PSAB
Public Sector
Accounting Board

Introduction to International Public Sector Accounting Standards (IPSAS)

Disclaimer

The Handbook of International Public Sector Accounting Pronouncements is the primary authoritative source of international generally accepted accounting principles for public sector entities.

SESSION 3:
Liabilities

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Session Agenda

Introduction

Provisions and Contingent Liabilities

Employee Benefits

Typical Liabilities

- Accounts payable and accrued expenses
- Provisions
- Pensions and other employee benefits
- Transfer payments payable
- Social benefit liabilities

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Liabilities and obligations

Public sector entity liabilities arise from many different types of obligations. They can arise from:

a) agreements or contracts;

b) legislation; or

c) constructive obligations, meaning they can be inferred from the facts in a particular situation.

The most common type of obligation is a legal obligation.

Liability Definition

A **liability** is a present obligation of the entity for an outflow of resources that results from a past event.

A **present obligation** is a legally binding obligation (legal obligation) or non-legally binding obligation (constructive obligation), which an entity has little or no realistic alternative to avoid.

A **constructive obligation** (non-legally binding obligation) generally results when an event, including an action of the entity, creates valid expectations in other parties that the entity will discharge the obligation.

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Liability Recognition Criteria - Timing

An item that meets the definition of a liability should be recognized if:

a) It is probable that there will be an outflow of service potential or economic benefits from the entity

b) The item has a cost or fair value that can be measured reliably

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Liability Recognition Criteria - Amount

Generally, liabilities are recognized in the financial statements at the amount of:

- cash or cash equivalents to be paid or
- the fair value ascribed to the liability when incurred (non-monetary transaction)
- in rare cases, an entity determines a range of possible outcomes and can make an estimate of the obligation that is sufficiently reliable

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IPSAS® 19: Provisions, Contingent Liabilities, Contingent Assets

Liabilities and Uncertainty

Accounts Payable	Accruals	Provisions	Contingent Liability
Certainty Continuum			
Recognize liability	Recognize liability	Recognize liability	Disclose

Provisions and Contingent Liabilities

Provisions – liabilities of uncertain timing or amount

Contingent liabilities – possible obligations to be confirmed by occurrence of future events

Provisions - Recognition

A provision is recognized when:

a) An entity has a present obligation (legal or constructive) as a result of a past event

b) It is probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation

c) A reliable estimate can be made of the amount of the obligation

Contingent Liabilities

A contingent liability is a possible obligation that arises from past events, and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.

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Measurement of Provisions

- Amount recognized is best estimate of the expenditure required to settle the present obligation at the reporting date
- Best estimate is the amount an entity would rationally pay to settle the obligation or to transfer it to a third party at reporting date
- Uncertainty is dealt with by various methods
  - Expected value
  - Individual most likely outcome

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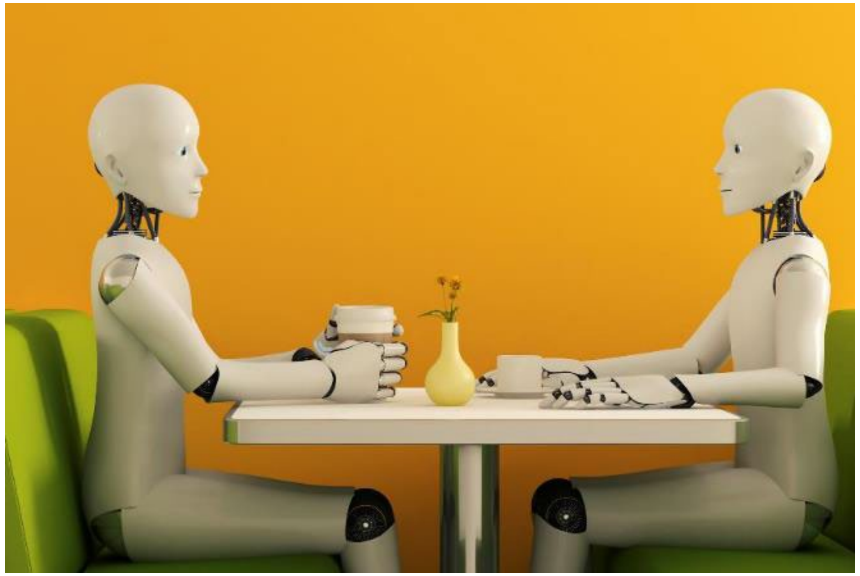
Present Value

- Estimate based on *present value* when time value of money is material
- The discount rate used reflects
  - Current market assessments
  - Risks specific to the liability
- Does *not* reflect risks for which future cash flow estimates adjusted
- Increase in PV due to passage of time is recognized as an interest expense

Future Events

- The estimate of the provision should reflect expected future events
- Future events may be
    - Inflation
    - Changes in technology
    - Cost reductions due to experience
    - New legislation



Changes in Provisions

- Provisions reviewed at each reporting date
  - Adjusted to reflect current best estimate
  - Reversed if not probable settlement required
- Change in provision is change in estimate made prospectively (current year result)

Disclosures

Opening and closing carrying amount	Additional provisions or increases in provisions	Amounts used
Amounts reversed	Increase in present value from the passage of time	Effect of a change in the discount rate
Description of nature and timing	Uncertainties and major assumptions	Expected reimbursements

IPSAS® 39: Employee Benefits: Short-Term, Long-Term and Termination Benefits

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Scope of IPSAS 39

- Deals with accounting by public sector entities for all employee benefits
- Provided:
  - Under formal plans
  - Legislative requirements
  - Informal practices

Note – Funding not required

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Types of Employee Benefit Plans

- All forms of consideration given in exchange for service rendered by employees
  - Short-term
    - Settled wholly before 12 months after period end
  - Post-employment
    - Payable after the completion of employment
      - Defined benefit
      - Defined contribution
  - Other long-term
    - Other benefits (not settled within 12 months)
  - Termination
    - Event is termination not service

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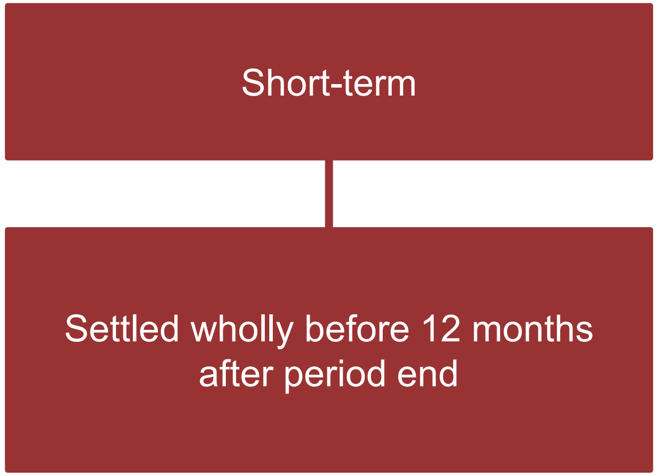
Short-term Employee Benefit Plans

- Employee benefits (other than termination benefits) that are due to be settled wholly before twelve months after the end of the reporting period in which the employees render the related service.
- Short-term employee benefits include items such as:
  - Wages, salaries, and social security contributions
  - Paid annual leave and paid sick leave
  - Profit-sharing and bonuses
  - Non-monetary benefits (such as medical care, housing, cars, and free or subsidized goods or services) for current employees



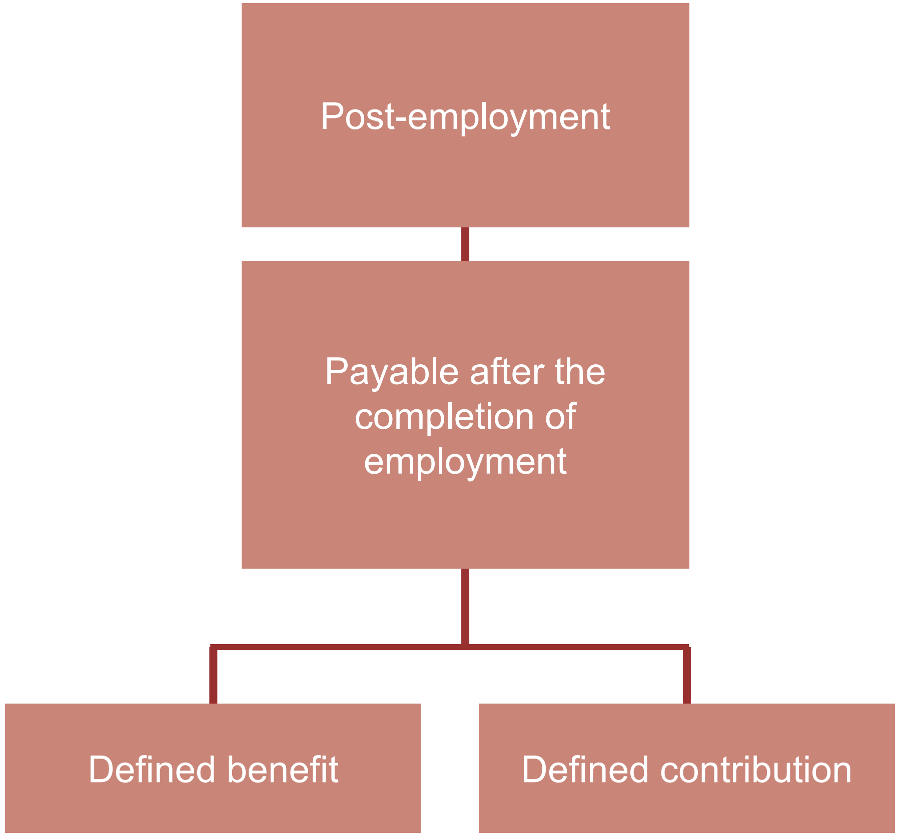
Short-Term Benefits

- Recognize the undiscounted amount of short-term employee benefits expected to be paid as a liability
- Compensation for absences
  - Accumulating compensation increases with employee service – recognize liability for vesting; partial liability for non-vesting
  - Non-accumulating benefits recognized when absence occurs
- Bonuses – recognize when obligation to pay

Consider materiality when estimating liability for short-term benefits

Post-employment Benefit Plans

- Employee benefits (other than termination benefits and short-term employee benefits) that are payable after the completion of employment.
- Examples:
  - Retirement benefits, such as pensions
  - Other post-employment benefits, such as post-employment life insurance, and post-employment medical care.



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Other Long-Term Benefits

- Employee benefits other than short-term employee benefits, post-employment benefits and termination benefits.
- Examples include:
  - Long-term compensated absences such as long service or sabbatical leave
  - Jubilee or other long service benefits
  - Long-term disability benefits
  - Profit sharing and bonuses
  - Deferred remuneration
  - Compensation payable by the entity until an individual enters new employment

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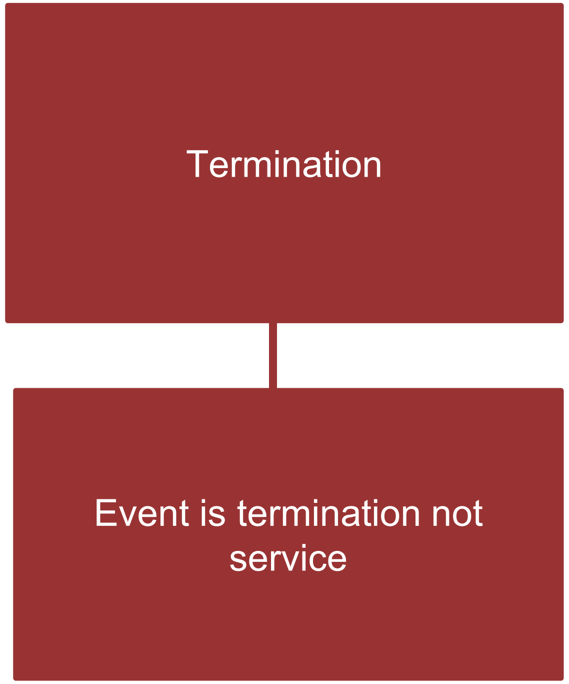
Other Long-Term Benefits

- Recognition and measurement similar to post-employment benefits
- Measurement not usually subject to same degree of uncertainty
- Simplified method of accounting
  - Remeasurements are recognized in Surplus or Deficit, not Net Assets/Equity

Termination Benefits

- Employee benefits provided in exchange for the termination of an employee's employment as a result of either:
  - An entity's decision to terminate an employee's employment before the normal retirement date or
  - An employee's decision to accept an offer of benefits in exchange for the termination of employment



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Termination Benefits

Entity decides to terminate an employee's employment or employee decides to accept an offer of benefits in exchange for the termination of employment

Recognize termination benefits at the earlier of the following dates:

- When the entity can no longer withdraw the offer of those benefits
- When the entity recognizes costs for a restructuring that is within the scope of IPSAS 19 and involves the payment of termination benefits

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IPSAS® 39: Employee Benefits: Post-Employment Benefits

Post-Employment Benefits

Can be significant for public sector entities

Payable after completion of employment

- Defined contribution plans
  - Liability limited to annual fixed contributions
  - Actuarial and investment risk borne by employee
- Defined benefit plans
  - Entity's obligation is to provide agreed benefits
  - Actuarial and investment risk borne by employer
- Multi-Employer Plans

Defined Contribution Plans

- Paid in exchange for service rendered by employees
- Contributions payable recognized as a liability and an expense
- Contributions not due within twelve months of period end are discounted
- The amount recognized as an expense for the period must be disclosed

Defined Benefit Plan

- Complex
- Require actuarial assumptions - usually qualified actuary involved
- Maybe unfunded, partially funded or wholly funded
- Include some pension plans, post-employment life insurance and medical plans

Determining the Net Defined Benefit Liability (Asset)

1

Estimate of the ultimate cost to the entity using an actuarial technique (the projected unit credit method)

2

Discount that cost to determine the present value of the defined benefit obligation

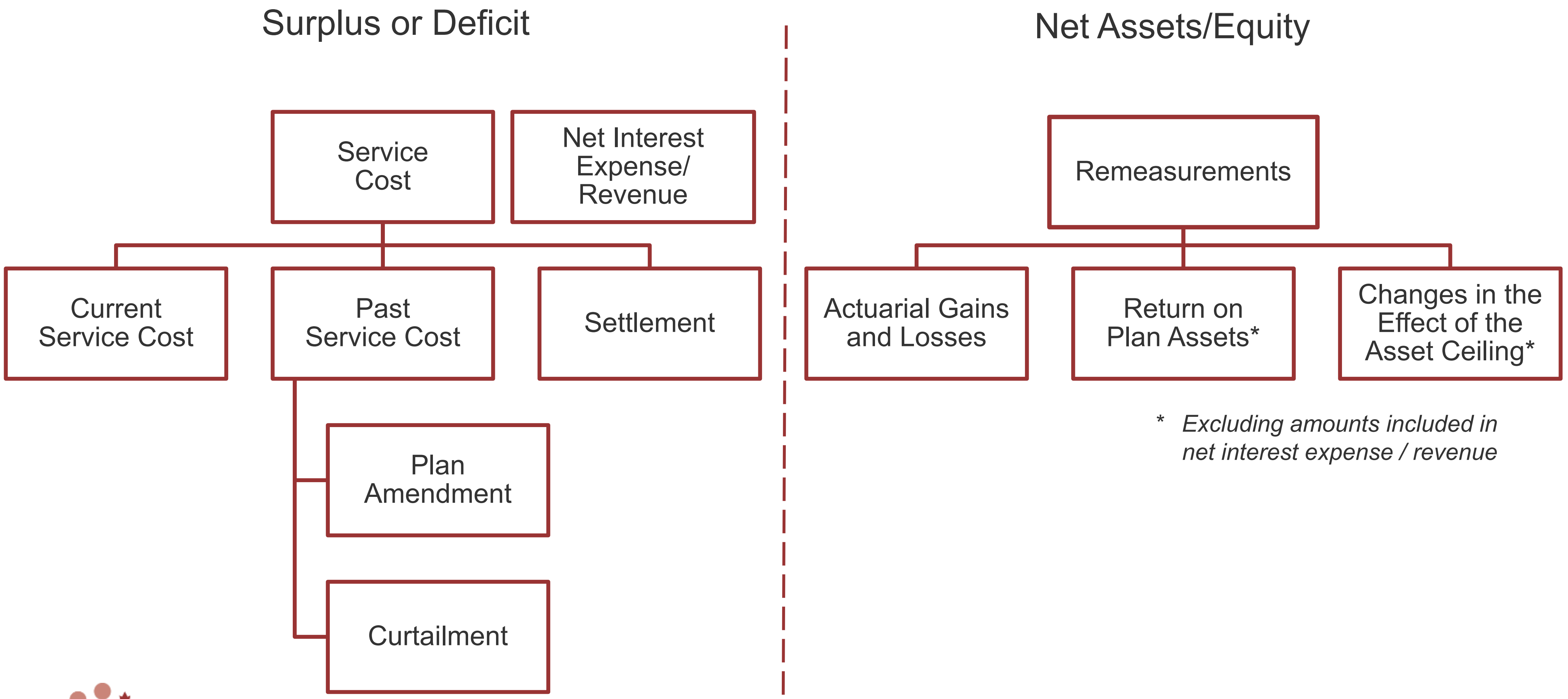
3

Deduct the fair value of any plan assets from the present value of the defined benefit obligation

4

Adjust the balance calculated from the steps above for any effect of limiting a net defined benefit asset to the asset ceiling

Defined Benefit Cost



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Amounts to be Recognized in Surplus or Deficit

- Current Service Cost
  - the increase in the present value of the defined benefit obligation resulting from employee service in the current period

Amounts to be Recognized in Surplus or Deficit (cont'd)

- Any **past service cost** and **gain or loss on settlement**

- Past service cost is the change in the present value of the defined benefit obligation for employee service in prior periods, resulting from a plan amendment or a curtailment

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Amounts to be Recognized in Surplus or Deficit (cont'd)

- **Net interest** on the net defined benefit liability (asset)

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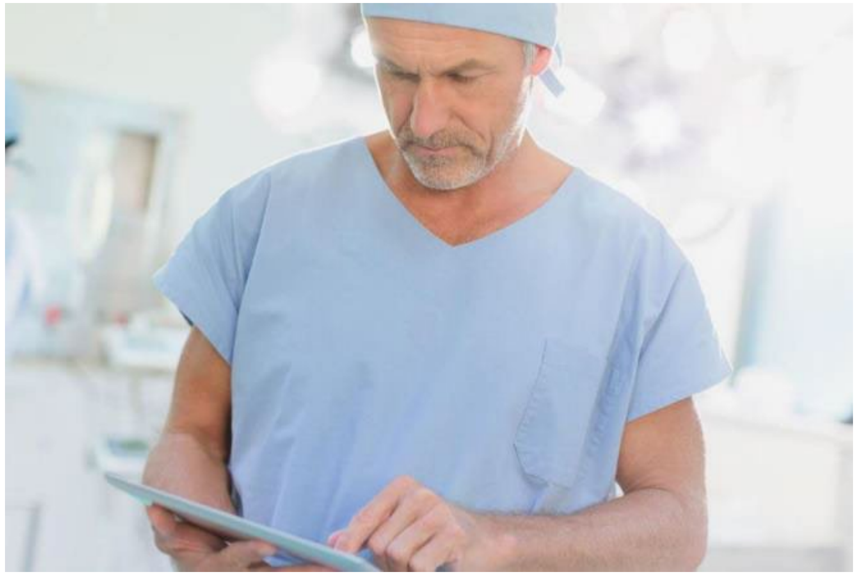
Remeasurement of net defined benefit liability (asset) recognized in net assets/equity

- **Actuarial gains and losses** result from increases or decreases in the present value of the defined benefit obligation due to:
    - Changes in actuarial assumptions
    - Experience adjustments



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Remeasurement of net defined benefit liability (asset) recognized in net assets/equity

- **Return on plan assets**, excluding amounts included in net interest on the net defined benefit liability (asset)

Remeasurement of net defined benefit liability (asset) recognized in net assets/equity

- Any change in the effect of **the asset ceiling**

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Plan Assets

- Plan assets comprise:
  - Assets held by a long-term employee benefit fund
  - Qualifying insurance policies
- Exclude unpaid contributions due from the reporting entity

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Presentation

Assets and liabilities from different plans not offset except in specific circumstances

Current/
Non-current
distinction

Components of
defined
benefit costs

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Disclosures

- An entity discloses information that:
  - Explains the characteristics of its defined benefit plans and risks associated with them
  - Identifies and explains the amounts in its financial statements arising from its defined benefit plans
  - Describes how its defined benefit plans may affect the amount, timing and uncertainty of the entity’s future cash flows