



# Accounting and Reporting Policy FRS 102

## Staff Education Note 9 Short-term employee benefits and termination benefits

### **Disclaimer**

This Education Note has been prepared by FRC staff for the convenience of users of FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*. It aims to illustrate certain requirements of FRS 102, but should not be relied upon as a definitive statement on the application of the standard. The illustrative material is not a substitute for reading the detailed requirements of FRS 102.

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## Introduction

This Staff Education Note provides a comparison of the accounting requirements for short-term employee benefits and termination benefits set out in Section 28 *Employee Benefits* of FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* and current UK accounting standards.

Current UK accounting standards do not include explicit requirements for accounting for short-term employee benefits or termination benefits. However, the principles set out in a number of current accounting standards may be relevant, including:

- (a) FRS 12 *Provision, contingent liabilities and contingent assets*; and
- (b) FRS 5 *Reporting the substance of transactions*.

This Staff Education Note is written to highlight key areas of consideration when transitioning to FRS 102 and is not designed to be exhaustive.

## Short-Term Employee Benefits

### Definition

Current UK accounting standards	FRS 102
<p>Not defined, although the Companies Act 2006 requires disclosure of employee costs paid or payable in respect of the year, which includes wages, salaries and social security costs.</p>	<p>Short-term employee benefits are employee benefits (other than termination benefits) that are expected to be settled wholly before twelve months after the end of the reporting period in which the employees render the related service.</p> <p>(FRS 102 paragraph 28.1(a))</p>
<p>No further detail of components of employee costs, but the following is relevant:</p> <p style="padding-left: 20px;">Accruals are liabilities to pay for goods or services that have been received or supplied but have not been paid... including amounts due to employees (for example amounts relating to accrued holiday pay).</p> <p>(FRS 12 paragraph 11(b))</p>	<p>Short-term employee benefits include items such as the following, if expected to be settled wholly before 12 months after the end of the annual reporting period in which the employees render the related service:</p> <ul style="list-style-type: none"> <li>(a) wages, salaries and social security contributions;</li> <li>(b) paid annual leave and paid sick leave;</li> <li>(c) profit-sharing and bonuses; and</li> <li>(d) non-monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees.</li> </ul> <p>(FRS 102 paragraph 28.4)</p>

## Measurement

Current UK accounting standards	FRS 102
No explicit requirements, but employee costs would be measured at transaction amount.	<p>When an employee has rendered service to an entity during the reporting periods, the entity shall measure the amounts at the undiscounted amount of short-term employee benefits expected to be paid in exchange for that service.</p> <p>(FRS 102 paragraph 28.5)</p> <p>An entity shall recognise the expected cost of accumulating compensated absences when the employees render service that increases their entitlement to future compensated absences, at the undiscounted additional amount that the entity expects to pay as a result of the unused entitlement that has accumulated at the end of the reporting period. The entity shall present this amount as falling due within one year at the reporting date.</p> <p>(FRS 102 paragraph 28.6)</p> <p>An entity shall recognise the cost of other (non-accumulating) compensated absences when the absences occur, at the undiscounted amount of salaries and wages paid or payable for the period of absence.</p> <p>(FRS 102 paragraph 28.7)</p>

Current UK GAAP is much less explicit about the accounting for short-term benefits than FRS 102, but there is no conceptual difference between the two. However, in practice many UK reporting entities do not provide for holiday pay (short-term compensated absences) and will need to consider this when applying FRS 102 for the first time.

### Example 1

Employees of Company A are permitted 24 days annual leave which must be taken in the holiday year which commences on 1 April. Company A's financial year end is 31 December.

At 31 December an employee, pro-rata is entitled to have taken 18 days holiday. Company A calculates from holiday records that outstanding holiday (ie holiday not taken from an allowance of 18 days) is 56 days for all employees at the same grade.

Company A considers that it is appropriate to make an accrual for the 56 days outstanding holiday measured at the average salary per day.

### Overall impact

On the date of transition to FRS 102, a new provision would be recognised for short-term employee benefits with a corresponding adjustment to opening retained earnings. In future years, assuming the annual holiday allowance, the pattern of holidays taken and holiday year remain constant, the movement in the provision from one year to the next will probably be limited.

## Termination Benefits

### Definition

FRS 12	FRS 102
<p>Not defined, but referred to in FRS 12.</p>	<p>Termination benefits are employee benefits payable as a result of either:</p> <ul style="list-style-type: none"> <li>(a) an entity's decision to terminate an employee's employment before the normal retirement date; or</li> <li>(b) an employee's decision to accept voluntary redundancy in exchange for those benefits.</li> </ul> <p>(FRS 102 paragraph 28.1(d))</p>
<p>A provision for restructuring costs would include termination benefits meeting the definition of a provision. (FRS 12 paragraph 77)</p>	<p>An entity may be committed, by legislation, by contractual or other agreements with employees or their representatives or by a constructive obligation based on business practice, custom or a desire to act equitably, to make payments (or provide other benefits) to employees when it terminates their employment. Such payments are termination benefits. (FRS 102 paragraph 28.31)</p>

## Recognition

FRS 12	FRS 102
<p>As noted above, termination benefits would be included in a restructuring provision, which should include only the direct expenditures arising from the restructuring, which are those that are both:</p> <ul style="list-style-type: none"> <li>(a) necessarily entailed by the restructuring; and</li> <li>(b) not associated with the on-going activities of the entity.</li> </ul> <p>(FRS 12 paragraph 85)</p>	<p>Termination payments do not provide an entity with future economic benefits therefore an entity shall recognise them as an expense in profit or loss immediately.</p> <p>(FRS 102 paragraph 28.32)</p>
<p>A constructive obligation to restructure arises only when an entity:</p> <ul style="list-style-type: none"> <li>(a) has a detailed formal plan for the restructuring identifying at least... ...the location, function, and approximate number of employees who will be compensated for terminating their services; and</li> <li>(b) has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it.</li> </ul> <p>(FRS 12 paragraph 77)</p> <p>Negotiations with employees' representatives for termination payments may have been concluded subject only to Board approval. Once that approval has been obtained and communicated to the other parties, the entity has a constructive obligation to restructure (assuming the other conditions are met).</p> <p>(FRS 12 paragraph 81)</p>	<p>An entity shall recognise such payments as a liability and an expense only when the entity is demonstrably committed either:</p> <ul style="list-style-type: none"> <li>(a) to terminate the employment of an employee or group of employees before the normal retirement date; or</li> <li>(b) to provide termination benefits as a result of an offer made in order to encourage voluntary redundancy.</li> </ul> <p>(FRS 102 paragraph 28.34)</p> <p>An entity is demonstrably committed to a termination only when the entity has a detailed formal plan for the termination and is without realistic possibility of withdrawal from the plan.</p> <p>(FRS 102 paragraph 28.35)</p>

There appears to be no difference in the recognition of termination benefits.

## Measurement

Current UK accounting standards	FRS 102
<p>The amount recognised as a provision should be the best estimate of the expenditure required to settle the present obligation at the balance sheet date.</p> <p>(FRS 12.36)</p>	<p>An entity shall measure termination benefits at the best estimate of the expenditure that would be required to settle the obligation at the reporting date. In the case of an offer made to encourage voluntary redundancy, the measurement of termination benefit shall be based on the number of employees expected to accept the offer.</p> <p>(FRS 102 28.36)</p>
<p>Where the effect of the time value of money is material, the amount of the provision should be the present value of the expenditures expected to be required to settle the obligation.</p> <p>(FRS 12.45)</p>	<p>When termination benefits are due more than twelve months after the end of the reporting period, they shall be measured at their discounted present value.</p> <p>(FRS 102 28.37)</p>

FRS 102 appears to be more prescriptive in requiring discounting whenever the termination benefits are payable after more than one year. However, in practice, if the effect of the discounting was not material it may not be necessary to adjust for it.

### Example 2

Company B has a 31 December year end. On 5 December 20X1 it makes a public announcement that it will close its manufacturing facilities in Wales during the next financial year. It currently employs 250 personnel in its manufacturing facilities but considers that it will be able to relocate 50 personnel within the company. It anticipates the cost of statutory redundancy for the 200 staff will be CU3m. Company B however, decides to pay a further CU5,000 as an enhancement to each employee (which is not related to future service<sup>1</sup>). The public announcement sets out the Company B's intentions including the enhancement of CU5,000 to each employee.

Company B recognises a liability of CU4m (being CU3m for its statutory liability and CU1m for the enhancement) in its 31 December 20X1 financial statements, being its best estimate of the amount required to settle the obligation.

<sup>1</sup> If the payments were a 'staying bonus' to encourage employees not to leave before a certain date, they would be recognised over the period of the service (ie they would be short-term employee benefits).