AASB 119 defines employee benefits as all forms of consideration given by an entity in exchange for service rendered by employees.

This should be recognised as:

a liability where the employee has provided services which require payment of benefits in the future,

and as an expense where the entity has received the services from the employee in exchange for the benefits.

The standard recognises four types of employee benefits:

Short-term benefits, eg wages, salaries, social security contributions, annual leave, sick leave, profit sharing and bonuses (payable in short-term), and non-monetary benefits eg medical care, housing, cars, free or subsidised goods and services.

Post-employment benefits, eg pensions, retirement benefits, post employment life insurance, and post employment medical care,

Other long-term benefits, eg long service leave, sabbatical leave, jubilee or other long service benefit, profit sharing and bonuses (payable in long-term)

Termination benefits
Short-term benefits are measured at cost and on an undiscounted basis. Benefits that are to be paid in more than twelve months time must be discounted to the present value. The discount rate to be used will be determined by reference to market yields at the end of the reporting period date on high quality corporate bonds. Salaries and wages, will usually be regarded as an expense, with unpaid amounts treated as liabilities, can be brought in as part of the cost of inventory, where there is a labour component in the manufacturing process. Likewise labour can be added to the cost of construction of property, plant and equipment.

Salaries and wages example. Totnes Ltd. pays its staff on a Thursday every two weeks for a ten day working period ending on the previous Wednesday evening. The salary expense is $15,000 with Totnes Ltd. deducting 30% PAYG tax and 2% union subscriptions. The year end date falls on the Monday preceding the pay day. The accounting entry at that date would recognise 7 days salary and wages expense.

Dr Salaries and wages expense 10,500
Cr PAYG tax payable 3,150
Cr Union subscriptions 210
Cr Salaries and wages payable 7,140

When the salaries and wages are paid on the Thursday, assuming no reversing entries, the entry would be:

Dr Salaries and wages expense 4,500
Dr Salaries and wages payable 7,140
Cr PAYG tax payable 1,350
Cr Union subscriptions 90
Cr Cash at bank 10,200

The PAYG tax and the union fees are paid 4 days after pay day:

Dr PAYG tax payable 4,500
Dr Union subscriptions 300
Cr Cash at bank 4,800
It is usual in Australia for employees to be granted 4 weeks annual leave. This leave may also attract a leave loading which typically is 17.5%. If the annual leave is to be paid within 12 months discounting the obligation to the present value is not required.

The annual leave will accrue as the employee works throughout the year and an expense and a provision is created. When the annual leave is taken by the employee the provision is utilised a payment is made and a PAYG tax liability is created.

Annual leave example
Sarah is employed by Innovative Solutions Ltd. on an annual salary of $78,000 with an annual leave entitlement of 4 weeks with a leave loading of 17.5%.

Annual leave will cost $78,000 x 4/52 x 1.175 = $7,050.
The weekly provision will be $7,050/52 = $136.

Dr Annual leave expense 136
Cr Provision for annual leave 136

If Sara takes three weeks’ leave, with a tax deduction of $470 per week, the entry would be:
Dr Provision for annual leave ($7,050 x 2/3) 4,700
Cr PAYG tax payable ($470 x 3) 1,410
Cr Cash at bank 3,290

The weekly provision of $136 will continue to be made by Innovative Solutions Ltd each week, including the time that Sarah is on leave.

The total amount paid to Sarah during the year would be:
48 weeks at standard rate of pay 78,000 x 48/52 = $72,000
4 weeks annual leave with 17.5% leave loading $7,050
Total $79,050

In this example the employer’s extra on-costs have not been included, but which will add to the total employment expense, such as state and territory payroll taxes, workers compensation insurance and superannuation contributions.
Sick leave can come in two forms. Vesting and non-vesting. When something vests, a legal term, it simply means that you become legally entitled to it.

With sick leave that is vesting the employee is entitled to sick leave in a manner similar to annual leave and their entitlements can accumulate.

If they resign from their employment they can be paid out any unused sick leave entitlement that they haven’t already claimed.

Vesting sick leave is accounted for in the same manner as annual leave.

Non-vesting sick leave will only be granted and paid out when the employee is sick and has submitted a valid claim.

The employer will make a provision based on past experience providing the entitlement can be reliably measured.

Sick leave is awarded on a non-vesting basis at Sparkly Ltd. The weekly total payroll bill is $160,000. On past experience only 10% of employees will take the full entitlement of two weeks’ sick leave per year. 25% of employees will take one week’s sick leave.

Expected annual expense will be $160,000 x 2 x 0.1 = $32,000
$160,000 x 1 x 0.25 = $40,000

$72,000

This would require a weekly provision of $1,385.

Dr Sick leave expense 1,385
Cr Provision for sick leave 1,385

When an employee becomes sick and submits a valid claim the cost is debited to the provision account.

Peter is sick for four days and works one day during July. His annual salary is $88,400 and he pays tax at 30%. $88,400 annually equates to a weekly salary of $1,700 and a daily rate of $340, with tax of $102.

Dr Provision for sick leave (4 x $340) 1,360
Dr Salaries expense (1 x $340) 340
Cr PAYG tax payable (5 x $102) 510
Cr Cash at bank ($1,700 x 70%) 1,190
Long service leave is an entitlement given to employees who have worked for an employer over a long period of time, typically 10 years, where they are given a period of extended leave, typically 13 weeks. The employer will need to recognise an expense and create a liability for this future obligation.

The length of time that the employee has worked for the employer will determine the size of that entitlement.

This amount would then have to be projected forward to take into account inflation.

This figure then needs to be discounted to represent the present value of the future obligation where payments are due in more than twelve months time.

The discount rate to be adopted will be based on rates generated by high quality corporate bonds.

The bond rates selected would have periods to maturity that would match the time that would need to elapse before the long service leave becomes payable.

Based on past experience this figure will then be adjusted according to the probability that it will need to be paid. Will the employee stay that length of time to collect it?

This then should represent today's value of the entity's future obligation which will appear as a liability in the balance sheet.

Long service leave example:
Millennium Ltd. has 4 employees. Their award provides for 13 weeks long service leave (LSL) after 10 years in the job. When an employee has been with the firm for 5 years they will be entitled to a pro-rata payment if they should leave. Assume wages increase matches inflation rate of 3.5%.

<table>
<thead>
<tr>
<th>No. of employees</th>
<th>Current salaries</th>
<th>Years of service</th>
<th>Years until LSL vests</th>
<th>Probability that LSL will vest</th>
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</thead>
<tbody>
<tr>
<td>2</td>
<td>$70,000</td>
<td>2</td>
<td>3</td>
<td>25%</td>
</tr>
<tr>
<td>1</td>
<td>$80,000</td>
<td>3</td>
<td>2</td>
<td>35%</td>
</tr>
<tr>
<td>1</td>
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<td>8</td>
<td>0</td>
<td>100%</td>
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High quality corporate bonds:

<table>
<thead>
<tr>
<th>Period to maturity</th>
<th>Bond rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>3</td>
<td>7%</td>
</tr>
<tr>
<td>2</td>
<td>6%</td>
</tr>
<tr>
<td>Current salary</td>
<td>Years of service</td>
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<tr>
<td>----------------</td>
<td>------------------</td>
</tr>
<tr>
<td>140,000</td>
<td>2</td>
</tr>
<tr>
<td>80,000</td>
<td>3</td>
</tr>
<tr>
<td>90,000</td>
<td>8</td>
</tr>
</tbody>
</table>

(a) \((2 \times 70,000) \times (1.035)^3\)
(b) \(155,221 \times 2/10 \times 13/52\)
(c) \(7,761 \times 0.8163\)

0.8163 from PV tables, 7% after 3 years, or \(1/(1.07)^3\)

If the opening balance on the provision for long service leave had been $15,760 the journal entry would be

Dr Long service leave expense 5,826
Cr Provision for long service leave 5,826

When the employees take their long service leave the journal entries are:

Dr Provision for long-service leave xxx
Cr Cash at bank xxx

Where an entity provides post-employment benefits, for example superannuation these are classified as either defined contribution plans or defined benefit plans

A defined contribution plan is a superannuation benefit scheme where the retirement benefits that will be received by the employee depend upon the contributions made to the fund and the investment returns on those contributions.

The entity’s obligation is the amount that it agrees to contribute to the fund. It is the size of these contributions together with the investment returns on them that will decide the amount of the employee’s benefit.
A defined benefit plan is a superannuation benefit scheme where it is the size of the required benefits and the actuarial assumptions that will determine the size of the contributions that must be made by the entity.

As most of the superannuation schemes are defined contribution schemes it is these that this session will concentrate on.

The amount recognised as an expense for defined contribution plans must be disclosed in the financial statements.

Oily Rag Ltd has a defined contribution superannuation plan for its employees. The company contributes 9% of employee’s salaries to the plan. The salaries for the year totalled $500,000. The contribution would be $45,000. The accounting entry would be:

Dr Employee benefits cost – superannuation $45,000
Cr Employee benefits payable $45,000