave loadings) arising from the services rendered by employees during the reporting period would generally satisfy the recognition criteria for expenses set out in paragraph 13, except for those circumstances set out in paragraph 15 where employee entitlement costs would be recognised as an asset. This is because employees obtain their entitlement to wages, salaries and annual leave as they provide their services.
- 32 The component of wages, salaries and annual leave entitlements arising from services rendered by employees during the reporting period that is not paid as at the reporting date would satisfy the recognition criteria for liabilities set out in paragraph 13.

Non-monetary benefits

COMMENTARY

- 33 An employer may provide employee entitlements in the form of non-monetary benefits. Such benefits may take the form of free or subsidised goods or services. In most circumstances, employees' rights to non-monetary benefits do not accrue in proportion to their periods of service and do not accumulate. Usually, the right to receive those benefits in each period exists irrespective of the duration of service provided by employees. In such circumstances, an employer would recognise the expense associated with providing the benefits in the period during which the benefits are taken by employees. A liability would not be recognised for any benefits which the employees do not take during the period.
- 34 In other circumstances, employees' entitlements to non-monetary benefits may vest and/or accumulate over a number of periods. To the extent that employees' entitlements to non-monetary benefits are accumulating and have not been settled as at the reporting date, those entitlements will satisfy the definition of liabilities and expenses set out in paragraph 10. In such cases, the amount recognised as liabilities should be determined on the basis of the net marginal cost (if any) to

the employer of the benefits expected to be provided. This will require employers to recognise expenses for accumulating non-monetary benefits in the reporting periods during which employees accumulate those entitlements and not in the reporting periods during which the benefits are paid. Where the goods or services have been purchased from other entities, the net marginal cost will be the cost of the acquired goods or services less any amount expected to be paid or payable by employees. For example, if a retailer (employer) has a present obligation to provide discounted merchandise to employees as a result of their service to date, the amount recognised as liabilities would be the expected cost of the goods to the employer less any amount expected to be paid by employees for those goods. In respect of benefits such as low-interest or interest-free loans to be provided to employees, the amount recognised as liabilities would be based on the expected marginal cost to the employer of borrowing those funds, less the expected interest charged to employees. Where goods or services that the employer produces or manufactures (for example, motor vehicles) are to be sold to employees at a discount, the amount recognised as liabilities will be based on marginal production costs less amounts expected to be paid or payable by employees.

Long service leave

COMMENTARY

- 35 Whilst differences exist between the various Acts and Awards specifying long service leave entitlements in Australia, the following entitlement categories are common:
- (a) an unconditional legal entitlement to payment arises after a qualifying period of service (usually ten or fifteen years). Accumulation of long service leave entitlement continues after this point, until the leave is taken. This entitlement is termed the "unconditional" entitlement category in this Standard;
 - (b) in certain circumstances (for example, death, retrenchment or early retirement under some Awards), a legal entitlement to pro rata payment in lieu of long service leave arises (in some circumstances, after a qualifying period of service). This entitlement is termed the "conditional" entitlement category in this Standard; and

- (c) no legal entitlement to any payment or leave exists before the accumulation of the period of service necessary to qualify for the entitlement described in (b) above. This entitlement is termed the "pre-conditional" entitlement category in this Standard.

At any point in time, an employer will usually have employees in more than one of the above categories.

- 36 To the extent that they are expected to result in future cash outflows of an employer, long service leave entitlements accumulated by employees in the unconditional, conditional and pre-conditional entitlement categories during the reporting period will satisfy the definition of expenses set out in paragraph 10. This is because the employer will have consumed employees' services during the period and the entitlement accumulates with the provision of employees' services. Also, the component of the expense not settled as at the reporting date will usually satisfy the definition of liabilities set out in paragraph 10, since the employer has a present obligation to make future cash outflows as a result of consuming employees' services.
- 37 As well as satisfying the definitions of expenses and liabilities, unconditional entitlements will usually satisfy the probability criterion for recognition in paragraph 13. That is, in the case of expenses, the consumption of employees' services has occurred, and in the case of liabilities, it will be probable that settlement of the unpaid component of the unconditional entitlement will occur. Reliable measurement of the unconditional entitlement will usually be straightforward.
- 38 In respect of the long service leave entitlements accumulated by employees in the conditional and pre-conditional categories, it will usually be appropriate to estimate the amount of cash outflows required to be made by the employer in the future on a group basis, rather than on the basis of individual employees. As discussed in paragraph 17, estimates based on an employer's experience with appropriately determined groups of employees will usually enable reliable measurement of the employer's liability in relation to conditional and pre-conditional long service leave entitlements.
- 39 It will often be possible for employers to estimate the present value of the future cash outflows associated with their long service leave liabilities by using "short-hand" measurement techniques. For example, past experience may indicate that accrual of an employer's long service leave liability based on remuneration rates current as at the reporting

date for all employees with five or more years of service may provide an estimate of the long service leave liability not materially different from the estimate determined by using the present value basis of measurement and detailed group-based estimates.

- 40 While most employers provide long service leave benefits to employees directly, some employers participate in industry-based long service leave schemes. Where an employer has an obligation to contribute to any funding shortfalls of such a scheme, that obligation would satisfy the definition of liabilities set out in paragraph 10. This is because the employer has a present obligation to make future cash outflows as a result of the long service leave scheme arrangements. Accordingly, subject to satisfaction of the recognition criteria for liabilities, an employer's obligations to industry-based long service leave schemes should be recognised as a liability of the employer.
- 41 Some industry schemes operate so that employers directly meet their long service leave obligations to employees, and subsequently receive reimbursement from the scheme for all or part of the payments made to employees. In such cases, employers should recognise separately, as liabilities and assets respectively, the amount of payments expected to be made to employees and the amount expected to be reimbursed by the scheme.

Sick leave

COMMENTARY

- 42 Sick leave entitlements fall into two broad categories:
- (a) vesting sick leave entitlements, which accumulate and vest (whether by agreement or custom) in a similar manner to annual leave entitlements; and
 - (b) non-vesting sick leave entitlements, which may accumulate in a similar manner to annual leave entitlements, but do not vest and are paid only upon a valid claim for sick leave by an employee.
- 43 Vesting sick leave entitlements accumulated by employees during the reporting period will satisfy the definitions of expenses and liabilities, since the employer will have consumed employees' services during the reporting period and entitlements accumulate with the provision of

those services. Thus, vesting sick leave is of the same nature as annual leave.

- 44 In measuring the liability to be recognised for non-vesting accumulating sick leave it will be necessary to recognise as a liability only that component of the entitlements accumulated as at the reporting date that is expected to result in payments to employees. This is because not all accumulated non-vesting entitlements will result in payments being made by the employer.
- 45 As well as satisfying the definitions of expenses and liabilities, both vesting and non-vesting sick leave entitlements will usually satisfy the probability criterion for recognition in paragraph 13. For non-vesting sick leave entitlements, the probability criterion in the case of expenses and liabilities should be assessed on a group basis, rather than on the basis of individual employees.
- 46 An employer's experience with claims for non-vesting sick leave and the use of estimation techniques will usually allow a reliable measurement of the employer's expense and liability to be determined. In some instances, the pattern of sick leave taken may be so stable that the best estimate of the sick leave expense for the reporting period is the amount of sick leave paid during the reporting period. Consistent with the requirements of paragraph 8, the recognition of liabilities in respect of non-vesting sick leave is only required where those amounts are expected to be material.

Post-employment benefits other than superannuation

COMMENTARY

- 47 Employers may undertake to provide to employees forms of post-employment benefits other than superannuation. Post-employment benefits may take various forms, including post-employment medical benefits and retirement, termination, retrenchment or redundancy payments other than superannuation. Where an employer's obligation to provide employees with such benefits results from services rendered by employees up to the reporting date, employees' entitlements to those benefits satisfy the definition of expenses set out in paragraph 10. In addition, to the extent that those obligations have not been settled as at the reporting date, they will meet the definition of liabilities set out in paragraph 10.

Post-employment medical benefits

COMMENTARY

- 48 Employers may provide various forms of post-employment medical benefits to employees. Such benefits may involve the employer in making payments for employees' future health insurance premiums, or may involve the establishment of a medical benefits plan which makes payments to employees for out-of-pocket medical costs. Post-employment medical benefit expenses and liabilities should be recognised over the period of service during which employees become entitled to those benefits. As with long service leave, it will usually be appropriate to estimate the liability for post-employment medical benefit liabilities and expenses on a group basis, rather than on the basis of individual employees. Such estimates, based on an employer's experience with appropriately determined groups of employees, will usually enable reliable measurement of an employer's liability and expense for post-employment medical benefits.

Termination, retirement, retrenchment or redundancy payments

COMMENTARY

- 49 The existence of liabilities relating to retirement, termination, retrenchment or redundancy of employees depends on the existence of a present obligation of the employer as at the reporting date. The existence of a liability which should be recognised in the statement of financial position is dependent upon events which bind the employer to make payments to employees. Where there exists an award, agreement or established custom or practice which provides for retirement, termination, retrenchment or redundancy payments to employees in specified circumstances, the point of time at which the obligation becomes binding on the employer will normally be clear. In such cases, a present obligation of the employer will exist at the point in time at which the employer is bound by the conditions of the award, agreement or established custom or practice to make payments to employees. For example, where retrenchment or redundancy payments are covered by an award and an employer has taken sufficient actions under that award so that employees will be retrenched or made redundant, a present obligation to employees will usually exist. Where there is not a

standing award, agreement or established custom or practice with respect to retirement, termination, retrenchment or redundancy payments, the establishment of the point in time at which the obligation becomes binding on the employer will usually be more difficult to determine. In most cases, a liability should be recognised in the statement of financial position prior to the date at which individual employees will be identified as recipients of such payments. However, the mere intention of an employer to make such payments to employees does not, of itself, create a present obligation to employees which is binding on the employer, and thus there will not exist a liability at the point in time at which the board of directors or other governing body of an employer makes a unilateral decision to undertake a retrenchment or redundancy program. A liability which should be recognised in the statement of financial position will exist when, and only when, the employer is obliged to make such payments to employees. Factors indicative of a present obligation which is binding on the employer may include a negotiated agreement with employees or their representatives and a public announcement by the board of directors or other governing body of the employer.

- 50 In addition to satisfying the definition of liabilities, it must be probable that settlement of liabilities relating to retirement, termination, retrenchment or redundancy payments will be required and that they can be measured reliably. Regardless of whether there exists a standing award, agreement or established custom or practice, liabilities relating to retirement, termination, retrenchment or redundancy payments will usually be probable and be able to be reliably measured at the point in time at which a present obligation comes into existence.

Disclosures

STANDARDS

- 51 **The financial report shall disclose:**
- (a) **the aggregate employee entitlement liability recognised as at the reporting date;**
 - (b) **the aggregate employee entitlement asset recognised as at the reporting date;**
 - (c) **in relation to each type of employee entitlement, details of the nature of liabilities and assets as at the reporting date**

and revenues and expenses for the reporting period that have not been recognised in the financial statements because of a failure to satisfy the condition set out in paragraph 13(a) and the reasons for such non-recognition;

- (d) in relation to each ownership-based remuneration scheme operating during the reporting period:**
- (i) a description of the nature of the scheme, including the number of employees eligible to participate, the groups of employees eligible to participate (if the scheme is not open to all employees), the number and types of shares or other equity interests employees are able to acquire and the exercise date or period during which employees can acquire shares or other equity interests under the scheme;**
 - (ii) the price(s) that employees are to pay for any shares or other equity interests issued under an ownership-based remuneration scheme or, if the price(s) are not determinable as at the reporting date, how such price(s) will be determined;**
 - (iii) the number and types of shares or other equity interests that employees have acquired or have become entitled to acquire under the scheme up to the reporting date, the number and types of shares or other equity interests still available to employees under the scheme as at the reporting date and the market price of those shares or other equity interests as at the reporting date;**
 - (iv) the number and types of shares or other equity interests that have been issued to employees during the reporting period, the total market value of those shares or other equity interests at issue date and the total amount received and/or receivable from employees for those shares or other equity interests; and**
 - (v) details of the employer's accounting policy in respect of ownership-based remuneration schemes, and any amounts recognised in the financial statements in relation to the reporting period; and**

- (e) **in respect of defined benefit superannuation plans sponsored by the employer:**
- (i) **the following information which has been determined in accordance with Australian Accounting Standard AAS 25 "Financial Reporting by Superannuation Plans" and which, in the absence of more recent information, has been determined as at the date of the most recent financial report of the plan:**
 - (A) **for each plan and in aggregate, accrued benefits (including benefits which have accrued since the last measurement date up to the plan reporting date), the net market value of the plan assets and the difference between the two preceding items, and vested benefits; or**
 - (B) **where a public sector entity participates in a multiple employer superannuation plan, and the entity's proportion of the net market value of plan assets cannot be determined reliably, the employer's share of the difference between employees' accrued benefits and the net market value of plan assets;**
 - (ii) **the dates at which amounts required to be disclosed in paragraphs (e)(i)(A) and (B) above were measured; and**
 - (iii) **details of the employer's accounting policy, and any amounts recognised in the financial statements of the employer in relation to the reporting period.**

COMMENTARY

- 52 Employee entitlement costs recognised as part of the cost of other assets, such as work in progress (as discussed in paragraph 15), are not required by paragraph 51(b) to be disclosed as employee entitlement assets.

- 53 The disclosures about ownership-based remuneration schemes are required by this Standard irrespective of the entity within the economic entity in which employees are able to acquire equity.
- 54 This Standard requires entities to disclose, in notes to the financial statements, information about the defined benefit superannuation plans which they sponsor in respect of its employees. These disclosures are required to be determined in accordance with the requirements of Australian Accounting Standard AAS 25 "Financial Reporting by Superannuation Plans". Where an employer sponsors a defined benefit superannuation plan in which two or more entities participate, each entity will be required to determine its proportionate interest in the accrued benefits and plan assets of that plan. An employer's proportionate interest in a multiple employer defined benefit superannuation plan will often be able to be reliably determined by reference to its proportion of total annual contributions to the plan or by reference to its proportion of total plan members. Where the superannuation liabilities of an entity are assumed by another entity (as is often the case, for example, with government departments) the employer does not sponsor the superannuation plan in which its employees participate. Accordingly, in such cases an employer is not required to make the disclosures specified in paragraph 51(e)(i) of this Standard.
- 55 This Standard also requires the disclosure of the accounting policy adopted in respect of ownership-based remuneration schemes and employer sponsored defined benefit superannuation plans and of any amounts relating thereto recognised in the employer's financial statements. It is intended that this Standard will be revised in due course to include requirements with respect to the recognition and measurement of employer sponsored defined benefit superannuation plans and ownership-based remuneration schemes. In the interim, the disclosures required by this Standard will enhance users' understanding of the economic impact of employers' involvement in ownership-based remuneration schemes and in defined benefit superannuation plans.
- 56 Where employee entitlement liabilities have been measured at their present value, users' understanding of the amount of the liabilities recognised would be enhanced if information is disclosed about assumptions adopted in determining the present value. Accordingly, this Standard encourages disclosure of the weighted average of each of:

- (a) the assumed rates of increase in the annual employee entitlements of persons who were employees as at the reporting date, over the periods to settlement of the liabilities;
- (b) the discount rates used to measure liabilities at their present value; and
- (c) the terms to settlement of the liabilities.

Netting of Revenues, Expenses, Assets and Liabilities

STANDARDS

57 **The following revenues and expenses shall be recognised on a net basis:**

- (a) **those arising in respect of wages and salaries, non-monetary benefits, annual leave, long service leave, sick leave and other leave entitlements; and**
- (b) **in respect of those arising within employee entitlement types not specified in paragraph 57(a), only those arising within the same employee entitlement type.**

COMMENTARY

58 Both revenues and expenses may arise within the one employee entitlement type in any one reporting period. For example, in relation to long service leave, one employer within an economic entity may have an increase in its long service leave liability (expense) and another employer within the economic entity may have a reduction in its long service leave liability (revenue). In such cases, the revenues and expenses are to be recognised by the reporting entity on a net basis so that only net revenues or net expenses, as the case may be, will be recognised. Similarly, where an employer has, for example, a revenue arising in respect of long service leave and an expense arising in respect of sick leave, these are to be recognised on a net basis in accordance with paragraph 57(a). However, except for the netting-off of revenues and expenses arising from employee entitlements of the type identified in paragraph 57(a) or within the same type of other employee entitlements as dealt with in paragraph 57(b), the netting-off of revenues and expenses is not permitted. For example, revenues arising

from long service leave are not permitted to be offset against expenses arising from post-employment medical benefits.

- 59 Assets and liabilities arising from different types of employee entitlements should only be netted-off against each other where there exists a right of set-off in accordance with Australian Accounting Standard AAS 23 "Set-Off and Extinguishment of Debt".

Comparative Information

STANDARDS

- 60 **The financial report shall disclose information for the preceding corresponding reporting period which corresponds to the disclosures specified for the current reporting period, except in respect of the following:**
- (a) **the financial report for the reporting period to which this Standard is first applied;**
 - (b) **the first financial report after the establishment of the entity; and**
 - (c) **the first consolidated financial report after the entity becomes a parent entity.**

COMMENTARY

- 61 Paragraph 60(a) does not require disclosure of comparative information, prepared using the accounting policies required to be applied by this Standard, in the financial report for the reporting period to which this Standard is first applied. This relief applies to information required, by this Standard, to be disclosed on the face of the profit and loss or other operating statement or statement of financial position or in notes thereto. Notwithstanding the relief provided by this Standard, paragraphs 16 and 17 of Australian Accounting Standard AAS 6 "Accounting Policies: Determination, Application and Disclosure" are applicable and require disclosure of the nature, reasons and financial effects of changes in accounting policies, including those arising from the initial adoption of an Accounting Standard, which have a material effect on the financial report. In addition, the financial report for the first reporting period to which this Standard is applied would disclose employee entitlement information which is prepared in accordance with

the previous accounting policies adopted in respect of employee entitlements.

Transitional Provisions

STANDARDS

- 62 **Where the accounting policies required by this Standard are not already being applied as at the beginning of the reporting period to which this Standard is first applied, they shall be applied as at that date. Where this gives rise to initial adjustments, the net amount of those adjustments, including any adjustments to deferred income tax balances, shall, in accordance with Australian Accounting Standard AAS 1 "Profit and Loss or other Operating Statements", be adjusted against retained profits (surplus) or accumulated losses (deficiency) as at the beginning of the reporting period to which this Standard is first applied.**

*COMPATIBILITY WITH
INTERNATIONAL AND NEW ZEALAND ACCOUNTING STANDARDS*

International

The scope of this Standard differs from International Accounting Standard IAS 19 "Accounting for Retirement Benefits in the Financial Statements of Employers" issued by the International Accounting Standards Committee. IAS 19 does not deal with employee entitlements such as wages and salaries, annual leave, sick leave or long service leave.

Furthermore, IAS 19 specifies recognition, measurement and disclosure requirements in respect of employer sponsored retirement benefit plans. This Standard specifies only disclosure requirements with respect to employer sponsored defined benefit superannuation plans. It is intended that this Standard will be revised to include requirements in respect of employers' accounting for superannuation.

New Zealand

No corresponding accounting standard on accounting for employee entitlements has been issued in New Zealand. However, the New Zealand Society of Accountants has issued Financial Reporting Standard FRS-30 "Reporting Share

Ownership Arrangements Including Employee Share Ownership Plans" which requires more detailed disclosures about ownership-based remuneration schemes than does this Standard. For example, FRS-30 requires comprehensive disclosures about the nature and funding arrangements of ownership-based remuneration schemes, and the assets, liabilities, revenues and expenses arising from such schemes. However, in common with this Standard, FRS-30 does not specify recognition and measurement requirements in relation to ownership-based remuneration schemes. As explained in the preface, the Australian Accounting Standards Board and the Public Sector Accounting Standards Board intend to develop more comprehensive accounting standards for ownership-based remuneration schemes.

DEVELOPMENT OF THE STANDARD

This section does not form part of the Standard or commentary thereon. It is only a summary of the development of the Standard and the Boards' consideration of the key issues dealt with in the Standard.

- 1 The issue of this Standard follows consideration of the responses received on Exposure Draft ED 53 "Accounting for Employee Entitlements", which was prepared by the Public Sector Accounting Standards Board (PSASB) of the Australian Accounting Research Foundation and by the Australian Accounting Standards Board (AASB) and released in August 1991. In addition, responses to a Public Hearing on the "Present Value Measurement of Employee Entitlement Liabilities and its Implications for the Measurement of Other Items Recognised in Financial Statements" were considered by the Boards before the Standard was finalised.
- 2 The Boards believe that the Standard, and the completion of standards on accounting for an employer's superannuation obligations and ownership-based remuneration schemes, will improve the quality of financial reporting in Australia. Previously, there were no accounting Standards specifically dealing with employee entitlements, and accounting practices of entities have been varied and inconsistent. Accordingly, this Standard will enhance the relevance, reliability, comparability and consistency of information about employee entitlements in general purpose financial reports.

Noteworthy Changes to ED 53

- 3 In addition to the exclusion of requirements for the recognition and measurement of an employer's superannuation obligations (as discussed in the preface to this Standard), a number of noteworthy changes have been made to the proposals in ED 53. These are explained below.
- 4 Notwithstanding the Boards' retention of the present value basis of measurement for long-term employee entitlement liabilities, the Boards noted and concurred with the concerns of some respondents to ED 53 and the Public Hearing regarding the adoption of this measurement basis in all circumstances. In particular, the Boards concurred with the view that requiring liabilities that are usually short-term in nature (such as wages and salaries, annual leave and sick leave) to be measured at their present value is not justified on the basis of perceived costs and benefits, regardless of whether they are expected to be settled within

twelve months of the reporting date. The Boards also acknowledge that in overseas standard-setting jurisdictions, employee entitlement liabilities of this nature are not required to be measured at their present value. Accordingly, the Boards have exempted the above-mentioned employee entitlement liabilities, and any employee entitlement liabilities expected to be settled within twelve months of the reporting date, from the requirement to be measured at their present value.

- 5 The Boards noted the concerns of respondents to ED 53 and the Public Hearing about the ED 53 proposal for "current, market-determined, risk-adjusted discount rates" to be used when measuring employee entitlement liabilities at their present value. Most respondents were concerned with the difficulty of reliably determining such rates. Many respondents indicated that the specification of some form of "risk-free" or "benchmark" rates would alleviate concerns about the reliability of the rates used by entities to discount estimated future cash outflows to present value. The Boards concurred with this view and decided that requiring discount rates to be determined by reference to the rates attaching to government guaranteed securities would result in more reliable estimates of employee entitlement liabilities.
- 6 A number of other less significant changes were made to the ED 53 proposals:
 - (a) the definition of "employee" has been narrowed to "... a natural person appointed or engaged under a contract of service ..." from the definition proposed in ED 53 of "... a natural person who receives benefits in exchange for services provided to an employer". The Boards have made this change as a response to concerns that the ED 53 definition was too wide and would encompass employers' transactions with sub-contractors and others who were not normally perceived to be employees;
 - (b) commentary in the Standard regarding accounting for non-monetary benefits, non-vesting sick leave, long service leave, medical benefits and retirement, termination, retrenchment and redundancy payments has been clarified as a result of feedback from respondents to ED 53; and
 - (c) the disclosures required by the Standard are significantly less extensive than those proposed in ED 53. Many respondents to ED 53 expressed the view that some of the disclosures proposed by ED 53 were not warranted on a cost/benefit basis.

The Boards have accepted this view and have revised the disclosure requirements of the Standard accordingly.

Principal Features of ED 53 Retained in the Standard

- 7 The Standard has retained the essential features of ED 53. The definitions of liabilities, expenses, assets and revenues form the general platform of the Standard's requirements. The Boards are of the view that this is necessary in order to ensure that Accounting Standards which deal with the recognition of liabilities, expenses, assets and revenues (as this Standard does) adopt appropriate and consistent definitions of, and recognition criteria for, those elements.
- 8 Consistent with the definitions of, and recognition criteria for, the elements adopted in ED 53, this Standard requires that employees' entitlements to such benefits as wages and salaries, annual leave, sick leave, long service leave, medical benefits and retirement, termination, retrenchment and redundancy payments be recognised as liabilities where those entitlements have arisen as a result of services rendered by employees up to the reporting date. The Boards are of the view that a failure to require the recognition of such items as liabilities where they are expected to result in future cash outflows, even though those entitlements may not be legally vested to employees as at the reporting date, would result in the understatement of entities' financial obligations.
- 9 The Boards have also retained, in a modified form, the requirement for certain long-term employee entitlement liabilities, including long service leave liabilities and post-employment medical benefits, to be measured using the present value basis of measurement. Commentary is included in the Standard to indicate that "short-hand" measurement techniques may be used to determine the amounts of liabilities recognised, providing that use of such techniques does not result in amounts being recorded which differ materially from those which would be determined using the present value basis of measurement.
- 10 The Standard will not require a change to current accounting practice in respect of the measurement of long-term liabilities in many cases. Many employers which offer post-employment medical benefits to employees currently measure their liabilities for these at present value. Employers currently apply "short-hand" measurement techniques such as the one set out in commentary paragraph 39 to determine their liability for long service leave. In many cases, the amounts of liabilities

determined using these techniques will not differ materially from those which would be determined using the present value basis of measurement, and the techniques will continue to be applied.

- 11 Pronouncements dealing with long-term employee entitlement liabilities which have been issued by standard-setting bodies in overseas jurisdictions require application of the present value basis of measurement as follows: in the United States of America, SFAS 87 "Employers' Accounting for Pensions" and SFAS 106 "Employers' Accounting for Post-Retirement Benefits Other than Pensions"; in the United Kingdom, SSAP 24 "Accounting for Pension Costs"; and in Canada, Section 3460 "Pension Costs and Obligations". Entitlements to long service leave do not exist in these jurisdictions, and accordingly there are no pronouncements which specifically deal with this type of entitlement.
- 12 The Boards are of the view that long service leave is an entitlement which is long-term in nature and should, in principle, be accounted for in a manner consistent with other long-term entitlements. This approach is supported in International Accounting Standard IAS 19 "Accounting for Retirement Benefits in the Financial Statements of Employers" which states that where the characteristics of benefits other than pension benefits, including long service leave benefits, have characteristics similar to pension benefits, they should be accounted for in a similar manner.