Audit Committee Forum

Position Paper 7

Audit Committee Guidelines for the Evaluation of Retirement Obligations

July 2019

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Promoting Corporate Governance across the board

About the Audit Committee Forum

Recognising the importance of Audit Committees as part of good Corporate Governance, the Mauritius Institute of Directors (MIoD) and KPMG have set up the Audit Committee Forum (the Forum) in order to help Audit Committees in Mauritius, in both the public and the private sectors, improve their effectiveness.

The purpose of the Forum is to help Audit Committee members adapt to their changing role. Historically, Audit Committees have largely been left on their own to keep pace with rapidly changing information related to governance, risk management, audit issues, accounting, financial reporting, current issues, future changes and international developments.

The Forum provides guidance for Audit Committees based on the latest legislative and regulatory requirements. It also highlights best practice guidance to enable Audit Committee members to carry out their responsibilities effectively. To this end, it provides a valuable source of information to Audit Committee members and acts as a resource to which they can turn for information or to share knowledge.

The Forum's primary objective is thus to communicate with Audit Committee members and enhance their awareness and ability to implement effective Audit Committee processes.

Position Paper series

The Position Papers, produced periodically by the Forum, aim to provide Board directors and specifically Audit Committee members with basic best practice guidance notes to assist in the running of an effective Audit Committee.

Position Paper 7 deals with the Audit Committee's guidelines for the evaluation of retirement obligations.

Previous Position Papers are listed below and may be accessed at http://www.kpmg.com/mu and http://www.miod.mu/.

Paper 1: Best Practice Guidance Notes for Audit Committees (July 2014)

Paper 2: Interaction of Audit Committee with Internal and External Auditors (May 2015)

Paper 3: The Audit Committee's Role in Control and Management of Risk (December 2015)

Paper 4: Guidelines for the Audit Committee's assessment and response to the Risk of Fraud (October 2016)

Paper 5: Guidelines for the Audit Committee's approach to Information Technology Risk (July 2017)

Paper 6: Audit Committee Guidelines for evaluating whistleblowing systems (September 2018)

Members of the Forum

Collectively, the Forum is made up of the following members drawn from diverse professional backgrounds with significant experience in both the private and the public sectors.

Mr Bernard Yen was co-opted as a member for Position Paper 7.

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Chung John

De Marassé Enouf Maurice

Dinan Pierre

Gooroochurn Bharatee

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Jolicoeur Eddy

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Koenig Fabrice

Leung Shing Georges

Molaye Sanjay

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Ramdin-Clark Madhavi

Reetun Khemraj

MIoD Co-ordinator:
***Mulung** Nafeeza*

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Sources that have been used in writing this Paper:

– *Employment Rights Act*. 2008 (Republic of Mauritius). Updated, August 2018. http://labour.govmu.org/English/Documents/Legislations/Employment%20rights%20acts%202008/ERiA%202008%20-%20updated%20as%20at%20Aug%2018.pdf

– Financial Reporting Council. 2018. *The Audit of defined benefit obligations: Findings from 2017/2018 Audit Quality Reviews*. London, UK: https://www.frc.org.uk/getattachment/4fbf1bb2-930b-4032-a5be-b93aa84f06f0/Audit-of-defined-benefit-pension-obligations_v4.pdf

– Sweatman, Scott. 2017. *20 Questions Directors Should Ask about Pension Governance*. 2nd ed. Toronto, Canada: Chartered Professional Accountants of Canada.

Introduction

Retirement obligations can be referred to as the future expenses or liabilities associated with a pension or retirement plan. Organisations provide employees with a pension plan as part of a larger array of employment benefits. The pension plans are structured so as to provide a periodic and reliable source of income when the employee reaches the plan's normal retirement age. Other retirement plans provide lump sums at retirement or assistance with medical costs during retirement.

Key Terms

A **defined benefit** plan is one where the amount of pension or other benefit to be paid is predefined in terms of a formula based on service and career average or final salary of the employee, irrespective of how any assets set aside to fund the benefit in advance actually perform.

A **defined contribution** plan is one where the amount of contributions to be paid into the plan is predefined in terms of fixed percentages of salary throughout the employee’s career and the resulting pension or other benefit depends on the accumulated value of these contributions and investment returns earned thereon, as well as prevailing costs of purchasing pensions at retirement which cannot be predicted in advance.

Accounting Standards require organisations to measure and disclose retirement obligations as well as the performance and financial conditions of their plans at the end of each accounting period. Under the International Financial Reporting Standards (IFRS), more specifically the International Accounting Standard 19 (IAS 19), an organisation:

- uses an actuarial technique to estimate the ultimate cost of the benefits that employees have earned in return for their services in the current and prior periods;
- discounts the defined benefit in order to determine its present value and the current service cost;
- deducts the fair value of any plan assets from the present value of the defined benefits;
- determines the amount of the deficit or surplus of the plan; and
- determines the respective amounts to be recognised in profit or loss and other comprehensive income in the current period.

The measurements are updated at each reporting date.

Retirement obligations may be an important consideration for Audit Committee members. The net pension obligation appearing on the balance sheet may not in itself be significant while the related pension assets and liabilities are significant balances appearing in the financial statements. The valuations of these assets and liabilities are complex and rest on a range of assumptions and management judgements which may cause a risk of material misstatement or manipulation through management bias. An incorrect valuation of the pension scheme assets or liabilities could easily lead to a material misstatement in the net defined benefit liability or asset in the entity's financial statements.

Also, where an organisation has a significant net defined benefit liability, the directors should carefully consider how this may affect its future viability or going concern. They should ensure that the relevant disclosures in the annual report and financial statements are fair, balanced and understandable so that users of the financial statements have the information they need to understand the risks that funding the pension plan puts on the business.

The level of security for retirement obligations in the balance sheet is also important to employees of an organisation. If, for example, they are too large compared to the realisable assets of the organisation and the latter faces financial difficulties, the assets may not be sufficient to repay the obligations.

Forms of employee benefits and their management

IAS 19 Employee Benefits is the relevant standard for accounting and reporting on all forms of employee benefits provided by employers in Mauritius.

IAS 19 covers four categories of employee benefits:

Category A: Short-term employee benefits, such as the following (if expected to be settled wholly before twelve months after the end of the annual reporting period in which the employees render the related services): wages, salaries and social security contributions, paid annual leave and paid sick leave, profit-sharing and bonuses, and non-monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees.

Category B: Long-term employee benefits provided during employment, such as passage benefits, long-service leave or sabbatical leave, jubilee or other long-service benefits, long-term disability benefits.

Category C: Termination benefits.

Category D: Post-employment benefits such as retirement benefits (e.g. pensions and lump sum payments on retirement), post-employment life insurance and post-employment medical care.

Short-term employee benefits

For short-term employee benefits under category A, IAS 19 requires the employer to recognise the expected cost of these short-term benefits when an employee has provided the related service in exchange for those benefits and such calculations are relatively straightforward.

Long-term employee benefits

For long-term employee benefits under category B, IAS 19 requires the same recognition and measurement as for post-employment benefits under category D. However, instead of being recognised partly in profit or loss (POL) and partly in other comprehensive income (OCI), all changes in the carrying amount of liabilities for such long-term benefits are recognised in POL only and no specific disclosures are required. In Mauritius, typical examples of such benefits include passage benefits that are paid every 2, 3, 5 or 7 years and significant cash payments or gifts to employees attaining 5, 10, 20 or 30 years of service.

Termination benefits

Termination benefits under category C are employee benefits payable as a result of either the employer'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. The employer is required to recognise termination benefits at the earlier of:

i. when it can no longer withdraw an offer of those benefits; and

ii. when it recognizes any related restructuring costs.

In Mauritius, any voluntary retirement scheme or equivalent offered by the employer would fall under this category and the estimated capital cost of these benefits would typically be recognized in POL straightaway.

Post-employment benefits

For categories B and D, the calculations are more complicated unless the plans are classified as defined contribution in nature.

Under defined contribution plans, an employer pays fixed contributions into a separate organisation (a fund) and will have no legal or constructive obligation to pay further contributions even if the assets of the fund have performed poorly. IAS 19 requires employers to recognise contributions to a defined contribution plan when employees have provided service in exchange for those contributions.

IAS 19 also allows for certain State social security and multi-employer plans to be treated and accounted for as defined contribution plans even when they may in fact be defined benefit in nature. For example in Mauritius, the National Pension Fund (NPF) can be treated as defined contribution under IAS 19 because an employer's liability is limited to making the required monthly contributions to it. Similarly, some conglomerates in Mauritius sponsor a multi-employer group defined benefit plan where the holding company accounts for the whole plan as a defined benefit plan and the participating subsidiaries can then account for their share of contributions to the plan as if they were defined contribution in nature for them.

All other post-employment or other long-term benefit plans are defined benefit plans typically requiring the use of professional actuaries in computing their costs and preparing the relevant disclosures in financial statements. This is because the benefits payable from those plans have to be estimated and projected over a long period into the future, taking into account the benefit formulae and the various probabilities of payment relating to retirement, death, resignation or other causes.

Defined benefit plans may be unfunded, or they may be wholly or partly funded. IAS 19 requires the employer to:

1) account not only for its legal obligation, but also for any constructive obligation that arises from the employer's practices;

2) determine the present value of defined benefit obligations and the fair value of any plan assets with sufficient regularity, ideally at the end of each reporting period. In Mauritius, most employers have opted for a full actuarial valuation at the end of each reporting year. Some large listed employers have opted for a quarterly assessment in line with their reporting requirements and some smaller employers have decided to ask their actuaries to carry out full actuarial valuations once every 3 years and use approximate roll-forward calculations in the intermediate years;

3) use an actuarial method called the projected unit credit method to measure its obligations and costs;

4) attribute benefit to periods of service under the plan's benefit formula, unless an employee's service in later years will lead to a materially higher level of benefit than in earlier years;

5) use unbiased and mutually compatible actuarial assumptions about demographic variables (such as employee turnover and mortality) and financial variables (such as future increases in salaries, changes in medical costs and particular changes in State benefits). Financial assumptions should be based on market expectations, at the end of the reporting period, for the period over which the obligations are to be settled;

6) determine the discount rate by reference to market yields at the end of the reporting period on high quality corporate bonds (or, in countries such as Mauritius where there is no deep market in such bonds, government bonds) of a currency and term consistent with the currency and term of the post-employment benefit obligations;

7) deduct the fair value of any plan assets from the carrying amount of the obligation in order to determine the net defined benefit liability or asset;

8) limit the carrying amount of a net defined benefit asset so that it does not exceed the economic benefits available to the employer in the form of potential future refunds from the plan or potential reductions in future contributions to the plan; and

9) recognise all changes in the net defined benefit liability or asset when they occur, as follows:

   i. service cost and net interest in profit or loss (POL); and

   ii. remeasurements in other comprehensive income (OCI).

The classification between items in POL and OCI are based on what is considered to be within management's control. Items in POL are generally considered to be substantially within management's control (e.g. salaries) and items in OCI are generally considered to be outside management's control (e.g. changes in assumptions due to market conditions and demographic developments).

Mauritian context

Typical examples of post-employment defined benefit plans in Mauritius that require these detailed calculations and disclosures include:

— funded pension plans set up by an employer that aim to provide a pension of up to two-third ($^2/_3$) of an employee's final salary on normal retirement at the age of 60 or 65 (often inclusive of any NPF pension or related offset) after completing $33^1/_3$, 35 or 40 years of service and any associated ancillary benefits to spouses and other dependants;

— funded or unfunded top-up pension plans that aim to provide a minimum defined benefit pension on top of a defined contribution or other pension benefits;

— unfunded discretionary pensions paid out of an employer's cash flow to retirees who did not receive significant pensions from the employer's funded pension plans when they retired;

— unfunded medical insurance and other costs paid out of an employer's cash flow to retirees and their beneficiaries;

— significant refunds of unused sick or local leave entitlements on retirement; and

— unfunded lump sums or gratuities on death or retirement payable by an employer under the *Employment Rights Act* equal to 15 days' remuneration for each year of service (net of any permitted deductions under the *Act* in respect of the employer's share of contributions to funded pension or retirement plans).

It is interesting to note that the *Employment Rights Act* gratuity requirements, which are defined benefit in nature, apply irrespective of whether the employer has set up a defined benefit or defined contribution funded pension plan for its employees.

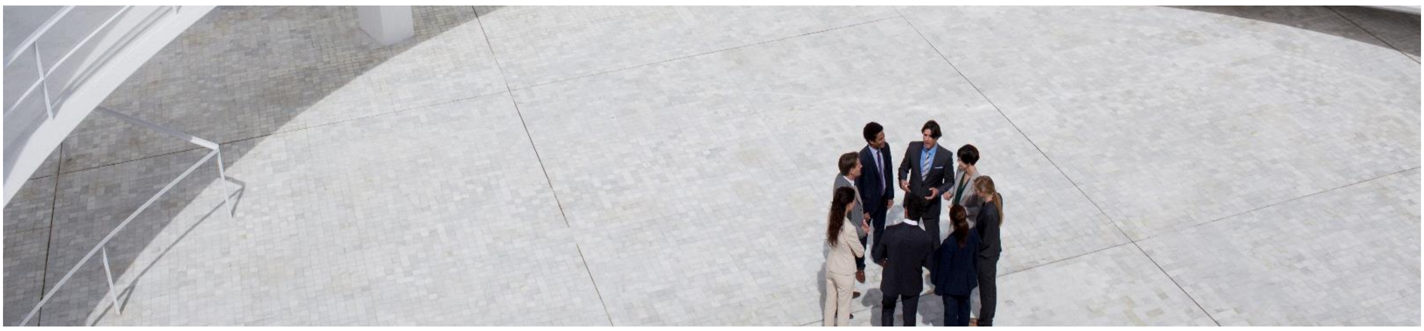
In other words, an employer who has set up a defined contribution pension plan in order to avoid the cost uncertainties of a defined benefit pension plan still has the cost uncertainties of a defined benefit retirement plan imposed by the *Employment Rights Act*, unless the employer's contribution rate to the defined contribution plan is so high as to completely offset the *Act*'s liability in all or most individual cases.

For the rest of this Paper, we will focus on employee benefits under category D, i.e. pensions and lump sum payments on retirement, which are defined benefit in nature and require specialist actuarial calculations.

These defined benefit obligations, net of any plan assets where the plans are funded, are also commonly called retirement obligations in Mauritius.

Please refer to **Appendix A** on page 15 of this Paper for an example to illustrate how actuarial calculations are performed and how the disclosures are built up.

Audit Committee members should pay attention to the sufficiency of the disclosures around retirement obligations in the financial statements.



Legislations for retirement obligations

There are various legislations affecting retirement obligations like the *Employment Rights Act*, the *Pensions Act* and the *Statutory Bodies Pension Funds Act.* The main legislation affecting retirement obligations in Mauritius is Section 49 of the *Employment Rights Act*, as included in **Appendix B** on page 18 of this Paper.

The following points in Section 49 of the Employment Rights Act are worth noting:

The retirement gratuity is only payable by the last employer where the employee has worked before retiring on or after age 60 (or earlier in case of permanent incapacity). For any prior periods of employment, the previous employers do not need to pay any such gratuity. At the time of writing this Paper, the Government is considering the introduction of a Portable Retirement Gratuity Fund to require all employers to make a minimum contribution to that fund (or acceptable alternatives) so that employees can benefit in future from a retirement gratuity in respect of all service provided, instead of just the service being provided to the last employer before retirement.

Subsection (1A) allowing for the optional advance payment of the retirement gratuity at age 60 is a new provision since 2013. It is unfortunate that this section is silent on what allowance can or should be made for adding any interest to the advance payment when the excess of the full retirement gratuity over the advance payment is subsequently paid when the employee retires later.

The definition of remuneration in subsection (5) for the purpose of calculating the retirement gratuity is subject to interpretation and, in particular, different employers and employees may disagree on what constitutes a regular payment to be included in the calculation. For example, performance or profit-sharing bonuses can be highly variable and/or discretionary and some consider that an average of the last 3 years, rather than simply the actual figure for the last 12 months, may be more appropriate for this purpose. Whatever the interpretation, it is recommended that employers should ideally agree and communicate beforehand with their employees on how they intend to calculate their retirement gratuities in future.

Subsection (3) parts (a) and (b) relate to the permitted deductions from the retirement gratuity calculations in respect of any employer contributions to a pension fund or other scheme. It is unfortunate for employers that these parts only allow for roughly half the value of employer contributions to be deducted, whereas parts (c) and (d), which are almost never used, do allow for roughly the full value of unfunded pensions to be deducted. This anomaly has been highlighted to the Government by some employers in the past as it discourages many employers from setting up pension plans for their employees.

As a result, for those employers who nevertheless contribute to pension plans for their employees, they are exposed to any underperformance of these plans because this could result in lower deductions under Section 49(3) of the *Employment Rights Act* and therefore higher residual gratuities to be paid at retirement.

In this context, the *Private Pension Schemes Act 2012* and associated Rules issued by the Financial Services Commission (FSC) which licenses, regulates and supervises almost all funded pension plans in Mauritius, are another part of the legislative framework to consider. Although these provisions are aimed at improving pension governance and protection for employees in general, employers generally have an interest in ensuring that their sponsored plans are well run and appropriately invested so as to minimise the risk that they may be called upon to top up the retirement benefits paid by these plans.

The role of the Audit Committee in the evaluation of retirement obligations

It is essential for Board members to know their responsibilities as Directors and the organisation's roles with respect to retirement obligations. The Audit Committee, to which the Board often delegates its responsibilities regarding financial statements ensures that retirement obligations are well managed and reported. In carrying out its duties, the Audit Committee can take the following key elements into consideration:

- ✓ Proper management of the obligations
- ✓ Appropriate controls in place to mitigate risks related to the obligations
- ✓ Accurate computation of the amount of the retirement obligations
- ✓ Compliance with laws and regulations
- ✓ Correct disclosure of the retirement obligations in the financial statements

Apart from obtaining confirmation from management that the organisation has formally documented and approved the policies and procedures related to retirement obligations, it is important for the Audit Committee to have assurance that such policies and procedures are being duly adhered to and key controls are working as expected.

The Audit Committee needs to be aware of whether the pension and other obligations are managed internally by a qualified personnel or whether this responsibility is outsourced to a professional advisor. If a pension fund is managed internally, the Audit Committee should be made aware of any potential conflict of interest. For example, a plan administrator (who forms part of the board) cannot knowingly permit his/her own interest to conflict with his/her duties and powers as the administrator of the pension fund. If the management of a pension fund is outsourced, the Audit Committee should be informed of the credentials of the professional advisor and rationale for selecting the advisor.

A few suggested questions that the Audit Committee can ask to assess the accuracy of retirement obligations:

1) Have the roles of the relevant teams (e.g. HR and Accounting) been clearly mentioned in respect of the procedures and controls on pensions and retirement benefits?
2) Is the pension fund and other retirement plan managed internally or is this responsibility outsourced to a professional advisor?
3) Have the responsibilities and accountabilities of the third party managing the pension fund been clearly stated (where applicable)?
4) Has the Board evaluated the competence and independence of the third party managing the pension fund?
5) Has the pension plan's performance been benchmarked against that of other pension funds?
6) Has the Board evaluated the governance structure of the pension fund?
7) What is the financial health of the pension plan? What is the size of the pension fund's asset compared to the organisation's operating assets?
8) Have the risks associated with managing pension funds internally or by third party been assessed and controls put into place to mitigate those risks?
9) Has the external auditor reviewed the retirement obligation independently or have they placed reliance on third party for the evaluation and disclosure requirements?
10) What mechanisms have been put into place with respect to retirement obligations that ensure compliance with the relevant laws and regulations such as the *Pensions Act* and the *Employment Rights Act*? Have there been any changes affecting the pension plan and retirement obligations during the year?
11) Has the Board sought any external guidance in case of any change in the pension plan from defined benefit to defined contribution?
12) Have the figures related to pensions and retirement obligations been properly accounted and disclosed in the financial statements as per the IFRS requirements?
13) Does the organisation clearly explain to its employees the purpose, objectives and rules of the pension plan and associated risks?

Internal Auditors can give independent assurance on retirement obligations by assessing the key controls that are in place.

However, the scope of work of the Internal Auditors may be restricted to the extent of their skills and competence regarding accurate evaluation of retirement obligations which can be very complex as mentioned in Section 2 on pages 6-8 of this Paper.

Apart from the evaluation performed by Internal Auditors, the Audit Committee can request:

- The services of professional advisors to assess the accuracy of retirement obligations and submit a report;
- External Auditors to give their feedback on the amount of the retirement obligations as part of their audit (refer to Section 5 on page 12 of this Paper).

The role of the External Auditor in the evaluation of retirement obligations

The defined benefit obligation is a figure based on actuarial assumptions. External Auditors therefore need to exercise sufficient professional scepticism when auditing these estimates. They will often engage their own experts to provide assistance in auditing valuations for both the pension obligation and these more complex investment assets.

The audit of pensions is further complicated by companies often having numerous schemes with differing benefit structures, arising from past acquisitions which may also include both private and public sector arrangements, as well as open and closed schemes. Schemes will also use a range of investment managers and custodians to manage the pension scheme assets, and may also engage a pension administrator to maintain membership details, collect contributions and pay benefits. In the light of the different parties involved, there is a need to decide upon whether reliance can be placed on the work of the External Auditor of these parties or whether they need to perform their own audit work. The use of these management experts and service organisations therefore needs to be carefully considered when planning the audit.

Auditing the defined benefit obligations and related pension assets encompasses a number of more complex aspects of audit including:

i. Auditing significant accounting estimates;

ii. Using service organisations' and management's experts;

iii. Using External Auditor's experts; and

iv. Using the work of other External Auditors and the audit of disclosures.

External Audit teams need to tie all of the key threads together, carrying out their work with appropriate professional scepticism, to reach overall soundly-based conclusions.

Interaction with the Audit Committee

Where organisations have significant pension scheme balances, Audit Committees and External Auditors are expected to discuss the findings of the actuarial report and consider whether the audit approach taken could be enhanced. In particular, Audit Committees should ensure that:

— they discuss how the external auditor has reached independent estimates and ranges and how these have been used to benchmark against management's assumptions;

— their External Auditor clearly communicates the financial impact of assumptions that are at the optimistic or pessimistic ends of the range, and whether those assumptions have been reviewed and their reasonableness.

— they consider whether the assumptions are positioned at an appropriate place in the range bearing in mind the circumstances of the organisation, for example the economic environment, and how changes in those assumptions impact upon the organisation's reported financial performance; and

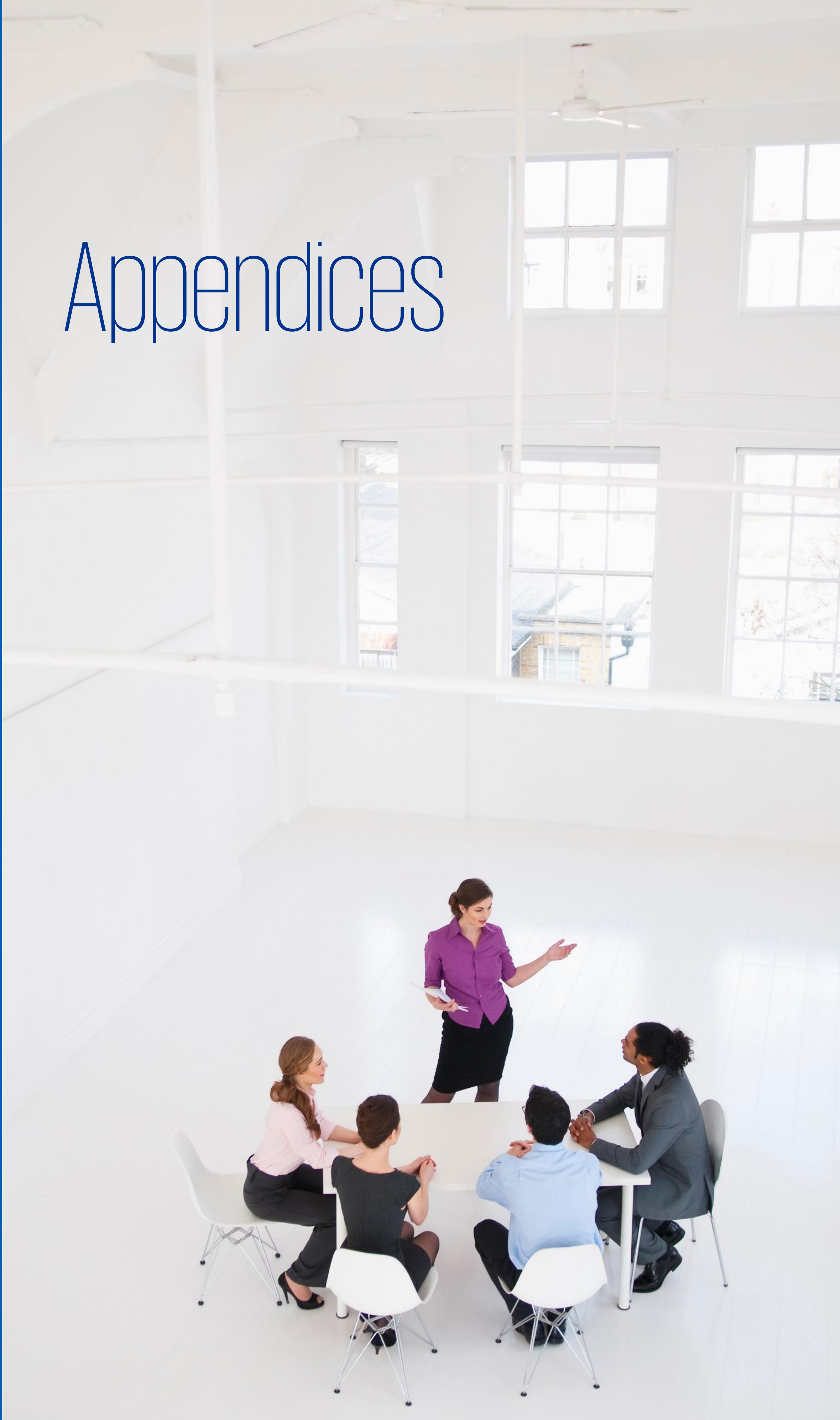
— they clearly understand whether the External Auditor has taken a controls-based or substantive approach to the audit of the scheme assets and, in particular, where these are material, how the External Auditor has obtained evidence to value assets.

Conclusion

Retirement obligations remain a key consideration for employers and their employees. The various types of retirement obligations need to be carefully understood to recognise their financial reporting requirements and under which circumstances, they remain an obligation for the employer to fund any deficit on the retirement benefit plan or not.

Accounting for post-employment benefits is an important financial reporting issue. Audit Committees and External Auditors have a key role in questioning the valuation and sufficiency of any required liabilities and related disclosures in the financial statements.

Appendices



Appendix A

An example to illustrate how actuarial calculations are performed and the disclosures built up

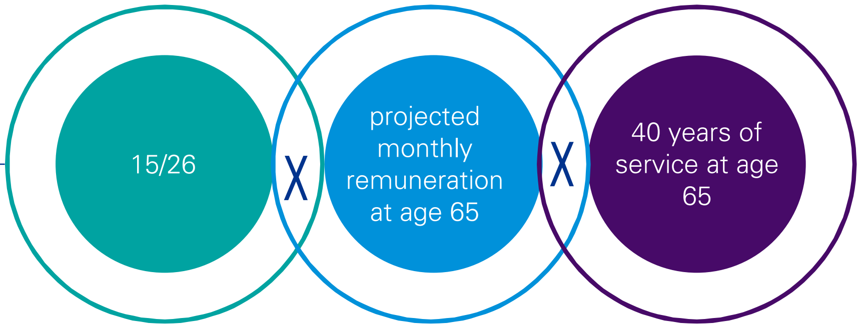
Let us take an employer with a single employee at the balance sheet date of 31 December 2018 and the following details:

- Exact age: 45
- Date employed: 1 January 1999 (i.e. past service 20 years)
- Monthly remuneration for purposes of calculating the *Employment Rights Act* (ERA) gratuity: Rs52,000

Let us also take the following simple actuarial assumptions:

- Discount rate: 6% p.a.
- Salary/remuneration increase rate: 4% p.a.
- Expected date of retirement: 31 December 2038 (i.e. at exact age 65)
- Probability of death, disablement or withdrawal from service before retirement: Nil

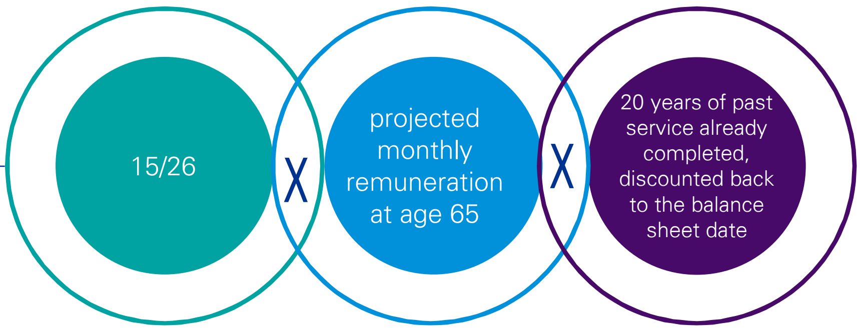
The ERA gratuity which is expected to be paid at age 65 is calculated as follows:



$$= 15/26 \times 52{,}000 \times 1.04^{20} \times 40$$

$$= \text{Rs}2{,}629{,}348.$$

The Retirement Obligations (RO) required at 31 December 2018 in the employer's balance sheet is calculated as follows:



$$= 15/26 \times 52{,}000 \times 1.04^{20} \times 20 \,/\, 1.06^{20}$$

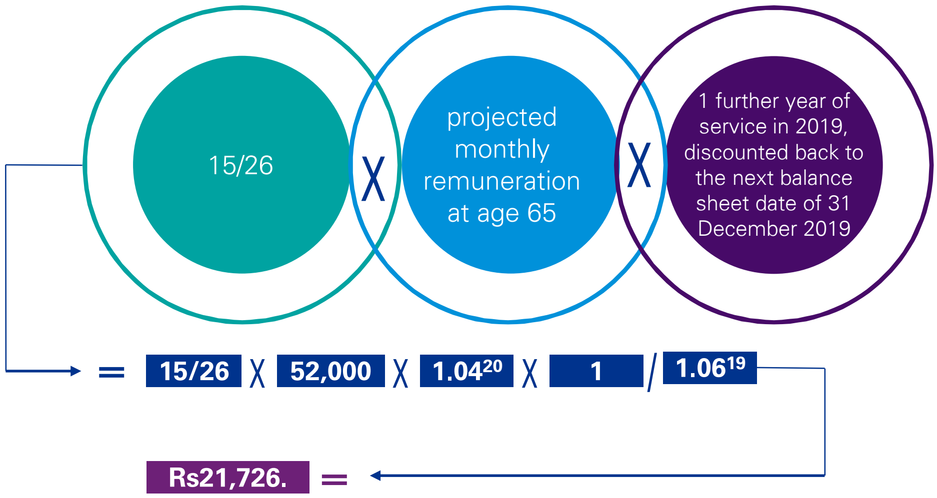
$$= \text{Rs}1{,}314{,}674 \,/\, 1.06^{20}$$

(i.e. half the above total expected gratuity at age 65 because only 20 years out of 40 have been completed so far)

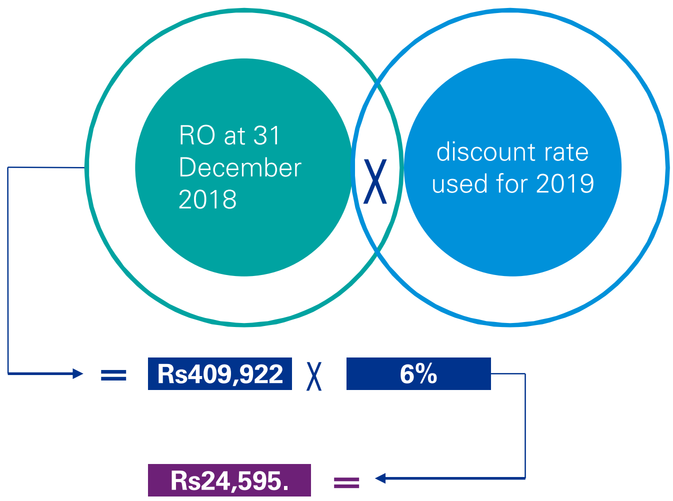
$$= \text{Rs}409{,}922.$$

The POL charge for the year 2019 is calculated in two parts as follows:

i. Current service cost



ii. Net interest expense



Therefore, the POL charge for 2019 will be Rs21,726 plus Rs24,595 = Rs46,321.

If all the assumptions are borne out and the same assumptions remain valid at the end of 2019, the new RO at the end of 2019 can be calculated in two alternative ways to get the same result:

i. RO at end of 2018 + POL charge for 2019 = Rs409,922 + Rs46,321 = Rs456,243, or
ii. RO at end of 2019 = 15/26 x 52,000 x 1.04 x 1.04^{19} x 21 / 1.06^{19} = Rs456,243.

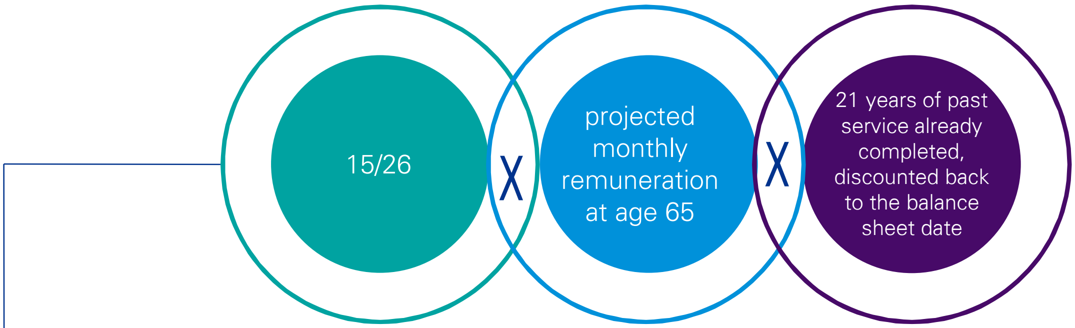
In practice, this perfect situation never happens for at least 2 reasons:

i. The monthly remuneration at the end of 2019 may not have increased at the same rate as assumed at the end of 2018, and
ii. The actuarial assumptions at the end of 2019 may not be the same as those used at the end of 2018.

If, for example:

i. The monthly remuneration at the end of 2019 is Rs60,000 rather than the Rs54,080 (52,000 x 1.04) previously assumed, and
ii. The discount rate and salary/remuneration increase rate at the end of 2019 are 7% and 4.5% respectively,

the new RO at the end of 2019 will be calculated as in the next illustration.



$= 15/26 \times 60{,}000 \times 1.045^{19} \times 21 \,/\, 1.07^{19} =$ **Rs463,881.** instead of the previously expected Rs456,243.

The difference of Rs7,638 between these two figures will not be recognized in POL but in OCI for 2019 in its two parts as follows:

i. Liability experience loss:

This loss has arisen because the monthly remuneration actually increased by 15.4% (to Rs60,000) instead of 4% in 2019. Based on the 2018 year-end assumptions, the RO would have therefore become:

$=$ **Rs506,186.** instead of the previously expected Rs456,243.

The difference of Rs49,943 between these two figures represents a liability experience loss for 2019.

ii. Gain due to change in financial assumptions

This gain has arisen because the change in assumptions at the end of 2019 has actually been favourable to the employer. The gap between the discount rate and the salary/remuneration increase rate was 2% (i.e. 6% less 4%) at the end of 2018 and 2.5% (i.e. 7% less 4.5%) at the end of 2019. In general, the higher the gap, the lower the RO and the lower the gap, the higher the RO.

The higher gap at the end of 2019 resulted in a reduction of Rs42,305 (i.e. Rs506,186 – Rs463,881) in the RO.

To summarise, the OCI charge is therefore Rs49,943 – Rs42,305 = Rs7,638 and the RO movement for 2019 can be reconciled as follows:

RO at the end of 2018 + POL charge for 2019 + OCI charge for 2019 = RO at the end of 2019,
i.e. Rs409,922 + Rs46,321 + Rs7,638 = Rs463,881.

In practice, the calculations are more complicated when, for example:

a. Potential monthly pension benefits instead of single lump sum benefits are calculated for each employee
b. The pension formula includes a deduction for part or all of any NPF pension
c. The ERA gratuity formula needs to allow for any deductions in respect of funded pension plans
d. Demographic assumptions such as mortality and employee turnover are included.

IAS 19 requires all the components of the RO, POL and OCI calculations to be disclosed in sufficient detail each year so as to enable readers of the employer's financial statements to better understand the risks underlying these employee benefit costs and to carry out their own sensitivity analyses on alternative assumptions if they wish.

Appendix B

Section 49 of the *Employment Rights Act*

Section 49 "Gratuity on retirement" reads as follows:

1) An employer shall pay a gratuity to a worker who has been in continuous employment with him for a period of 12 months or more where –
   a) the worker, on or after attaining the age of 60, retires voluntarily;
   b) the worker who has been in continuous employment with the same employer for not less than 10 years retires before the age of 60 on grounds of permanent incapacity to perform his work and such incapacity is duly certified by a government medical practitioner; or
   c) the worker, on or after attaining the retiring age, retires at the request of the employer.

   (1A) (a) Where a worker who has attained the age of 60 remains in continuous employment with the same employer up to the retirement age, the worker and the employer may agree on an advance payment of the total gratuity payable at the retirement age, amounting to the gratuity payable at the age of 60 calculated in accordance with subsection (2).
   (b) Advance payment of the gratuity, where agreed upon under paragraph (a), shall be effected upon the worker attaining the age of 60.

   (1B) Notwithstanding any agreement or any provision to the contrary in any other enactment, an employer shall not require a worker to retire before the retirement age.

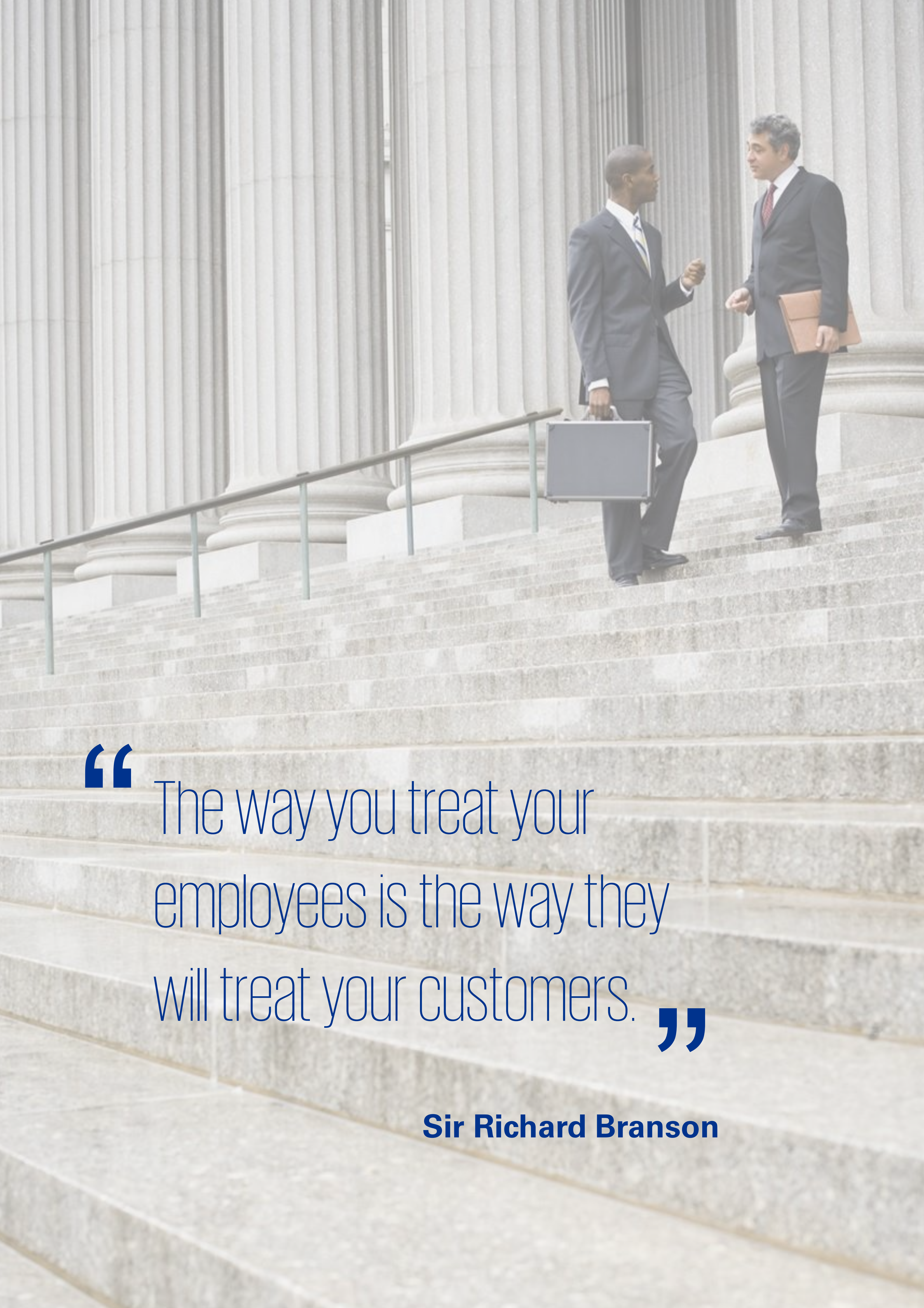
2) The gratuity referred to in subsection (1) shall be paid in a lump sum and shall be calculated –
   a) in the case of a worker, other than a part-time worker, on the basis of –
      i. 15 days' remuneration for every period of 12 months' continuous employment; and
      ii. a sum equal to one twelfth of the sum referred to in subparagraph (i) multiplied by the number of months during which the worker has remained in the continuous employment of the employer, for every period less than 12 months.
   b) in the case of a part time worker, on the basis of the following formula –
      N/H x amount of gratuity payable under subsection (a), where "N" means the number of days of work performed by the part-time worker in a week and "H" means the number of days of work performed by a comparable full time worker in a week.

3) An employer may deduct from any gratuity payable under subsection (2) and section 49A –
   a) half the amount of any gratuity due at the retirement age or the age of 60 or at death from any fund or scheme, computed by reference only to the employer's share of contributions;
   b) five times the amount of any annual pension granted at the retirement age or the age of 60 or at death from any fund or scheme, computed by reference only to the employer's share of contributions;
   c) any other gratuity granted at the retirement age or the age of 60 or at death by the employer;
   d) ten times the amount of any other annual pension granted at the retirement age or the age of 60 or at death by the employer.

4) In this section, "fund or scheme" means any pension or provident fund or scheme set up by the employer for the benefit of the worker.

5) For the purposes of this section —
   a) a day's remuneration shall be —
      i. the remuneration drawn by the worker in respect of his last normal working day other than a public holiday; or
      ii. an amount computed in the manner as is best calculated to give the daily rate at which the worker was remunerated over a period of 12 months prior to the termination of his agreement, inclusive of payment for extra work, productivity bonus, attendance bonus, commission in return for services and any other regular payment,
      whichever is the higher; and
   b) in order to determine a day's remuneration —
      i. a month shall be deemed to consist of 26 days;
      ii. a fortnight shall be deemed to consist of 12 days; and
      iii. a week shall be deemed to consist of 6 days.

6) Where a claim for gratuity on retirement has been made, the Court may, where it thinks fit and whether or not a claim to that effect has been made, order an employer to pay interest at a rate not exceeding 12 per cent per annum on the amount of gratuity payable from the date of retirement to the date of payment.



> “The way you treat your employees is the way they will treat your customers.”

Sir Richard Branson

KPMG
KPMG Centre
31 Cybercity, Ebène, Mauritius
T: (230) 406 9999 **F:** (230) 406 9998
E: kpmg@kpmg.mu **W:** KPMG.com/mu
Business registration number: F07000189

Mauritius Institute of Directors
1st Floor, Standard Chartered Tower
19 Cybercity, Ebène, Mauritius
T: (230) 468 1015 **F:** (230) 468 1017
E: info@miod.mu **W:** miod.mu
Business registration number: C08077130