

4. ACCOUNTING FOR ACCUMULATED SICK LEAVE

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- The purpose of this report is to make recommendations with regard to the Council's approach to accounting for accumulated sick leave when it adopts New Zealand Equivalents to International Financial Reporting Standards ("NZ IFRS").

2. BACKGROUND/DISCUSSION

- The requirements for accounting for accumulated sick leave under NZ IFRS are provided by NZ IAS 19: *Employee Benefits* ("NZ IAS 19"). The standard requires an entity to recognise:
  - a liability when an employee has provided service in exchange for employee benefits to be paid in the future; and
  - an expense when the entity consumes the economic benefit arising from service provided by an employee in exchange for employee benefits.
- Council employees have an entitlement to ten days of paid sick leave per annum. Those employed under the collective agreement have an uncapped entitlement to accumulated sick leave; for those on an IEA accumulated sick leave is capped at 40 days.
- The Council does not currently accrue for accumulated sick leave, but will be required to do so when it adopts NZ IFRS.

11. Paragraph 12 states, "Entitlement to compensated absences falls into two categories, accumulating and non-accumulating"

'Accumulating compensated absences' are defined in paragraph 13 as, 'those that are carried forward and can be used in future periods if the current period's entitlement is not used in full'. The paragraph goes on to say, "(they) may be either vesting or non-vesting" and that "the obligation (to pay future compensated absences) exists, and is recognised, even if the compensated absences are non-vesting, although the possibility that employees may leave before they use an accumulated non-vesting entitlement affects the measurement of that obligation".

12. Paragraph 14 states, "An entity shall measure the expected cost of accumulating compensated absences as the additional amount that the entity expects to pay as a result of the unused entitlement that has accumulated at the balance sheet date".

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13. Paragraph 126 defines these as including "deferred compensation paid twelve months or more after the end of the period in which it is earned" which clearly applies to some portion of the sick leave which has actually been taken by Council employees in the two years of our sample period. Paragraph 129 requires such liabilities to be measured at the "present value of the defined benefit obligation at the balance sheet date" less "the fair value at the balance sheet date of plan assets (if any) out of which the obligations are to be settled directly" (the Council does not have any such assets).

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14. Although the amounts involved are not material, the Council should adopt the practice of accounting for accumulated sick leave entitlements. The provision should be based on the most up to date data of the Council's actual exposure, including trends in total accumulated sick leave and the annual amount of paid sick leave in excess of the current year's entitlement. The provision should be calculated as the sum of the following amounts for each employee:

- Accumulated sick leave that is likely to be used in the coming financial year. This amount will not be present valued, but will take into account the likelihood of the employee using sick leave in addition to the current entitlement and the employee's likely pay rate when additional sick leave is used.
- Accumulated sick leave that is likely to be used after the end of the coming financial year. This amount will be present valued and will take into account the likelihood of the employee using sick leave in addition to the current entitlement and the employee's likely pay rate when additional sick leave is used.

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It is recommended that the Council adopt the practice of accounting for accumulated sick leave entitlements.