Basic Principles of IAS 19

The cost of providing employee benefits should be recognised in the period in which the benefit is earned by the employee, rather than when it is paid or payable.

Short –term employee benefit

For short-term employee benefits (those payable within 12 months after service is rendered, such as wages, paid vacation and sick leave, bonuses, and non-monetary benefits such as medical care and housing), the undiscounted amount of the benefits expected to be paid in respect of service rendered by employees in a period should be recognised in that period. [IAS 19.10] The expected cost of short-term compensated absences should be recognised as the employees render service that increases their entitlement or, in the case of non-accumulating absences, when the absences occur. [IAS 19.11]

Profit sharing bonus payment

The enterprise should recognise the expected cost of profit-sharing and bonus payments when, and only when, it has a legal or constructive obligation to make such payments as a result of past events and a reliable estimate of the expected cost can be made. [IAS 19.17]

The ***obligations*** and the ***costs*** have to be determined by utilising the Projected Unit Credit Method. No other method is allowed. The valuation of the obligations has usually to be performed yearly.

Where the plans are funded, the ***assets*** have to be valued yearly at fair value, being the market value at the balance sheet date or, if such value is not available, an appropriate surrogate such as the present value of future cash flows from the assets should be used.

Actuarial gains and losses, represented by the difference between the actuarial assumptions and the actual figures for the assets and liabilities, may be recognised if they fall outside a certain limit known as the "corridor". If they do not fall outside such limit, they are described as unrecognised, which means in practice that they are deferred.

IAS 19 also encompasses not only retirement benefits but also post-employment benefits such as health care benefits and termination benefits. Such benefits may also have to be computed on the basis of actuarial methods.

Defined Benefit Plans, both funded and unfunded, which encompass the following categories:

- retirement benefits, final salary plans or flat salary plans,
- medical benefits,
- end of service indemnities, long service benefits or deferred compensation,
- compensated leave.

Defined Benefit Plan

There is a Defined Benefit Plan when the company has a legal or contractual obligation to assume certain benefits in favour of its employees. Such benefits consist of retirement benefits, medical benefits and end of service benefits. Defined Benefit Plans are subject to actuarial calculations. For defined benefit plans, the amount recognised in the balance sheet should be the present value of the defined benefit obligation (that is, the present value of expected future payments required to settle the obligation resulting from employee service in the current and prior periods), as adjusted for unrecognised actuarial gains and losses and unrecognised past service cost, and reduced by the fair value of plan assets at the balance sheet date. [IAS 19.54]

Defined Contribution Plan

In contrast, where the company has not guaranteed any fixed payments to the employees, the plans have the characteristics of Defined Contribution Plans. They are subject to reporting requirements of key data at year-end only. Social security plans are usually treated as Defined Contribution Plans. Under a defined contribution plan, the enterprise pays fixed contributions into a fund but has no legal or constructive obligation to make further payments if the fund does not have sufficient assets to pay all of the employees' entitlements to post-employment benefits. For defined contribution plans (including multi-employer plans, state plans and insured schemes where the obligations of the employer are similar to those arising in relation to defined contribution plans), the cost to be recognised in the period is the contribution payable in exchange for service rendered by employees during the period. [IAS 19.44]. If contributions to a defined contribution plan do not fall due within 12 months after the end of the period in which the employee renders the service, they should be discounted to their present value. [IAS 19.45]

Funded versus Unfunded Plan

A plan is said to be funded when a company pays contributions to a distinct legal entity (generally a trust or a foundation) to cover the fund's actuarial liabilities. Funded Defined Benefit Plans' net liabilities (assets), taking into account unrecognised actuarial gains or losses and unrecognised past service costs of non-vested benefits, however need to be reflected as liabilities or assets in the company's balance sheet.

A plan is said to be unfunded when no contribution is paid to a distinct legal entity. The actuarial liabilities are recognised as liabilities in the company's balance sheet. It means that the company should, at a certain point in time, utilise some of its assets to discharge its pension obligation.

Defined benefit and defined contribution plans can be either funded or unfunded plans.

In Defined Contribution Plans, the contributions of the company and of the employee are fixed, normally as a percentage of salary. The annual cost can be easily monitored, but benefits bear no fixed relationship to salary and years of service. The employees bear the entire financial and actuarial risk.

Explanation of the items:

Current service cost: This is the increase in the present value of the obligations that results from employee service during the period under review, based on the actuarial assumptions at the beginning of the reporting period. This item relates to the cost before the deduction of any employee contributions and it does not include interest cost.

Interest cost: As a matter of simplification, interest cost is calculated automatically based upon the present value of liabilities and the discount rate at 1 January.

Costs of curtailments or settlements: This refers to the additional cost of material changes due to, for example, the closure or the sale of a part or all of the employer's business or early retirement arrangements implemented at the request of the company.

Total past service costs: i.e. any costs of plan benefits amendments made during the year. These costs must be split into those of vested benefits and those of non-vested benefits.

Actuarial gains or a loss on Liability is a balancing figure obtained from subtraction of all the above items from the Present Value of Liability at 31 December.
Actuarial gains or losses consist of:
(a) experience adjustments; and
(b) the effects of changes in actuarial assumptions.

Experience adjustments reflect actuarial gains or losses that stem from *differences* between what was *expected* from actuarial assumptions and what has been actually *observed*. In other words, experience adjustments give an idea of how accurate actuarial assumptions were.

Experience Adjustments on Plan Assets refer to the difference between the expected return on plan assets and the actual return on plan assets. The return on plan assets consists of interest, dividends and other revenue derived from the plan assets, together with realised and unrealised gains or losses on the plan assets, less any costs of administering the plan and less any tax payable by the plan itself.

The *effects of changes in actuarial assumptions on Liability* arise due to a change in actuarial assumptions from one year to another (e.g. change of mortality tables, change of the discount rate).
The difference between actuarial gains or losses on liability and the effects of changes in actuarial assumptions on liability represents experience adjustments. *Experience Adjustments on Liability* refers to the difference between the expected actuarial assumptions and what has been observed. In other words, *Experience Adjustments on Liability* are the balancing figure needed to link Present Value of Liability at 1 January (PVL_{boy}) to Present Value of Liability at 31 December (PVL_{eoy}) :

(PVL_{eoy}) = PVL_{boy}
+ service cost
+ interest cost
+ cost of curtailments or settlements
+ total past service cost
– benefits paid
+/- experience adjustments on liability
+/- change of assumptions

Curtailment and Settlement

Curtailment occurs when an enterprise is demonstrably committed to making a material reduction in the number of its employees covered by a plan or amends the term of a plan such that a material element of future service by current employees will qualify for no or reduced benefit

Settlement occurs when an employee leaves the enterprise for a new job and he is being paid out of the plan. Under a settlement, the enterprise enters into a transaction to eliminate the obligation for part or all of the benefit under a plan.
It is possible to have curtailment with or without a settlement.

Accounting Treatment:

Gains and losses arising on a curtailment should be recognised when the curtailment and settlement occurs. This will be the difference between the fair value of the plan assets paid out and the reduction in the present value of the defined benefit obligation. It also includes any unrecognised actuarial gains and losses and past costs in respect of the transaction.

Illustration:

During the year the directors of Rod decided to form a defined benefit pension scheme for the employees of the holding company and contributed cash to it of $100 million. The following details relate to the scheme at 30 November 2002:

	$m
Present value of obligation	130
Fair value of plan assets	125
Current service cost	110
Interest cost – scheme liabilities	20
Expected return on pension scheme assets	10

The only entry in the financial statements made to date is in respect of the cash contribution which has been included in Rod's trade receivables. The directors have been uncertain as how to deal with the above pension scheme in the consolidated financial statements because of the significance of the potential increase in the charge to the income statement relating to the pension scheme. They wish to immediately recognize any actuarial gain.

Required: Show how the defined benefit pension scheme should be dealt with in the consolidated financial statements.

Suggested Solution

The accounting treatment of the defined benefit pension scheme under IAS 19 'Employee Benefits'

The income statement will be charged with the following:

	$m
Current service cost	110
Interest cost	20
Expected return on assets	(10)
	120

	$m
Scheme assets	
Cash contributed	100
Expected return on plan assets	10
Actuarial gain	15
Fair value of plan assets	125
Scheme liabilities	
Current service costs	110
Interest cost	20
Present value of obligation	(130)

Net pension liability of $5 million

The IAS requires a portion of the unrecognised gains and losses at the end of the previous reporting period to be recognised either using the 10% corridor approach, or another systematic method including immediate recognition. The company, therefore, does not have to recognise the actuarial gains ($15m) as there were no opening gains but in view of the significance of the extra charge for the pension scheme in the income statement, the immediate recognition of the actuarial gain is the best policy. Where actuarial gains are immediately recognised, they must be charged outside the income statement and in equity. It must be pointed out that this practice of immediate recognition would lead to volatility in reported earnings so clear and concise disclosure of the practice needs to be made so that analysts may adjust their statistics if they so wish. Thus shareholders' funds fall by $105 million ($m (120 – 15)) and the cash contribution is taken out of Rod's trade receivables. The pension liability in the balance sheet will be reported as $5 million under the 'net approach'.

Practical Exercise

IAS 19 – Employee benefits – is applied to all employee benefits other than those to which IFRS 2 – Share-based payment – applies. Accounting for short-term employee benefits is relatively straightforward. However, accounting for post-employment benefits can be rather more complex. This particularly applies where post-employment benefits are provided via defined benefit plans.

Required: Explain:

(a) The meaning of post-employment benefits and the manner in which such benefits that are provided via defined contribution plans should be measured and recognised in the financial statements of employers. (3 marks)

(b) Why accounting for post-employment benefits provided via defined benefit plans is more complex than those provided via defined contribution plans in the financial statements of employers. (2 marks)

(c) The amounts that should be included in the financial statements of employers regarding post-employment benefits provided via defined benefit plans (ignore the effect of actuarial gains and losses at this stage). (6 marks)

Kappa provides post-employment benefits to its employees through a defined benefit plan. The following data relates to the plan:

	Year ended 31 March	
	2009	2008
	$'000	$'000
Present value of obligation at year end	36,000	33,000
Fair value of plan assets at year end	31,000	30,000
Current service cost	6,000	5,700
Benefits paid by plan	8,000	7,500
Contributions paid into plan	5,800	5,600
Discount rate at the start of the year	10%	9%
Expected rate of return on plan assets at the start of the year	7%	6%
Average remaining service lives of participating employees	20 years	20 years

On 1 April 2008 Kappa had net unrecognised actuarial losses of $4·2 million. Kappa accounts for actuarial gains and losses using the 'corridor method'.

Required:
(d) Prepare extracts from Kappa's statement of financial position at 31 March 2009 and from its income statement for the year ended 31 March 2009 relating to the defined benefits plan. (11 marks)

(e) Explain the various alternatives to the 'corridor approach' that IAS 19 allows for recognising actuarial gains and losses. (3 marks)

Suggested Solution
(a) Post-employment benefits are employee benefits (other than termination benefits) that are payable after completion of employment. Examples of such benefits include lump sum payments on completion of employment and ongoing cash sums payable on a monthly basis in the form of a pension. Such benefits are often (but not necessarily) payable via post-employment benefit plans. Where such plans are defined contribution plans the obligation of the entity is limited to the amount that it agrees to contribute to the plan. Therefore the related employee benefit is measured at the amount of contributions payable by an entity (and perhaps also the employee) to the fund. Unless another standard requires or permits the inclusion of the benefits in the cost of an asset the benefits should be recognised as an expense in the income statement. Any unpaid or prepaid contributions should be recognised in the statement of financial position as a liability or an asset.

(b) Where post-employment benefits are provided via defined benefit plans then the basis of measuring the benefit payable differs from defined contribution plans. The benefit is typically based on the length of service and the final salary of the former employee. There is no guarantee that the contributions paid plus associated investment income will be sufficient to fund the benefit payable. In such circumstances the contributing entity has a legal or constructive obligation to provide additional resources to the plan to ensure that the benefit can be paid. In addition these benefits are often payable on a regular basis until the death of the employee. Therefore measuring the cost of the benefit to the contributing entity is a more complex matter.

(c) IAS 19 requires entities to initially focus on amounts in the statement of financial position when accounting for benefits provided via defined benefit plans. The essential principle is that, in the statement of financial position, entities should measure the net obligation to provide benefits based on service provided up to the reporting date. This obligation should be measured at the net of the following amounts:
– The present value of the defined benefit obligation at the reporting date, less;
– Any obligation relating to past service costs that has not yet been recognised as an expense because the relevant benefits have not completely vested, less;
– The fair value at the reporting date of any plan assets out of which the obligations are to be settled directly.
Where the net obligation is negative then IAS 19 allows entities to recognise an asset provided this amount is recoverable either by receiving refunds from the plan or from reducing future contributions that would otherwise be payable to the plan.

The amounts that should be recognised in the income statement as costs (or in certain circumstances in the cost of an asset) are the net of:

– The current service cost.
– Any past service cost.
– The interest cost on the plan obligation.
– The expected return on any plan assets (this is a credit to the income statement).
– The net cost or benefit of any curtailments or settlements.

(d) Extracts from statement of financial position at 31 March 2009

	$'000
Obligation at reporting date	36,000
Fair value of plan assets at reporting date	(31,000)
Unrecognised actuarial losses (W3)	(4,755)
	245

Extracts from income statement – year ended 31 March 2009	$'000
Current service cost	6,000
Interest cost (10% X 33,000)	3,300
Expected return on plan assets (7% X 30,000)	(2,100)
Recognised actuarial losses (W1)	45

Working 1 – Recognised actuarial losses in period	
The corridor limit is 10% x 33,000 =	3,300.
The unrecognised actuarial losses at the start of the year are	4,200.
Therefore the excess is	900.
The amount recognised in income is 900 x 1/20 =	45

Working 2 – Actuarial gains/losses arising in the year	$'000
Net liability at the start of the year (33,000 – 30,000)	3,000
Current service cost	6,000
Interest cost	3,300
Expected return on plan assets	(2,100)
Contributions	(5,800)
Sub-total	4,400
Actuarial loss in the period	600
Net liability at the end of the year (36,000 – 31,000)	5,000

Working 3 – unrecognised actuarial losses at end of the year	$'000
Opening balance	4,200
Recognised in income statement	(45)
Arising in the year (W2)	600
	4,755

(e) IAS 19 allows entities to recognise actuarial gains and losses in the income statement on any rational basis that results in faster recognition than is the case under the corridor method. This could include, for example, immediate recognition of all actuarial gains and losses as they arise, or recognition of any corridor excess immediately, rather than over the average remaining service lives of the employees participating in the plan.

As an alternative to recognising actuarial gains and losses in the income statement, an entity may recognise them as 'other comprehensive income (or expense)' in the statement of comprehensive income. This option is only available where the gains or losses are recognised in the period in which they occur.

IFRS 2 Share Based Payment.

In a share based payment, an enterprise pays a third party for goods or services, either in shares or in share options, or in cash (but the price paid is based on the entity's share price).

IFRS 2 prescribes the financial reporting by an entity when it undertakes a share based payment transaction. It applies to grants of shares, share options or other equity instruments made after 7 November 2002 that had not yet vested at the effective date of the IFRS. However, the standard applies retrospectively to liabilities arising from share based payment transaction existing at the effective date.

The main impact of the standard for companies is to insert cost for a share or share option schemes. This principle has generated a lot of controversies. The opponents of IFRS 2 are of the view that share based payments are cost that never involves outflow of cash. Some even see it as a cost borne by the shareholders directly (through dilution of their stake) and not as a cost to the business.

Argument against IFRS 2 Positions on Recognition of share based payment

1. **No cost, No charge:** The commentators argued that share options are usually at no cost to the company; and therefore, should not be recognised. They further argued that expense arising from share options does not meet the definition of an expense as set out in the "framework" document. Expenses are decreases in economic benefit that arises from outflow of assets, depletion of assets or increases in liabilities. The framework requires an outflow of assets or liabilities to be incurred before an expense is created. Services do not normally meet the definition of an asset and therefore, consumption of these services does not represent an outflow of assets. However, this argument ignores the fact that a transaction has occurred. The employees have provided their services to the enterprise in return for a valuable share or options. The conclusion must therefore be that the recognition of the expense arising from share based payment transaction is consistent with the "framework". Otherwise, the financial statement would fail to reflect the economic transaction that had occurred.

2. **Dual impact on EPS:** The argument here is that the charge to the Income statement for the employee services consumed will reduce the entity's earnings and simultaneously, an increase in the number of shares issue (or to be issued). This argument is not appropriate as the impact of EPS reflects the two economic events that have occurred. The company has issued share options with the subsequent effect in the diluted EPS and it has consumed the resources that it received for awarding those options, thereby decreasing earnings. Those two different effects on EPS are

counted once each. Recognising the transaction ensures that its economic consequences are not reported.

3. **Adverse Economic Consequences:** Recognition of employee share based payment might discourage entities from introducing or continuing employee share plans, since the requirement will reveal the economic consequences of such plans. However, the main reason for the non-continuation of such schemes could be that the true economic consequences of the plan are being revealed rather than the situation where resources are consumed by issue of share options without accounting properly for those transactions. The role of accounting is to report in a neutral manner and not to distort the financial statement.

Accounting for Share Based Payments

Despite the numerous controversies, the concept has gained general acceptance and the question now is, how do we calculate the cost and when do we charge it against profit?

The following three important dates must be identified in respect of a share based payment:

- The Grant Date: the date the scheme is established;
- Vesting Date: the scheme usually come with some certain conditions, e.g., the employees may be entitled to some share options subject to their staying with the company or meeting other conditions like meeting a particular performance target. The date those conditions are fulfilled is the vesting date;
- Exercise Date: This is very common with options. It is the date that option are turned to shares that can be sold for cash

Allocation of cost to accounting periods:

IFRS 2 'Share Based Payment' requires that the cost be based on the fair value of the shares or options at the ***grant date.*** The cost is thereafter spread over the period up to the vesting date and reflects the extent to which performance has been achieved and final number of shares or options issued.

Some equity instruments granted may vest immediately (i.e. the holder is unconditionally entitled to the instrument. Under this circumstance, the transaction should be accounted for in full on the grant date. But where the equity instrument granted do not vest until counterparty completes a specified period of services or fulfilled some certain conditions (a case of vesting period), the cost of the transactions should be recognised over the vesting period.

IFRS 6 – Exploration for and Evaluation of Mineral Resources:

IFRS was issued on 9 December 2004 and effective from 1 January 2006 (earlier application is encouraged) and applies to expenditure incurred by an entity in connection with the search for mineral resources.

The principal objective of IFRS 6 is to limit the need for entities to change their existing accounting policies for exploration and evaluation assets.

The standard permits entities to continue to use their existing accounting policies for exploration and evaluation assets provided that such policies result in information that is relevant and reliable. It also requires such entities to assess an exploration and evaluation for impairment when facts and circumstances suggest that the carrying amount of assets may exceed the recoverable amount. The recognition of impairment in respect of such assets is varied from that in IAS 36 'Impairment of Assets' but once an impairment has been identified, it is measured in accordance with IAS 36.

Scope:
IFRS 6 applies to exploration and evaluation expenditures. These are expenditures incurred by an entity in connection with the exploration fee and evaluation of mineral resources (including minerals, oil, natural gas and similar non-regenerative resources). Affected activities include the search for mineral resources, as well as the determination of the technical feasibility and commercial viability of extracting those resources.

Exemptions:
The following are specifically excluded from the scope of IFRS 6.
-expenditures incurred before the entity has obtained legal rights to in a specific area;
-expenditures incurred after the technical feasibility and commercial viability of extracting a mineral resources are demonstrable.

IFRS 6 – IAS 8

SELECTION OF ACCOUNTING POLICIES
IFRS 6 does not require or prohibit any specific accounting policies for the recognition and measurement of exploration and evaluation assets. Rather, it permits entities to continue to use their existing accounting policies provided they result in information that is relevant to the economic decision-making needs of users and that is reliable (IAS 8 para 10).

Changes in Accounting Policies
Entities may change their accounting policies for exploration and evaluation expenditures if the changes will make the financial statements more relevant to the economic decision-making needs of users and no less-reliable, or more relevant and no less-relevant to those needs, judged using the criteria in IAS 8.

IFRS 6, specifically states that, in order to justify a change in accounting policy, exploration and evaluation expenditures, the entity is required to demonstrate that the change brings its financial statements closer to meeting its criteria in IAS 8. However, the change need not achieve full compliance with those criteria.

Measurement and Recognition: **Assets:** (Initial Measurement)
In the balance sheet, exploration and evaluation of assets are required to be initially measured at cost. The expenditures to be included in the cost of such assets are determined by the entity as a matter of accounting policy which should be applied consistently. Examples include:

1. Acquisition right to explore
2. Topographical, geological, geochemical and geophysical studies.
3. Exploratory drilling,
4. Trenching

5. Sampling
6. Activities in relation to evaluating the technical feasibility and commercial viability of extracting a mineral resource.

Liabilities

Where an entity incures obligations for removal and restoration as a consequence of having undertaken the exploration for and evaluation of mineral resources, those obligations are recognised in accordance with the requirement in IAS 37, Provisions Contingent Liabilities and Contingent Assets.

Subsequent Measurement

For subsequent measurement, entities can apply either the cost model or revaluation model to exploration and evaluation assets.

Where the revaluation model is selected, the rules in IAS 16 are applied to exploration and evaluation of assets classified as tangible assets whilst the rules in IAS 38 are applied to those classified as intangible Assets.

Impairment

IFRS 6 modified the rules for IAS 36 as regards the circumstances in which such assets are required to be assessed for impairment. A detailed impairment test is required in the following two circumstances:

- when the technical feasibility and commercial viability of extracting a mineral resource become demonstrable, at which point the asset s fall outside the scope of IFRS 6 and is reclassified in the financial statement; and
- when fact and circumstances suggests that assets carrying amount may exceed its recoverable amount.

Examples of facts and circumstances included in IFRS 6 are [that may serve as impairment indicator]
-the period for which the entity has the right to explore in the specific area has expired during the period or will expire in the near future, and is not expected to be renewed.
-substantive expenditure on further exploration for the evaluation of mineral resources in the specific area is neither budgeted nor planned.
-exploration for and evaluation of mineral resources in the specific area have not led to the discovery of commercially viable quantities of mineral resources ,and the entity has decided to discontinue such activities in the specific area,
-sufficient data exist to indicate that , although a development in the specific area is likely to proceed, the carrying amount of the exploration and evaluation assets is unlikely to be recovered in full from successful development or by sale.

Presentation and Disclosure:

Entities are required to classify exploration and evaluation assets as tangible or intangible, according to the nature of the assets.
Examples of Tangible assets include: Vehicles, Drilling rigs, e.t.c
Intangible assets include- Drilling rigs
Exploration and evaluation assets will be treated as a separate class of assets for disclosure purposes. The disclosures required by either IAS 16 or IAS 38 should be made consistent with how the assets are classified.

Once the technical feasibility and commercial viability of extracting a mineral resource becomes demonstrable, any previously recognised exploration and evaluation asset falls outside the scope of IFRS 6 and is reclassified in accordance with other relevant standards. The assets should be assessed for impairment, and any impairment loss recognised, before reclassification.

In summary, the following should be disclosed:
-the entity's accounting policies for exploration and evaluation expenditures, including the recognition of exploration and evaluation assets,
- the amounts of assets , liabilities, income and expense and operating and investing cash flows arising from the exploration for and evaluation of mineral resources.

Practice Questions

1. IAS 19 – *Employee benefits* – is a comprehensive standard that deals with the financial reporting of short and long-term employee benefits. The most complex type of employee benefit dealt with in IAS 19 is post-employment benefits. Such benefits are usually provided via a separate plan into which the employer makes contributions. The impact of such arrangements on the financial statements of contributing employers depends on the type of retirement benefit plan.

One of the particularly complex aspects of the standard is the treatment of actuarial gains and losses arising on the measurement of obligations relating to post-employment benefits. IAS 19 allows a number of alternative treatments.

Required:
You are required to provide an explanation of:

(i) The difference between a defined contribution and a defined benefit plan. Your explanation should include an analysis of which party bears the risks attaching to the level of benefits

(ii) The difference, in the financial statements of contributing employers, between the method of accounting for contributions to defined contribution plans and contributions to defined benefit plans.

(iii)The two alternative ways other than the corridor method of reporting actuarial gains and losses arising in respect of defined benefit plans.

The following mark allocation is provided as guidance for this requirement:
(i) 3 marks (ii) 3 marks (iii) 2 marks Total (8 marks)

(b) Omicron prepares financial statements to 30 September each year. Omicron makes contributions to a defined benefit post-employment benefit plan for its employees. Omicron accounts for actuarial gains and losses arising on these arrangements using the corridor method. Relevant data is as follows:

(i) At 1 October 2010 the plan obligation was $35 million and the fair value of the plan assets was $30 million. Unrecognised actuarial losses at that date totalled $6·5 million.

(ii) The actuary advised that the current service cost for the year ended 30 September 2011 was $4 million. Omicron paid contributions of $3·2 million to the plan on 30 September 2011. These were the only contributions paid in the year.

(iii) The expected annual rate of return on plan assets at 1 October 2010 was 5%. The actuary revised this estimate to 4% at 30 September 2011.

(iv) The appropriate annual rate at which to discount the plan liabilities was 6% on 1 October 2010 and 5·5% on 30 September 2011.

(v) The plan paid out benefits totalling $2 million to retired members on 30 September 2011.

(vi) At 30 September 2011 the plan obligation was $41·5 million and the fair value of the plan assets was $32·5 million.

(vii) The average remaining service lives of plan members still in employment was estimated to be 20 years.

Required:
Compute the amounts that will appear in the statement of comprehensive income of Omicron for the year ended 30 September 2011 and the statement of financial position at 30 September 2011 in respect of the post-employment benefit plan.

Note: You should indicate where in each statement the relevant amounts will be presented.
(12 marks) **(20 marks)**

2. Savage, a public limited company, operates a funded defined benefit plan for its employees. The plan provides a pension of 1% of the final salary for each year of service. The cost for the year is determined using the projected unit credit method. This reflects service rendered to the dates of valuation of the plan and incorporates actuarial assumptions primarily regarding discount rates, which are based on the market yields of high quality corporate bonds. The expected average remaining working lives of employees is twelve years.

The directors have provided the following information about the defined benefit plan for the current year (year ended 31 October 2005):

(i) The actuarial cost of providing benefits in respect of employees' service for the year to 31 October 2005 was $40 million. This is the present value of the pension benefits earned by the employees in the year.

(ii) The pension benefits paid to former employees in the year were $42 million.

(iii) Savage should have paid contributions to the fund of $28 million. Because of cash flow problems $8 million of this amount had not been paid at the financial year end of 31 October 2005.

(iv) The present value of the obligation to provide benefits to current and former employees was $3,000 million at 31 October 2004 and $3,375 million at 31 October 2005.

(v) The fair value of the plan assets was $2,900 million at 31 October 2004 and $3,170 million (including the contributions owed by Savage) at 31 October 2005. The actuarial gains recognised at 31 October 2004 were $336 million.

With effect from 1 November 2004, the company had amended the plan so that the employees were now provided with an increased pension entitlement. The benefits became vested immediately and the actuaries computed that the present value of the cost of these benefits at 1 November 2004 was $125 million. The discount rates and expected rates of return on the plan assets were as follows:

	31 October 2004	31 October 2005
Discount rate	6%	7%
Expected rate of return on plan assets	8%	9%

The company has recognised actuarial gains and losses in profit or loss up to 31 October 2004 but now wishes to recognise such gains and losses outside profit or loss in compliance with the IAS 19 – Employee Benefit (Revised)

Required:

(a) Show the amounts which will be recognised in the Statement of Financial Position, Statement of Comprehensive Income, Other Comprehensive Income and Expense of Savage for the year ended 31 October 2005 under IAS19 'Employee Benefits', and the movement in the net liability in the balance sheet. (Your calculations should show the changes in the present value of the obligation and the fair value of the plan assets during the year. Ignore any deferred taxation effects and assume that pension benefits and the contributions paid were settled at 31 October 2005.)
(16 marks)

(b) Explain how the non-payment of contributions and the change in the pension benefits should be treated in the financial statements of Savage for the year ended 31 October 2005.
(4 marks)
Total **(20 marks)**

3. Macaljoy, a public limited company, is a leading support services company which focuses on the building industry. The company would like advice on how to treat certain items under IAS19, 'Employee Benefits' and IAS37 'Provisions, Contingent Liabilities and Contingent Assets'. The company operates the Macaljoy (2006) Pension Plan which commenced on 1 November 2006 and the Macaljoy (1990) Pension Plan, which was closed to new entrants from 31 October 2006, but which was open to future service accrual for the employees already in the scheme. The assets of the schemes are held separately from those of the company in funds under the control of trustees. The following information relates to the two schemes:

Macaljoy (1990) Pension Plan
The terms of the plan are as follows:
(i) employees contribute 6% of their salaries to the plan
(ii) Macaljoy contributes, currently, the same amount to the plan for the benefit of the employees
(iii) On retirement, employees are guaranteed a pension which is based upon the number of years service with the company and their final salary

The following details relate to the plan in the year to 31 October 2007:

	$m
Present value of obligation at 1 November 2006	200
Present value of obligation at 31 October 2007	240
Fair value of plan assets at 1 November 2006	190
Fair value of plan assets at 31 October 2007	225
Current service cost	20
Pension benefits paid	19
Total contributions paid to the scheme for year to 31 October 2007	17

Actuarial gains and losses are recognised in the 'other comprehensive income'.

Macaljoy (2006) Pension Plan
Under the terms of the plan, Macaljoy does not guarantee any return on the contributions paid into the fund. The company's legal and constructive obligation is limited to the amount that is contributed to the fund. The following details relate to this scheme:

	$m
Fair value of plan assets at 31 October 2007 21	
Contributions paid by company for year to 31 October 2007	10
Contributions paid by employees for year to 31 October 2007	10

The discount rates and expected return on plan assets for the two plans are:

	1 November 2006	31 October 2007
Discount rate	5%	6%
Expected return on plan assets	7%	8%

The company would like advice on how to treat the two pension plans, for the year ended 31 October 2007, together with an explanation of the differences between a defined contribution plan and a defined benefit plan.

Warranties
Additionally the company manufactures and sells building equipment on which it gives a standard one year warranty to all customers. The company has extended the warranty to two years for certain major customers and has insured against the cost of the second year of the warranty. The warranty has been extended at nil cost to the customer. The claims made under the extended warranty are made in the first instance against Macaljoy and then Macaljoy in turn makes a counter claim against the insurance company. Past experience has shown that 80% of the building equipment will not be subject to warranty claims in the first year, 15% will have minor defects and 5% will require major repair. Macaljoy estimates that in the second year of the warranty, 20% of the items sold will have minor defects and 10% will require major repair.

In the year to 31 October 2007, the following information is relevant:

	Standard warranty (units)	Extended warranty (units)	Selling price per unit (both)($)
Sales	2,000	5,000	1,000

	Major repair $	Minor defect $
Cost of repair (average)	500	100

Assume that sales of equipment are on 31 October 2007 and any warranty claims are made on 31 October in the year of the claim. Assume a risk adjusted discount rate of 4%.

Required:
Draft a report suitable for presentation to the directors of Macaljoy which:
(a) (i) Discusses the nature of and differences between a defined contribution plan and a defined benefit plan with specific reference to the company's two schemes. (7 marks)
(ii) Shows the accounting treatment for the two Macaljoy pension plans for the year ended 31 October 2007 under IAS19 'Employee Benefits'. (7 marks)
(b) (i) Discusses the principles involved in accounting for claims made under the above warranty provision. (6 marks)
(ii) Shows the accounting treatment for the above warranty provision under IAS37 'Provisions, Contingent Liabilities and Contingent Assets' for the year ended 31 October 2007. (3 marks)

Appropriateness of the format and presentation of the report and communication of advice.
(2 marks)

Total (25 marks)