

# S02.03-EL-02-II.4

## II - Provisions: Specific points and Examples

### 2. Employee Benefits

#### Content

- 2.1. Introduction and categories of employee benefits
- 2.2. Accounting for Post-Employment Benefits
  - 2.2.1. Defined Contribution plans (DC)
  - 2.2.2. Defined Benefit plans (DB)
  - 2.2.3. Defined Benefit Obligation (DBO)
  - 2.2.4. With IAS 19 Revised, applicable as of Jan 2013
- 2.3. Accounting for Termination Benefits
- 2.4. Process Charts
- 2.5. Closing

It covers:

- Request for information IAS 19 quarterly reporting
- Yearly closing - Information required for annual disclosures at Group level

#### 2.1. Introduction and categories of employee benefits

IAS 19 identifies the following categories of employee benefits:

- (a) **Short-Term Employee Benefits**, or employee benefits which fall due wholly within 12 months after the end of the period in which the employees render the related service.  
**Examples:** salaries, bonuses, social security contributions, paid leave and non-monetary benefits for **current** employees such as medical care and cars.  
--> **Recognize costs when services are rendered** (no actuarial valuation, no discounting).

**THIS INSTRUCTION DOES NOT COVER THE ACCOUNTING FOR SHORT-TERM EMPLOYEE BENEFITS (a) BUT WELL THE CATEGORIES (b), (c), and (d) BELOW.**

- (b) **Post-Employment Benefits**, whether funded or not (retirement benefits and other post-employment benefits). Are employee benefits which are payable after the completion of employment.  
**Examples:** pensions, other retirement benefits (e.g. cash balance plans), termination and retirement indemnity plans, post-retirement medical plans, post-employment life insurance.  
Under IAS 19, a post-employment plan is:
  - Defined Benefit (DB), or
  - Defined Contribution (DC)

See note on [Actuarial valuation](#).

- (c) **Other Long-Term Employee Benefits**. Are employee benefits which do not fall due wholly within 12 months after the end of the period in which the employees render the related service.  
**Examples:** jubilee benefits, long-term disability benefits, long-service leave or sabbatical leave, and, if they are payable twelve months or more after the end of the period, profit sharing, bonuses and deferred compensation.  
**Actuarial gains and losses are recognized immediately in P&L under "R53640 - Interest costs - pension & other employee benefits / actuarial gains(losses) on other long-term benefits".**
- (d) **Termination Benefits**. §Are employee benefits payable as a result of either an employer's decision to terminate an employee's employment earlier, or an employee's decision to accept voluntary redundancy in exchange for those benefits.  
**Examples:** benefits payable on restructuring.  
§Where termination benefits fall due more than 12 months after the balance sheet date, they should be discounted.

**Solvay has decided, following the acquisition of Rhodia,**

- **to adopt the "SORIE" method** (Statement Of Recognized Income and Expense):
  - Full recognition of the defined benefits obligation in the balance sheet (except for past service costs)
  - Accounting of actuarial gains & losses on Post employment benefits directly in Equity, instead of amortizing unrecognized actuarial gains & losses in P&L (Underlying EBITDA).
- **to account for the actuarial gains / losses on "Other Long-Term benefits" as financial items in P&L ("R53640 - Interest costs - pension & other employee benefits / actuarial gains(losses) on other long-term benefits").**

**(IAS 19, par 93A)**

*If, as permitted by paragraph 93, an entity adopts a policy of recognising actuarial gains and losses in the period in which they occur, it may recognise them in other comprehensive income, in accordance with paragraphs 93B–93D, providing it does so for: (a) all of its defined benefit plans; and (b) all of its actuarial gains and losses.*

**(IAS 19, par 93B)**

Actuarial gains and losses recognised in other comprehensive income as permitted by paragraph 93A shall be presented in the statement of comprehensive income.

(IAS 19, par 93C)

An entity that recognises actuarial gains and losses in accordance with paragraph 93A shall also recognise any adjustments arising from the limit in paragraph 58(b) in other comprehensive income.

## 2.2. Accounting for Post-Employment Benefits

As said above, under IAS 19, a post-employment plan is

- **Defined Benefit (DB)**, or
- **Defined Contribution (DC)**

| <i>Characteristic</i>                          | <i>DC Plans</i> | <i>DB Plans</i> |
|--|-----------------|-----------------|
| Employer cost equals employer contribution?    | Yes - always    | Virtually never |
| Employer charges employer contribution to P&L  | Yes             | No              |
| Actuarial/accounting calculations are required | No              | Yes             |

For each plan, the qualification as DB or DC needs to be set up.



### Note

Insured plans can be classified as either Defined contribution or Defined benefit plans (IAS 19, par 39). The classification between DB or DC is notified by HR/Payroll & Benefits and the Group Coordinating Actuaries.

### 2.2.1. Defined Contribution plans (DC)

**Definition:** Under IAS 19, the current definition of a Defined Contribution plan is:

***"a post-employment benefit plan under which an enterprise pays fixed contributions into a separate entity (a fund) and will have no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in current and prior periods."***

DC plans are plans for which the company pays fixed contributions into a separate entity or fund, in accordance with the rules of the plan. **Once contributions have been paid, no further obligations exist for the company. A DC is not recognized as a liability.**

#### Observations:

- Just as the name implies, each year's contribution is defined
- Individual participant accounts are established into which annual contributions they are added (must be funded – not just notionally funded)
- Account credited with actual investment return
- Benefit payable at retirement or termination is solely dependent on amount of contributions and investment return
- Employee may have the choice of contribution rate
- Employer may have fixed contributions or may match the employee contributions
- Investment risk is with the employer

#### DC plans - Treatment in Income Statement and Balance Sheet:

DC expense will accrue monthly. Note that, depending on when contributions are paid to the plan, an accrual or prepaid may occur.

**Accrual:** for example if the cash outflows (contributions) to the plan are paid in arrears.

**Prepaid:** for example if the cash outflows (contributions) to the plan are paid in advance.

If there is no accrual or prepaid, no balance sheet entry is necessary.

### 2.2.2. Defined Benefit plans (DB)

**Definition:** Under IAS 19, the current definition of a Defined Benefit plan is:

**"post-employment benefit plans other than defined contribution plans."**

This is to say that all plans not considered as DC plans are deemed to be DB plans. These plans may be unfunded or externally funded with pension funds or insurance companies.

**For DB plans, the employer has a real obligation even if plan assets are not sufficient.**

DB plans are retirement plans where employee benefits are sorted out based on a formula, using factors such as salary history and duration of employment. Actuarial valuation is required for DB plans based on actuarial assumptions.

**Observations:**

- As name implies, benefit payable at retirement is defined, and is often based on:
  - Service,
  - Age at retirement, and
  - Pay
  - Employee contributions may apply and if so they are usually fixed as a percentage of salary
  - Employer contributions must meet the balance of the cost
    - cost to the employer is unknown
    - will heavily depend on variables such as salary inflation, price inflation (for pension increases), employee mortality, employee options and asset returns
    - Investment risk is with the employer

**When is a DC plan NOT a DC plan?**

**A YES answer to ANY of the questions below means that the plan is a DB plan.**

| <i>Characteristic</i>  | <i>Yes/No?</i> |
|--|----------------|
| Is the plan unfunded?  | ?              |
| Are pensions paid as annuities from the fund?  | ?              |
| Are there any guarantees during the accumulation period?<br><ul style="list-style-type: none"> <li>■ Minimum investment returns (including 0%)</li> <li>■ Defined benefit underpins</li> </ul> | ?              |
| Are there any guarantees at retirement?<br><ul style="list-style-type: none"> <li>■ Implicit (or explicit) in the conversion rates</li> </ul>  | ?              |
| Are there any guarantees (or risks) during retirement?<br><ul style="list-style-type: none"> <li>■ Pension increases</li> </ul>  | ?              |

**Examples of DB plans:**

- Final average pay plan
- Career average plan with indexation
- Termination indemnity/retirement indemnity
- Long service awards (e.g. Jubilee plan)
- Cash balance plan
- Post-employment medical
- Post-employment life insurance

### 2.2.3. Defined Benefit Obligation (DBO)

See also [HERE](#)

Are covered, among others, in the above link, the **Net Liability** and the elements that are impacting a change in the Net Liability, i.e.:

- Service cost
- Interest costs
- Expected Return on Plan Assets
- Expected Employer Contributions
- Actuarial Gains and Losses

- "Special Events" (Curtailment, Settlements)

**Recognition of these elements in the P&L:**

| <i>Element</i>                        | <i>Definition</i>  | <i>P&amp;L impact</i>             | <i>Calculation Method</i>  |
|---------------------------------------|--|-----------------------------------|--|
| <b>Service cost</b>                   | Increase in the present value of the defined benefit obligation resulting from employee service in the current period.                               | Recurring EBITDA                  | calculated by the actuary as of 31/Dec/N-1 on the basis of actuarial assumptions (evolution wages rate, pension turnover rate...) at this date |
| <b>Interest costs</b>                 | Increase during a period in the present value of a defined benefit obligation which arises because the benefits are one period closer to settlement. | Financial charges ("R53640") (1)  | calculated by the actuary as of 31/Dec/N-1 on the basis of the discount rate at this date  |
| <b>Expected return on plan assets</b> | Interests, dividends and other products + profits/losses, realized or unrealized related to these assets   | Financial products ("R53650") (2) | calculated by the actuary as of 31/Dec/N-1 on the basis of assumptions of the expected return rate at this date                                |
| <b>Past service cost</b>              | See definition   | Recurring EBITDA                  | calculated by the actuary as of 31/Dec/N-1 on the basis of assumptions of the expected return rate at this date                                |
| <b>Curtailment</b>                    | Impact of the reduction or liquidation of a plan   | Recurring EBITDA / restructuring  | calculated by the actuary when the event takes place   |
| <b>Actuarial gains &amp; losses</b>   | Difference between the expected and the realized (see definition)  | Recurring EBITDA                  | calculated by the actuary as of 31/Dec/N   |

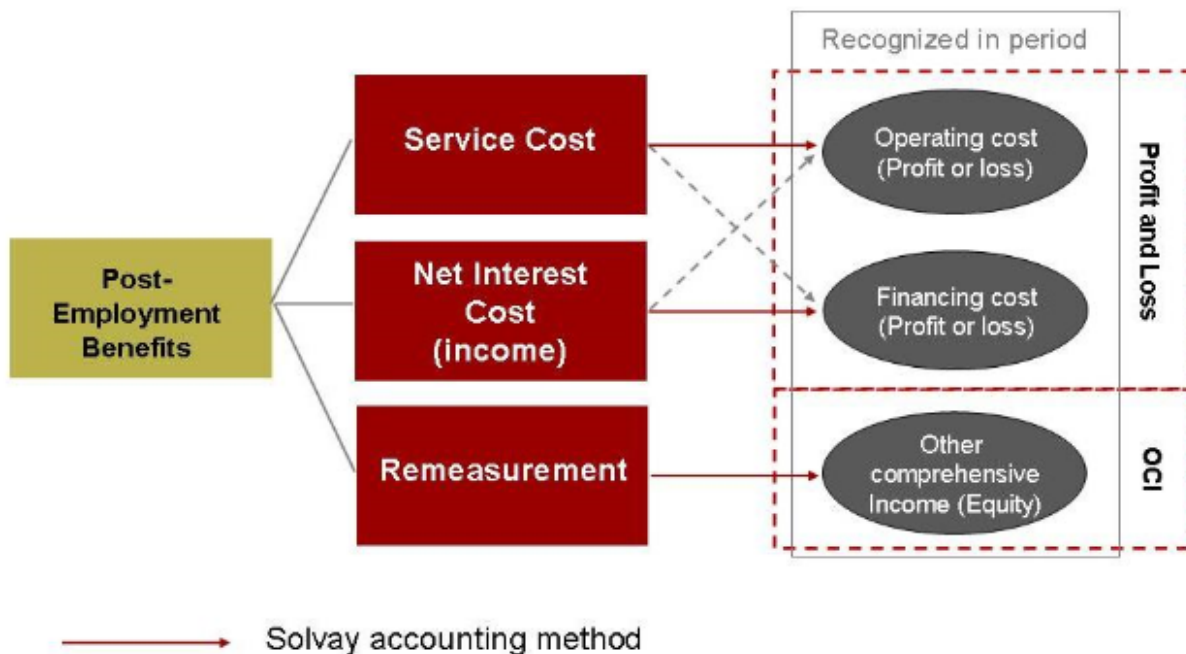
(1) R53640 - Interest costs - pension & other employee benefits / actuarial gains(losses) on other long-term benefits

(2) R53650 - Expected return on plan assets

**2.2.4. With IAS 19 Revised, applicable as of Jan 2013**

- All actuarial gains and losses are recognized in OCI, except for Other Long-Term Employee Benefits and Termination Benefits which continue to be recognized immediately in P&L.
- Removal of Past service cost smoothing mechanism (unvested past service cost amortized over period of vesting). These costs are, as of Jan 2013, immediately recognized in P&L.

Required cost treatment in IAS 19 Revised:



**Service cost: Recognized in Operating Cost**

- Cost of service accruals (no change from current standard)
- Cost for past service modifications
  - Plan amendments: all modifications will be recognized in P&L in the year they occur, **irrespective of vesting**

- Curtailment: a significant reduction by the entity in the number of employees covered by a plan
- **Note that the IASB has formally removed the distinction between curtailment and past service cost**
- Gains and losses from settlements: –All settlements will be recognized immediately in P&L, where a settlement is:
  - a transaction that eliminates all further legal or constructive obligation for part or all of the benefit provided
  - excludes payments of benefits to, or on behalf of, employees that are set out in the terms of the plan and included in the actuarial assumptions (i.e. regular pension and/or lump sum payments)

#### **Net Interest Cost: Recognized in Financing Costs**

- **(IAS 19R, par 123):** Net interest on the net defined benefit liability (asset) shall be determined by multiplying the net defined benefit liability (asset) by the discount rate, both as determined at the start of the annual reporting period, taking in account of any changes in the net defined benefit liability (asset) during the period as result of contribution and benefit payments.
- **(IAS 19R, par 124):** Net interest on the net defined benefit liability (asset) can be viewed as comprising:
  - interest income on plan assets
  - interest cost on defined benefit obligation (DBO)
  - [interest on the effect of the asset ceiling]
- The component represents the time value of money on the deficit / (surplus)
- Defined as the interest on the "**net defined benefit liability (asset)**" as presented in the balance sheet using the discount rate: **DBO – Assets – [Effect of asset ceiling]**

#### **Remeasurement: Recognized in Other Comprehensive Income (Equity)**

- Gains and losses on DBO
- Gains and losses on plan assets: – Difference between expected asset returns measured by discount rate included in "net interest cost" and actual returns (net of investment expenses)
- Any change in the effect of the asset ceiling
- Gains and losses from benefits payments – expected versus actual

#### 2.2.5. Plan changes: Accounting considerations.

## 2.3. Accounting for Termination Benefits

### 2.3.1. Definition

- Employee benefits payable as a result of either:
  - Entity's decision to terminate an employee's employment before the normal retirement date, or
  - Employee's decision to accept voluntary redundancy in exchange for those benefits
- Termination benefits may be:
  - required by status
  - required under a collective agreement/social plan/contract
  - specific to a particular case
  - a constructive obligation based on past practice
- + Post-Employment Benefits in what relates to employee benefits that are payable from an ongoing plan to virtually all terminating employees (e.g. Termination Indemnities in Italy, Retirement Indemnities in Austria and France)

### 2.3.2. Measurement

- Discounting of termination benefits:
  - Is required only for benefits which fall due more than 12 months after the balance sheet date
  - The discount rate is determined in the same way as for postemployment benefits
- In case of enhanced benefits provided through an existing plan, the cost of the termination benefits is:
  - **DBO for Enhanced Benefits**
  - **LESS DBO under normal circumstances**
- If an offer is made to encourage voluntary redundancies: Measure termination benefits based on the number of employees expected to accept the offer
- Service cost: NONE

### 2.3.3. Recognition

- Recognize a liability and expense when demonstrably committed to:
  - Terminate the employment of an employee/group of employees before normal retirement
  - Provide benefits pursuant to an offer made to encourage voluntary redundancy
- "**Demonstrably committed**" means that the company has a detailed formal plan which realistically cannot be withdrawn, which specifies:
  - Location, function, approximate number of employees whose employment is to be terminated
  - Termination benefits for each group
  - Timing for implementation
- **The cost is recognized immediately because the affected employees are providing no future economic benefit to the company. Therefore no service cost.**

## 2.4. Process Charts

### 2.4.1. General

A close collaboration between HR and Finance is needed to operate the process.

This process covers:

- Accounting for the expense of the year in line with the actuarial valuation
- The additional information required for quarterly closing and reporting
- Preparation of the disclosures to the Group consolidated accounts

#### *2.4.2. IAS 19 Yearly Evaluation and Quarterly Process*

## **2.5. Closing**